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Investment Treaty News Quarterly is published by
The International Institute for Sustainable Development
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Design:
The House London Ltd.
Web: www.thehouselondon.com

The Practice of Responsible Investment Principles in Larger-Scale Agricultural Investments

Hafiz Mirza and William Speller

feature 1



The recent and ongoing trend towards corporate, especially foreign, investment in developing countries' agricultural sectors has evoked sharply contrasting attitudes. For some, this "rediscovery" of agriculture as a focus of investment provides opportunities to again promote the sector within the larger agenda of economic development. For others, it has raised serious concerns about whether such investments, especially those involving large scale land acquisitions, are conducted in a manner which respects people's rights, livelihoods and resources.

After decades of struggling to attract a significant level of corporate investment, including foreign direct investment, in their agricultural sectors, developing countries are now faced with a challenge. How should they accept the type, size and number of such investments in order to maximise development benefits and minimise socio-economic and environmental risks? Unfortunately, a lack of analysis on such investments has meant that much of the debate on this issue has been fuelled by anecdotes and one-off case studies.

To fill this gap and bring discussions onto a more evidence-based footing, the Inter-Agency Working Group of the Food and Agriculture Organization, the International Fund for Agricultural Development, the United Nations Conference on Trade and Development (UNCTAD), and the World Bank resolved to collectively generate a body of empirical knowledge that could be used to identify desirable forms of investment.¹

This article is based on a recent joint UNCTAD-World Bank report entitled *The Practice of Responsible Investment Principles in Larger Scale Agricultural Investments* (Mirza, Speller, Dixie and Goodman, 2014). This presents results of a field-based survey on the conduct of agricultural investment at 39 large-scale, mature agribusinesses in sub-Saharan Africa and South East Asia, focusing in particular on their approaches to social, economic and environmental responsibility.

The report articulates, with detailed examples, what the responsible and sustainable conduct of agricultural investment consists of, in practical, operational terms for communities, governments and investors. In doing so, its primary aim is to provide lessons to these groups—which can be taken up as host government policies and procedures, corporate strategy and operational processes and community or NGO actions—in order to ensure that agricultural investments are conducted responsibly and maximize the benefits and minimize the risks for all parties concerned.

On balance, the investments studied have generated positive socio-economic benefits for surrounding communities and host countries. Direct job creation was the most frequently cited benefit arising from the investments. Investors also indirectly contributed to employment opportunities by providing a stable market for outgrowers' produce. The concomitant rise in rural incomes contributed positively to food security, directly and indirectly. Social development programmes and financially-inclusive business models are becoming more prevalent among agricultural investors, with investors provided social services such as education, health, rural and farming infrastructure, local water provision schemes and access to finance. Finally, investors introduced new farming technology and practices which, in rare but significant instances, had a catalytic impact which extended far beyond the investor.

Weighed against these benefits, negative impacts also arose in the investments examined. Most prominent were disputes over access to land, such as conflict between the formal rights provided to the investor by the state and the informal rights of existing users of the land. Such situations were at times exacerbated by a lack of clarity on the conditions and process for land acquisition, and further compounded in a significant number of cases where investors were using only a small portion of their land allocation. Resettlement was seldom sufficiently consultative, inclusive or adequately compensated. This lack of consultation was symptomatic of a broader concern: involvement by local communities in decisions affecting them was often insufficient; and, moreover, procedures to raise grievances or hold investors to account were commonly absent. Assessment, understanding and monitoring of the environmental impact of investments was generally inadequate, especially with regard to consequences for water resources.

Notable within the sample of investors was the extraordinarily wide range of outcomes arising from these investments in terms of their socio-economic and environmental impacts, their broader impact on the host country, and the operational and financial success of the investment itself. A key finding of this research is that a potentially win-win situation

vis-à-vis investment performance and their wider positive economic, social and environmental impact is achievable. In the survey, investors that were financially and operationally successful tended also to be those that had the most positive impact on their host economies and surrounding communities—the result of more sophisticated approaches to social and environmental responsibility. Similarly, those investments which were well-integrated with the host country and surrounding community were most likely to be financially successful. Investors which acquired land but did not conduct thorough consultations with communities and impact assessments, or left it to host governments to conduct them on their behalf, often found themselves subsequently dealing with costly and time-consuming land disputes.

The diversity of experiences, performance and impacts of investments in the survey suggests that a wide range of factors influence the outcomes of an agricultural investment. Some factors are context specific. As such, one cannot be categorical about the types of investment that are most or least desirable. This research finds that the static attributes of the investor (its crop, country of origin etc.) are less important than the dynamic actions, policies and practices of the investor and host country government in determining the outcome of investments.

Another key findings of the research is that many of the key decisions and actions which determine the ultimate outcome of investments are taken prior to the investment or during its initial phases. From the investor perspective, this includes the proper conduct of due diligence, consultations with communities, impact assessments, approaches to transparency and the design of the business model. From the host country perspective, this includes pre-screening and selection of investors, ongoing monitoring of investments, monitoring the conduct of consultations and impact assessments, phasing of investment approvals, and land and water rights. From the local community and civil society perspective, this includes engagement and negotiation with investors, monitoring investors, helping investors forge partnerships with marginalised groups, and ensuring access to grievance and redress mechanisms.

From all perspectives, greater clarity with regard to the contractual terms and conditions underpinning the investment, the rights, commitments and responsibilities of different parties is of paramount importance to ensure mutually beneficial outcomes. Investors, host country governments, and local communities interviewed during this study indicated that better and more detailed guidance is required to do so effectively. Guidance on the construct of better investment contracts is critical in this regard (Smaller, 2014).

These lessons must be heard, integrated carefully with findings from other research and acted upon in

order to feed the world's burgeoning population in a sustainable manner that preserves natural resources, utilizes agriculture as an engine for inclusive growth and fosters long-term development. The achievement of these goals will require more investment, private and public. The central role of smallholder farmers' investment in their own farms in any strategy for promoting the required agricultural investment is well-established.² But there nevertheless remains a key role for other forms of investment, including from the types of private sector investors included in this study. This research finds that private sector investments, including those that involve land acquisition, can generate positive outcomes if conducted in a socially and environmentally responsible manner.

Author

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Notes

¹ Recent publications by the World Bank, FAO and IFAD have already contributed to this emerging knowledge base. FAO and IFAD commissioned a joint FAO-IFAD paper on alternatives to large scale land acquisitions in developing countries, surveying business models that provide alternatives to smallholders (Vermeulen and Cotula, 2010). FAO conducted a series of case studies on the trends and impact of FDI in developing country agriculture (FAO, 2013). The World Bank completed a retrospective study of the agricultural investment portfolio of the Commonwealth Development Corporation, studying how 179 larger scale agribusinesses played out over a 50 year period (Tyler and Dixie, 2012). IFAD produced a review of global experiences in developing and managing outgrower programmes (IFAD and TechnoServe, 2011).

² See for example, FAO (2012) *The State of Food and Agriculture: Investing in Agriculture for a Better Future*, CFS HLPE (2013) *Investing in smallholder agriculture for food security: A report by The High Level Panel of Experts on Food Security and Nutrition*, and IFAD and UNEP (2013) *Smallholders, Food Security and the Environment*

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Foreign Investment in Farmland and Water: 10 Steps for Better Contracts

Carin Smaller

feature 2



An impressive body of knowledge now exists on what works and what does not in terms of foreign investment in agriculture generally, and farmland in particular. The previous article in this edition of ITN presented a new study by the World Bank and United Nations Conference on Trade and Development (UNCTAD), which surveyed 39 large-scale agribusinesses in sub-Saharan Africa and South East Asia and their approaches to social, economic and environmental responsibility.¹ While the overall picture shows benefits, particularly in terms of job creation, a number of negative impacts emerged. Most notably over competing land rights, but also badly managed resettlement programs, insufficient consultation with local communities, an absence of proper assessments of environmental impacts, particularly with respect to water, and a lack business planning to ensure profitability. Importantly, many of these negative impacts could have been resolved through better contracts between states and foreign investors. This means better preparations prior to negotiations, improvements in negotiating and drafting contracts, and more robust monitoring and evaluation of projects after the contract is signed.

So what would a better contract look like? The International Institute for Sustainable Development studied seventy contracts between states and foreign investors involving long-term leases of farmland. We have come up with our own model contract that we believe answers many of these concerns. Below are ten steps to follow when drafting a contract from a sustainable development perspective. These are drawn from a more detailed and comprehensive guide to drafting investment contracts.²

It is important to note at the outset that where States have the necessary domestic laws and regulations in place, there may be no need for a contract

between the state and a foreign investor. Domestic law will govern all issues that may arise in relation to foreign investment, including the issuing of licenses and permits for agricultural operators. However, many states do use investment contracts to lease farmland.

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The long-term success of an investment project is closely tied to the acceptance by and integration with the local community.

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Step 1: Prepare the negotiating environment

This is the precursor to success for any investment project. It involves: (1) identifying the country's agricultural needs (which areas and crops to prioritize); (2) understanding the economics behind the proposed project (and knowing the value of your natural resources); (3) clarifying the role of domestic law in relation to the contract; and (4) preparing the negotiating team.

In addition, the long-term success of an investment project is closely tied to acceptance by and integration with the local community, as evidenced by the findings from the World Bank-UNCTAD study. This is derived through the process of negotiation and by a sense within the community that their interests are taken seriously. Negotiating teams and investors should have appropriate meetings with the local community to ensure a coherent result that the community supports. It is also important to understand the needs of the investor to be able to respond properly to the negotiating demands.

Step 2: Conduct business feasibility studies

Business feasibility studies principally address the economic and technical viability of the proposed project. But they should also address the key social and environmental factors. Studies should be conducted and verified by an independent third party before the contract is signed. The results of the study will assist the investor in developing its business plan. The study should be presented and approved by the government prior to concluding contract negotiations, and its milestones incorporated into the contract itself.

Research now shows that the failure to properly conceive the project and determine its viability is the main cause of the high failure of agricultural investments. A World Bank survey of 179 projects found that 50 per cent were classified as failures or moderate failures in financial terms because the “concept was fatally flawed, for example wrong location, wrong crop, or over-optimistic planning assumptions.”³

Step 3: Conduct impact assessments

In principle, before an investment contract is signed and implemented, an environmental and social impact assessment (ESIA) should take place. The contract can then be revised and adapted based on the findings of the ESIA. The possibility of an ESIA leading to a decision to abandon the project should not be ruled out. In practice, however, ESIA's are often done after the contract is signed but before the investor starts construction and operations.

The investor should use the results of the ESIA to develop an Environmental and Social Management Plan. The investor should not be granted the licenses necessary to start production until these steps are complete. Unfortunately, even when ESIA's are required by law they are often not undertaken.⁴ As the World Bank-UNCTAD study reported, investors who did not conduct proper assessments found themselves dealing with costly and time-consuming disputes.

The results of ESIA's and subsequent management plan must be incorporated as legally binding obligations in the contract. The contract should also contain a requirement for annual reporting on the implementation of the management plan, with the reports to be made public and accessible to local communities

Step 4: Allocate land tenure and water rights

Disputes over land are now clearly considered the most problematic aspect of land investments. Where land and water tenure systems are well developed and where those rights are clear and vested in local owners or users, they will be entitled to have a say in how the land and water will be allocated to the investor. The problem is that, in many developing States where investment contracts for agricultural land are being signed, land and water rights are not formally recognized, vague, based on local customs or simply non-existent. The issue of land and water tenure for local owners and users must be clearly identified before the contract is signed, through a combination of

land reforms, consultation with local communities, and proper compensation when resettlement is deemed necessary.

Step 5: Determine financial and other incentives

Financial incentives and tax breaks are a common feature of many countries' investment promotion strategies and often enacted in domestic laws and regulations. Their effectiveness is highly debated, but there is an emerging consensus that few incentives achieve their economic goals despite the fact that they have significant costs to governments. The cost of incentives, in terms of denying developing countries much needed tax revenues, can undermine government efforts to invest in the local economy, in improved access to social services or in environmental conservation. Annual rental payments on land, for example, allow the State to establish a market value on the land that is being leased out and ensure that it becomes productive. This discourages speculative holding of land and water rights.

Step 6: Avoid stabilization provisions

A common demand of investors, particularly in developing countries, is the inclusion of stabilization provisions. These are clauses in investment contracts that freeze domestic laws at the time the contract is signed. The effect is that governments either have to preclude the application of, or compensate investors for, new or changed laws and regulations that affect the investments. Broad stabilization provisions that include all regulatory functions (such as environment, labour, health and safety) are now widely considered to be unacceptable. There is, however, some support for limited stabilization provisions for certain fiscal issues, in order to avoid arbitrary or discriminatory acts by the government. If a narrow tax stabilization clause is included, it should not override or conflict with domestic law, but may form part of the fiscal bargain.

Step 7: Specify the investor's development obligations

This is the part of the contract where the investor undertakes legally binding commitments to contribute to creating employment, training the local workforce, establishing processing industries, transferring appropriate technology, purchasing local goods and services, and selling part of the production to the local market, among others. The more specific and detailed a contract is on what can be expected from the investor in terms of development contributions, the higher the chance that the project will lead to the expected benefits.

This section can also include a Community Development Agreement (CDA), which creates a framework for engagement between the investor and local community. The CDA might allocate a percentage of profits from the project to a Community Development Fund for a range of economic and social activities, which the community defines. It can also create a framework for ongoing dialogue and discussion with the community in the event of conflict or grievances, and for periodic reviews of the project's impacts.

Step 8: Identify environmental parameters

It is important to refer to relevant environmental legislation in the contract, particularly domestic water management laws and clear water use and allocation rights for the investor. Where environmental laws are not fully developed or where there are gaps, the contract can temporarily fill the gap, using international standards of practice. This is important because the current global regime of investment treaties and contracts provide foreign investors with legal guarantees, which can include the right to draw water for agricultural purposes. Finally, periodic reviews of water allocation rights will help avoid conflicts with other water users.

Step 9: Choose an appropriate dispute settlement mechanism

From a host state perspective it is advisable to refer to domestic courts, tribunals or mediation centers, as the forum of choice for disputes arising under the contract. International arbitration should not be encouraged over domestic processes. In instances where international arbitration may be necessary, it should be preceded by an effort to settle the dispute amicably first, and through domestic processes prior to international arbitration.

Step 10: Ensure reporting, monitoring and evaluations

Designing the right contract is only the starting point. Implementing the commitments is a much tougher and longer-term challenge, particularly with limited capacity, as is often the case in many developing countries. Setting aside a percentage of the income from the project for implementation issues will help ensure that the government has capacity to monitor and evaluate the project effectively. Setting out clear reporting requirements and indicators in the contract will ensure the government can regularly track whether the investor is fulfilling its commitments. Transparency is a key part of the process.

Conclusion

Investment contracts for farmland operate within a complex legal environment with multiple layers of laws and regulations. Understanding this environment and the relationship between the different sources of law will allow negotiators to draft contracts that create benefits for all stakeholders involved, while remaining compatible with existing legal frameworks at the domestic, regional and international levels. A significant amount of groundwork is needed prior to entering into negotiations. This groundwork is essential for the long-term viability of the project. Finally, operating within an open and transparent environment will minimize the risk of corruption and ensure greater acceptance by those affected.

Author

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Notes

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Improving Investment Treaties through General Exceptions Provisions: The Australian Example

Simon Lester

feature 3



The recent Australian elections were decided mostly by domestic policy issues, but their outcome had an impact beyond the border as the new government decided to rethink Australia's somewhat unique view on the international investment regime. Whereas much of the world supports a core set of investment rules, Australia had long been a skeptic, particularly with respect to investor-state arbitration. Soon after the election, the Liberal-National coalition indicated that it would be more amenable to these rules. They put their new policy into practice quickly, and have recently released the completed text of the Australia-Korea free trade agreement (FTA), which includes an investment chapter with investor-state arbitration. This FTA will soon be submitted to parliament for approval.

In changing course, has the Australian government simply joined the rest of the world? Or have they tried to deal with some of the problems and concerns with investment treaties raised by critics over the years? In this piece, I evaluate one aspect of the Australia - Korea FTA: the "general exception" to investment obligations that exists for certain policy purposes, which parallels WTO exception provisions such as GATT Article XX and GATS Article XIV.

General concerns with investor-state

One of the main problems with investment treaties comes from vague and broad legal obligations such as "indirect expropriation" and "fair and equitable treatment." Such principles are common in domestic law, but there is no international consensus on what they mean. Elevating them to international legal status opens up limitless opportunities for litigation and thus makes for a great deal of uncertainty (as well as raising fears of intrusion into domestic policy-making).

The problem is intensified when investment obligations allow direct lawsuits by foreign investors against governments. Generally speaking, international law only allows state-state disputes, which helps filter out frivolous complaints and acts as a check on the system. The possibility of investor-state disputes opens up the floodgates on litigation. Thus,

it is investor-state provisions, combined with vague obligations, that are the main cause of concern.

Australia's history of investor-state skepticism

The international investment regime came to the average Australian's attention several years ago when the tobacco company Phillip Morris used an obscure Hong Kong-Australia investment treaty to challenge Australia's plain packaging cigarette laws before an international tribunal. This challenge helped cement Australian doubts about these treaties.

As a matter of government policy, this skepticism was already in place. In its 2004 free trade agreement with the United States, Australia had objected to the inclusion of investor-state rules, and these rules were ultimately excluded from the treaty. The absence of investor-state was a major departure from US policy, one that has not since been repeated. Australia's ability to dictate the terms to the US indicates the strength of Australian convictions on the issue. A few years later, Australia made a policy of excluding investor-state rules from trade agreements permanent, based on findings of an independent agency called the Productivity Commission.

In short, Phillip Morris' plain packaging case simply brought more attention to the issue and affirmed for many Australians the correctness of this view.

Saving the system with exceptions

Now Australia's new government has changed course. But in doing so, the government has offered reassurance that domestic policy space will be preserved. In this regard, it can point to Article 22.1 (General Exceptions) of the Australia-Korea FTA, which provides the following exception from investment obligations:

3. For the purposes of Chapter 11 (Investment), subject to the requirement that such measures are not applied in a manner which would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures:

- (a) necessary to protect human, animal or plant life or health;
- (b) necessary to ensure compliance with laws and regulations that are not inconsistent with this Agreement;
- (c) imposed for the protection of national treasures of artistic, historic or archaeological value; or
- (d) relating to the conservation of living or non-living exhaustible natural resources if such

measures are made effective in conjunction with restrictions on domestic production or consumption.

The Parties understand that the measures referred to subparagraph (a) include environmental measures to protect human, animal or plant life or health, and that the measures referred to in subparagraph (d) include environmental measures relating to the conservation of living and non-living exhaustible natural resources.

This exception is modelled, to a degree, on WTO exceptions provisions such as GATT Article XX and GATS Article XIV. While the GATT provisions were, in the past, subject to criticism for a perceived lack of flexibility, in recent years the jurisprudence has shifted a bit, and the concerns have lessened. For example, the “strict” WTO panel decision in *U.S.-Shrimp* was superseded by later Appellate Body decisions that were more forgiving to government regulation.

In the investment context, such exceptions are rare, but not entirely unheard of. Some Canadian agreements have similar exceptions, as do some of Australia’s past agreements. However, the scope of Article 22.1 is unclear for at least a couple of reasons.

First, there is a question as to how such an exception would apply in the investment context. Note the language: “nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures.” It could be argued that investment obligations only require compensation, and do not actually prevent any measures. A government can still take the measure; it simply has to pay. So if a government measure violates the rules, and the government has to pay compensation, would that “prevent” a party from adopting or enforcing measures? Presumably, the answer has to be yes, or else the provision would have no meaning. Indeed, even in the WTO context, measures are not “prevented,” as governments are able to maintain measures that violate WTO obligations if they are willing to accept trade retaliation.

Second, the requirement that “such measures are not applied in a manner which would constitute arbitrary or unjustifiable discrimination between investments or between investors” is different than what is used in the GATT context. There, the discrimination at issue is between “countries where the same conditions prevail.” Thus, it is nationality-based discrimination. It is arguably much more difficult to satisfy a standard relying on investor-based discrimination.

Another question is whether the listed policies are sufficient. Are there additional policy reasons that might eventually be included in such an exception, beyond the four sub-paragraphs listed here? Can those provisions be interpreted broadly enough to cover most policy goals? A classic GATT dispute

involved a “luxury tax” in the form of a higher tax rate on expensive automobiles. It is not clear that such a policy would fall within the exceptions in Article 22.1, and thus a broader list of policy exceptions might be useful.

Finally, in the WTO context, the legal obligations are narrow and bounded, for the most part. By contrast, a “fair and equitable treatment” requirement is extremely broad and vague. How would the Article 22.1 exception be applied in that context? When “due process” concerns have led to a violation, can general exceptions of this kind function as an exception? There is no experience with this situation, so the outcome remains to be seen, but there may be some doubt as to whether it will work to soften the impact of such rules.

Looking forward: investor-state in the TPP and beyond

Investor-state has been controversial in the context of the Trans Pacific Partnership (TPP), as it has been elsewhere. After initially resisting the inclusion of investor-state provisions in the TPP, Australia has, with the change in government, recently expressed a willingness to give ground on this issue, if it gets sufficient market access in return. But when it gives ground, will it only do so if there is a general exception? Or would it sign on to investor-state in the TPP based on the U.S. model, which does not include such an exception? If Australia has agreed to investor-state in the Korea FTA on the basis of the exception, doing so without an exception in the TPP would seem to be a step back. And would the U.S. consider including such an exception if that were the only way to get Australia on board? It has never used such a provision before.

The debate on investor-state is far from over. Different countries are pursuing different approaches, while at the same time creating a complex web of investment obligations. A general exception provision is one idea in the mix that could help resolve the concerns of critics and establish an acceptable balance of rights and obligations.

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ICSID's Annulment Decision in *Impregilo v. Argentina*:

Finality of Awards v. Legal Correctness

Nathalie Bernasconi-Osterwalder

feature 4



On January 24, 2014, an *ad-hoc* annulment committee at the International Centre for Settlement of Investment Disputes (ICSID) dismissed a request by the Argentine Republic to annul a June 2011 arbitral award that had granted an Italian contractor over US\$21,000,000 for harm suffered to an investment in a Buenos Aires water services concession.¹ While this was one of the smaller awards rendered against Argentina, it is nonetheless of utmost significance for Argentina and all countries facing claims under investment treaties. As this brief article discusses, the committee's decision exemplifies the barriers to overturning ICSID awards, due to a system that values the finality of an award more than legal correctness.

Background on ICSID annulment proceedings

In general, disputing parties have limited rights to challenge ICSID awards. This is partly because ICSID arbitral awards cannot be appealed before national courts; rather, the only way for the claimant or respondent to challenge an ICSID award is to request an ICSID *ad-hoc* committee to review and annul all or part of the award. Moreover, the annulment committee can only annul an award on five limited grounds: (1) if the tribunal was improperly constituted; (2) if the tribunal manifestly exceeded its powers; (3) if there was corruption on the part of the tribunal; (4) if there was serious departure from a fundamental rule of procedure; and (5) if the award failed to state the reasons on which it was based.² In previous decisions, annulment committees have declared that even if an award is based on manifest errors of law or fact, the award must nevertheless stand because such errors are not a ground for annulment under the ICSID Convention.³

As of December 31, 2013, a total of fifty ICSID annulment proceedings were concluded, and another eleven proceedings were pending.⁴ Reflecting the high-threshold for annulling ICSID awards, only thirteen annulment committees decided to annul the contested awards in part or in full, while twenty-two annulment applications were rejected and fifteen proceedings were discontinued.

Impregilo annulment committee takes narrow view of its tasks

The annulment decision in *Impregilo v. Argentina* is notable in two respects. First, an ICSID annulment committee confirmed once again that its role is not to correct legal mistakes. In other words, decisions that are incorrect in law under a treaty cannot be overturned on that basis. The annulment committee thus made it clear that the finality of the award is a more important value than the legal correctness of the award.

Second, the annulment committee applied a very narrow view on the function of the annulment process to the issue of jurisdiction. Specifically, the annulment committee stated that the most-favoured nation (MFN) provision in a treaty could extend to procedural issues unless there was a specific exclusion in the treaty text. If there was no explicit exclusion in the treaty, a tribunal could reach its own conclusion on whether to apply the MFN provision when determining jurisdiction. An annulment committee would then not review whether this was a correct decision in law, even if it related to the determination of the tribunal's competence to hear the ICSID case in the first place.

As a consequence, the annulment committee refused to annul the decision taken by the majority of the tribunal to allow the claimant to rely upon a MFN clause to circumvent an 18-month local-litigation requirement found in the Argentina-Italy bilateral investment treaty (BIT).

What constitutes a manifest excess of power by the tribunal?

In the annulment proceedings, Argentina had argued, among other things, that by importing conditions to jurisdiction from an outside treaty, the tribunal had "manifestly exceeded its powers," and that therefore the decision had to be annulled. However, the *ad-hoc* annulment committee instead stressed the limited nature of its mandate, and the fact that annulment is "... an exceptional recourse that should respect the finality of the award" (paragraph 118). On MFN, the committee noted that it might have had the authority to annul an award if a treaty expressly prohibited the application of an MFN clause to jurisdictional issues and a tribunal disregarded such an express prohibition, but not if it was silent (paragraph 136-137). It further reasoned:

140. From the discussion in the preceding paragraphs, it is clear to this Committee that the issue of whether the MFN clause in the Argentina-Italy BIT has jurisdictional effects in the circumstances of this case that allowed Impregilo to have recourse to the Argentina-US BIT, which does not require recourse to local courts before resorting to the ICSID jurisdiction, is a complex issue, subject to debate, with opposite views that were discussed by the

majority and the dissenting arbitrator. Neither applying an MFN clause to jurisdictional issues nor refusing to apply it to assume jurisdiction may be considered, *per se*, as a manifest excess of powers. The Committee is being asked to review in detail and *de novo* the complex issues involved in the jurisdictional debate in this case, to support the analysis of the dissenting arbitrator and to consider that such analysis is the one to prevail, and to conclude that the majority manifestly exceeded its powers. This is not the task of the Committee. The analysis required to reach a conclusion other than the majority's would imply a new and complex analysis of the issues at stake, a review that is far from the responsibility of this Committee according to Article 52.

141. For these reasons, it is clear that this Committee has no authority to determine whether or not the Tribunal should apply Article 3.1 of the BIT in order to establish its jurisdiction to review the merits of the dispute. The interpretation made by an Arbitration Tribunal in one way or another on the possible extension of the MFN clause to jurisdictional issues can never by itself constitute a clear, obvious, and self-evident excess of powers.

In other words, the annulment committee considered that if a provision is open to some level of interpretation, then it will not review that interpretation—even if the tribunal's interpretation is wrong. Only where a provision is fully clear and then ignored by the tribunal, would the committee consider annulling the tribunal's finding. However, the annulment committee's approach to demand absolute clarity in the MFN provision is particularly paradoxical considering the overall investment treaty at issue: the committee says that the states have to explicitly instruct arbitrators not to expand the MFN clause to procedural issues. But at the same time, the annulment committee is allowing the tribunal to circumvent what the state parties to the Italy-Argentina BIT did explicitly state: the investor must litigate in local courts for 18 months before initiating an international arbitration.

Proper treaty interpretation requires that each provision is interpreted in a way that does not lead to contradictions within the treaty that in turn render some provisions *inutile*. In the present case, however, clarity in one area (the 18 months requirement) is overridden by the MFN clause that does not explicitly state that it does not extend to procedural issues. If disregard of a clear 18-month requirement when determining its own competence is not a manifest excess of power by the tribunal, the question is what can be?

Conclusion

As mentioned, the ICSID Convention provides only limited grounds for annulment of arbitral awards and

annulment requests are more often dismissed than granted. Given the proliferation of ICSID arbitration and the inconsistency of arbitral awards on fundamental issues of treaty law, it is questionable whether a narrow understanding of the annulment committees' tasks and responsibilities is still appropriate. In this regard it would seem timely to initiate a discussion about reform opportunities at ICSID and beyond. One option for states to consider would be an expansion of the annulment process available under Article 52 of the ICSID Convention; for example, broadening the grounds for annulment to cover errors of law or fact. Another option would be the establishment of a standing appellate body for investment arbitrations (either for ICSID only, or also for arbitrations under other rules). Reforms at ICSID, however, could prove difficult, since amendments to the ICSID Convention need to be ratified by all contracting parties before entering into force, and to date the Convention has never been amended. Should states prefer deeper reform of dispute settlement in the area of investment, the idea of an appeals process might better be discussed outside any pre-existing arbitration framework, especially if they wished to move away from an arbitration-based system to a more judicial type of dispute settlement. For instance, a new treaty setting up a global appellate body or an appellate division within a permanent investment court could be considered here.

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Notes

¹ *Impregilo S.p.A. v. Argentine Republic*, ICSID Case No. ARB/07/17, Decision of the ad hoc Committee on the Application for Annulment, January 24, 2014; and Award, June 21, 2011

² See further Nathalie Bernasconi-Osterwalder and Diana Rosert, *Investment Treaty Arbitration: Opportunities to reform arbitral rules and processes* (IISD, 2014), Section 4.3.

³ However, a "few committees hypothesized that in certain cases those errors [erroneous interpretation or misapplication of the applicable law] could in fact warrant annulment." See Lise Johnson, *Annulment of ICSID Awards: Recent Developments* (IISD background paper, 2010), p. 7. Retrieved from <http://www.iisd.org/investment/research/reform.aspx>

⁴ See ICSID, *The ICSID Caseload – Statistics (Issue 2014-1)*, p. 17 (Chart 11). Retrieved from <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=CaseLoadStatistics>. For pending annulments, see ICSID, *List of Pending cases*. Retrieved from <http://icsid.worldbank.org>

Importing Consent to ICSID Arbitration? A Critical Appraisal of *Garanti Koza v. Turkmenistan*

Eric De Brabandere

feature 5

The application of the most-favoured-nation (MFN) clause to investor-State dispute settlement provisions remains both an unsettled question in investment treaty arbitration¹, and a controversial one. Legally, this is in part the consequence of the fact that bilateral investment treaties (BITs) invariably use different language, making it necessary to interpret the applicable treaty on a case-by-case basis. A difficulty also results from the fact that the MFN clause touches upon a fundamental principle of international dispute settlement, namely the consent of States, and the diverging views of arbitral tribunals on the essential features of expressing consent to arbitration.

This brief article provides a critical examination of the tribunal's decision in *Garanti Koza LLP v. Turkmenistan*,² where the majority took a particularly expansive reading of the MFN clause in the United Kingdom-Turkmenistan BIT.

Background on the case

The claimant, Garanti Koza LLP, a limited liability company incorporated in the United Kingdom (UK), submitted a request for arbitration to the International Centre for Settlement of Investment Disputes (ICSID) claiming that Turkmenistan breached its obligations under the UK-Turkmenistan BIT. Specifically, Garanti complained of modifications to its contractual relations with the State-owned highway authority *Turkmenavtoyollary* in respect of the design and construction of highway bridges and overpasses in Turkmenistan, and Turkmenistan's alleged attempts to confiscate its assets (para. 2).

The respondent's primary objection to the jurisdiction of the tribunal was based on the lack of consent to ICSID arbitration under the UK-Turkmenistan BIT (para. 7). Turkmenistan argued that consent to ICSID arbitration may not be "created by operation of the most favoured nation clause of the UK-Turkmenistan BIT" (para. 14). For its part, the claimant maintained that the MFN clause contained in the UK-Turkmenistan BIT allowed it to invoke more favourable dispute settlement clauses contained in other investment treaties signed between Turkmenistan and third States, and in particular third-party treaties that give foreign investors the option between ICSID arbitration and arbitration under the UNCITRAL arbitration rules (or access to ICSID Arbitration only) (para. 15).

In the long series of cases in which the application of the MFN clause to investor-State dispute settlement provisions contained in investment treaties has been discussed and analysed, the tribunal's decision in *Garanti Koza LLP v. Turkmenistan* is noteworthy. The decision stands out for allowing the claimant to invoke and rely on consent to arbitration before ICSID expressed by the respondent state in another investment treaty through application of the MFN clause. While claimants have traditionally limited the invocation of the MFN clause to dispute settlement provisions in order to override pre-arbitration requirements, such as waiting periods or requirements to submit the case first to domestic courts³, in this case the invocation of MFN clause was done to 'import' consent to ICSID arbitration in the United Kingdom-Turkmenistan BIT, which did not contain consent to ICSID arbitration. The tribunal's July

3, 2013 decision on the objection to jurisdiction for lack of consent was supported by a majority composed of Presiding Arbitrator John M. Townsend and Arbitrator George Constantine Lambrou. Arbitrator Laurence Boisson de Chazournes disagreed with the findings of the majority and issued a dissenting opinion on this question.

The decision of the tribunal

Article 8 of the UK-Turkmenistan BIT contains the investor-State dispute settlement clause. Considering its peculiar features, and the fact that the interpretation of the article formed the foundation of the majority's decision and Arbitrator Boisson de Chazournes' dissent, it is important to reproduce it in full:

(1) Disputes between a national or company of one Contracting Party and the other Contracting Party concerning an obligation of the latter under this Agreement in relation to an investment of the former which have not been amicably settled shall, after a period of four [months] from written notification of a claim, be submitted to international arbitration if the national or company concerned so wishes.

(2) Where the dispute is referred to international arbitration, the national or company and the Contracting Party concerned in the dispute may agree to refer the dispute either to:

(a) the [ICSID]

(b) the Court of Arbitration of the International Chamber of Commerce; or

(c) an international arbitrator or ad hoc arbitration tribunal to be appointed by a special agreement or established under the Arbitration Rules of the [UNICTRAL].

If after a period of four months from written notification of the claim there is no agreement to one of the above alternative procedures, the dispute shall at the request in writing of the national or company concerned be submitted to arbitration under the Arbitration Rules of the [UNICTRAL] as then in force. The parties to the dispute may agree in writing to modify these Rules.

Article 3 of the applicable BIT contains an MFN clause which, as one finds in several UK BITs, confirms explicitly in its third paragraph that MFN treatment applies to the provisions relating to investor-State dispute settlement.

The tribunal first noted that consent to jurisdiction is a fundamental requirement in investment arbitration, and in international law generally, and that it must be based on an express declaration of consent or any other action that demonstrates consent. It cannot, according to the tribunal, be presumed (para. 21), nor should dispute resolution provisions be interpreted differently than other provisions of a treaty (para. 22).

The tribunal subsequently analysed whether in this case Turkmenistan had consented to ICSID arbitration. First,

the tribunal confirmed the need to have, under Article 25 of the ICSID Convention, “consent in writing” (paras. 24). Secondly, the majority engaged in a “two steps” approach to the question of consent, corresponding to the investor-State dispute settlement clause contained in Article 8 of the UK-Turkmenistan BIT. According to the tribunal, the first paragraph of Article 8 dealt with consent to arbitration, while the second paragraph dealt with “the arbitration systems that may be used if the conditions of Article 8(1) are met” (para. 25). The tribunal interpreted the first paragraph to mean that Turkmenistan consented to submit disputes with UK investors to international arbitration generally, under three conditions, namely: (1) that the investor “so wishes”; (2) that the dispute has not been settled within four months following a written notification of the claim; and (3) that the dispute concerns an obligation of one of the Contracting States under the treaty (para. 27). That the first two conditions were satisfied in this case was uncontested. Discussion of the third condition, namely whether the claims concerned a treaty or a purely contractual breach, was deferred to the decision on the merits (*ibid.*).

The question remained, however, whether this sufficed to establish consent to ICSID arbitration. The tribunal first noted that the use of the word “shall” in Article 8(1) made the statement mandatory (para. 28), and thus appeared to the majority “to establish unequivocally Turkmenistan’s consent to submit disputes with UK investors to international arbitration” (para. 29). The tribunal secondly analysed whether this consent involves consent to *ICSID arbitration* in particular, which is regulated in Article 8(2) of the UK-Turkmenistan BIT. The tribunal considered that that paragraph contains a “menu of options” and a default selection if “there is no agreement to one of the above alternative procedure” (i.e., UNCITRAL arbitration) (para. 32). The tribunal concluded that under Article 8 of the BIT Turkmenistan unambiguously consented to arbitration but not to ICSID arbitration (paras. 36-38).

Following the establishment of consent to arbitration generally, the tribunal moved to the question of whether the claimant, through application of the MFN clause contained in the UK-Turkmenistan BIT, may rely on consent to ICSID arbitration contained in investment treaties concluded between Turkmenistan and third States. This, the tribunal admitted, is “venturing into a fiercely contested non-man’s land in international law” (para. 40). The tribunal decided it did not need to engage in a thorough interpretation of the MFN clause, since the clause in the UK-Turkmenistan BIT explicitly applied to investor-State arbitration clauses, which to the tribunal’s majority confirmed the parties’ intentions to this effect. After discarding other arguments of the Respondent in this respect, the majority concluded that, as a consequence, the MFN clause should be applied to investor-State dispute settlement clauses (para. 64).

The next step of the tribunal was to apply these principles to the case at hand. The claimant had invoked the benefit of more favourable dispute settlement provisions in multiple treaties, but since the focus was placed on the Switzerland-Turkmenistan BIT, the tribunal essentially focused on this treaty alone. The tribunal examined two separate questions: first, whether consent to ICSID arbitration may be ‘imported’ through operation of the MFN clause; and secondly, whether treatment of foreign investors and investments in the Switzerland-

Turkmenistan BIT is more favourable than treatment under the UK-Turkmenistan BIT.

On the first question, the Turkmenistan had argued that the MFN clause may not be used to ‘import’ the State’s consent to a different arbitration system from another treaty (para. 70 ff). In support of this argument, the respondent cited the decision of the tribunal in *Maffezini v. Spain*, the first decision to accept the application of MFN clauses to dispute settlement provisions. In that decision the tribunal explicitly excluded the invocation of MFN clauses “in order to refer the dispute to a different system of arbitration.”⁴ The tribunal, however, accepted that the MFN clause in the UK-Turkmenistan BIT, which explicitly applies to dispute settlement provisions, may be used to rely on more favourable dispute settlement clauses, such as the one contained in the Switzerland-Turkmenistan BIT, because the MFN clause of the UK-Turkmenistan BIT “effectively replaces Article 8(2) of the UK-Turkmenistan BIT with Article 8(2) of the Switzerland-Turkmenistan BIT, which requires no such case-specific consent” (para. 74). The tribunal thus did not argue that consent needed to be ‘imported’, since it had already established previously that Turkmenistan consented generally to arbitration (para. 75). The only provision to be ‘imported’ is the “choice between ICSID Arbitration and UNCITRAL Arbitration” (para. 75).

On the second question, whether the UK-Turkmenistan BIT provided less favourable treatment than the Switzerland-Turkmenistan BIT in respect of dispute settlement, the tribunal considered that it is impossible to establish, objectively, that ICSID arbitration is more favourable than arbitration under the UNCITRAL arbitration rules. However, the majority accepted that the *choice* given to investors to choose between both types of arbitration is in fact more favourable than BITs which restrict the submission of a claim to one system of arbitration (paras. 89-95).

The dissenting opinion

Arbitrator Laurence Boisson de Chazournes, appointed by the respondent, issued a powerful dissent, asserting that the central question was whether consent to ICSID arbitration had been established under the UK-Turkmenistan BIT (para. 8). Boisson de Chazournes considered first that construing Article 8 of the UK-Turkmenistan BIT as containing two separate provisions—the first paragraph containing the consent to arbitration and the second paragraph the arbitration system which may be used as a consequence—disregarded the need to interpret that article as a whole. Secondly, the dissenting arbitrator considered that in any event, consent to ICSID arbitration in another BIT may not be used by a tribunal to find jurisdiction if such consent is lacking in the basic treaty (UK-Turkmenistan BIT).

On the first point, Boisson de Chazournes maintained that Article 8(1) of the UK-Turkmenistan BIT contains consent in principle to arbitration, after a waiting period of four months, but that such consent must be read in light of the specific conditions governing that consent in Article 8(2). In other words, Article 8(1) cannot be read in isolation from Article 8(2). The first governs the conditions under which an investor can resort to arbitration; the second paragraph “fixes the strict conditions under which the foreign investor can pursue one specific venue for international arbitration” (para.

19). She considered that the interpretation given by the tribunal of Article 8(1) has been used “as a means to achieve an end that it could not easily achieve by acknowledging that consent to arbitration is contained in Article 8(2)” (para. 20). Drawing the conclusion that consent *has* been given in Article 8(1) was according to Boisson de Chazournes patently wrong, since it confounded the power to initiate arbitration with consent to arbitration (para. 21). Article 8(2) indeed states that “the national or company and the Contracting Party concerned in the dispute *may agree to refer* the dispute either to” the four listed options, implying the need for a consent of both the investor and the host State to the forum of arbitration (paras. 22 ff). This reading, according to Boisson de Chazournes, is further confirmed by the last line of Article 8(2), which identifies UNITRAL arbitration as the default forum “if after a period of four months from written notification of the claim *there is no agreement* to one of the above alternative procedures”⁵ (para. 26). Supplementary means of treaty interpretation also confirm such a reading of the dispute settlement clause, since the UK-Turkmenistan BIT contains the ‘alternative’ version of the UK Model BIT as opposed to the ‘preferred’ version which requires no prior agreement between the foreign investor and the host State and gives direct consent to ICSID Arbitration (paras. 28-30).

The dissenting arbitrator then analysed the ordinary meaning of the MFN clause in the UK-Turkmenistan BIT (Article 3(2)-(3)), which, as mentioned, explicitly applies to dispute settlement provisions. This article however should be read in light of the other provisions of the BIT, and not in isolation, which the majority failed to do (paras. 38 ff). Boisson de Chazournes considered that the “right” to MFN treatment “can only be exercised if the foreign investor and the host State are subject to a dispute settlement relationship under one of the dispute settlement options that are provided in Article 8(2)” (para. 41). This is a point that the majority had refused to accept, finding “no basis in the U.K.-Turkmenistan BIT for conditioning the rights enjoyed by an investor under the BIT on the temporal sequence in which the investor asserts those rights” (para. 61 of the decision). In Boisson de Chazournes’ opinion, MFN treatment in respect of ICSID arbitration is simply inapplicable given the lack of mutual agreement to ICSID Arbitration (paras. 43-44).

Linked to this, Boisson de Chazournes analysed the specificity of the ICSID Convention, and in particular the need for consent in writing contained in Article 25 of the ICSID Convention. Such consent clearly is lacking in this case, according to Professor Boisson de Chazournes (paras. 46-51).

On the second question, namely whether, assuming that the MFN clause is applicable, one could ‘import’ consent to ICSID Arbitration, Boisson de Chazournes pointed to several decisions, including *Maffezini v. Spain*, in which tribunals unambiguously stated that the MFN clause may not alter an explicit choice of forum. The MFN clause’s main objective is not to remedy the absence of consent, but rather to ensure that once consent is given, it is implemented in the most favourable way compared to treaties signed with other States (para. 61). From a more systemic perspective, Boisson de Chazournes argued that accepting the contrary “would involve a forum-

shopping attitude that bypasses the consent requirement of the Respondent while running against the fundamental principles of international adjudication” (para. 63).

A critical assessment of the tribunal’s decision

The majority’s decision stands out of in relation to many other decisions which have discussed the application of the MFN clause to dispute settlement provisions. Indeed, those decisions were mainly concerned with pre-arbitration requirements, such as waiting periods or exhaustion of domestic remedies requirements. A 2010 UNCTAD study reveals indeed that the invocation of the MFN clause to replace the arbitral forum or rules for the settlement of investor-State disputes has never been accepted by a tribunal.⁶ Since then several tribunals have equally emphasised, sometimes implicitly, that MFN clauses may not be invoked to alter the arbitral forum.⁷ Moreover, the few known decisions which have applied the MFN clause in order to broaden the scope of the legal issues susceptible of being arbitrated are dissimilar to the present case.⁸

Although the majority’s decision is without doubt well-argued, there are several interpretative and conceptual constructions which leave it open to criticism, as has been thoroughly exposed in the dissenting opinion.

First, the tribunal’s interpretation of Article 8 of the UK-Turkmenistan BIT seems to run counter to the exact wording and logic of the clause. To read the first and second paragraphs of the clause as two unconnected parts of an investor-State dispute settlement clause is contrary indeed to the logic behind the Article 8 of the UK-Turkmenistan BIT. It seems difficult to dissociate the first paragraph from the second, since doing so would simply render the second paragraph irrelevant. The very fact that in the second paragraph of Article 8 includes a ‘default’ option in case no agreement is reached on any of the listed options seems to clearly indicate that specific consent is required in order to initiate arbitral proceedings under the ICSID Convention, and that consent in fact is only give for arbitration under the UNCITRAL arbitration rules—the default option. In fact the first paragraph of Article 8 contains only pre-arbitration requirement—a waiting period of four months—and reading into that paragraph a general consent to arbitrate seems to be overly inventive.

Secondly, there is a question that precedes the possible application of the MFN clause, namely whether the parties to the dispute are in a “dispute settlement relationship,” to use the words of Boisson de Chazournes. The argument developed in the dissenting opinion echoes the decision of the Tribunal in *Diamler v. Argentina*. The Tribunal there noted:

“... a claimant wishing to raise an MFN claim under the German-Argentine BIT – whether on procedural or substantive grounds – lacks standing to do so until it has fulfilled the domestic courts proviso. *To put it more concretely, since the Claimant has not yet satisfied the necessary condition precedent to Argentina’s consent to international arbitration, its MFN arguments are not yet properly before the Tribunal.* The Tribunal is therefore presently without jurisdiction to rule on any MFN-based claims unless the MFN clauses themselves supply the Tribunal with the necessary jurisdiction.”⁹

The tribunal's argument in *Daimler*, based on the decision of the International Court of Justice in the *Anglo-Iranian Oil Co* case¹⁰, is logical in that it provides that an MFN-clause, generally, can only be invoked if a tribunal first has jurisdiction to entertain a claim; the only exception to this being when the MFN clause *itself* provides jurisdiction to the tribunal. Boisson de Chazournes takes up this argument in her dissent, arguing that since Turkmenistan has not provided consent to ICSID arbitration in the basic treaty, the claimant is not in a position to invoke the MFN clause. The question then is whether, in the absence of consent in the basic treaty, the MFN clause *itself* can provide consent. This question is of course related to the problem whether one can 'import' consent through the application of an MFN clause, which Boisson de Chazournes categorically refutes. The tribunal in *Daimler* also made the same point.¹¹ The dissenting opinion has the merit of pointing to this important aspect of applying MFN clauses to dispute settlement provisions, and it is regrettable that the majority did not engage with this argument.

Thirdly, even if one assumes that the MFN clause applies and may be invoked by the claimant, it is doubtful that, through operation of that clause, consent to a particular form of arbitration may be 'imported' from another treaty. Here, the relative ease with which the majority discarded the paramount need for consent to a specific form of arbitration is very much open to criticism. Indeed, and this is of course peculiar to international law and the involvement of a State, the default principle is that international courts and tribunals have no jurisdiction unless States have given explicit consent. As such, the choice of the specific dispute settlement method made by the States needs to be respected. As noted by Boisson de Chazournes

'consent to jurisdiction in international adjudication must always be established. First, this is a necessary prerequisite to the exercise of the international judicial function. The principle of *compétence de la compétence* as defined under general international law, and under Article 41 of the ICSID Convention, empowers an arbitral tribunal or any other international court to determine proprio motu the extent and limits of its jurisdiction. At the same time, the principle of *compétence de la compétence* requires an arbitral tribunal or any other international court to establish the extent and limits of its jurisdiction objectively, i.e., on the basis of the title of jurisdiction that is conferred to the said tribunal, and not to go beyond it.'¹²

'Importing' consent to ICSID Arbitration through operation of the MFN clause runs counter this fundamental principle. The only legal argument one can find to accept such a possibility is in the event that States parties to the BIT which contains the MFN clause have intended that that clause may be invoked in order to establish consent – and not just to override pre-arbitration requirements - expressed in another treaty. In such a case consent to arbitration would in fact present in the basic treaty. This, however, seems not to have been the case in the UK-Turkmenistan BIT, although the majority argued otherwise. Linked to this, it should not be forgotten that consent to ICSID arbitration, as opposed to arbitration generally, is not only subject to the general

rules of consent to jurisdiction applicable in international law, but is specifically addressed in Article 25 ICSID Convention which requires "consent in writing".

From a systemic perspective, it should also not be forgotten that creative findings of jurisdiction may well be counterproductive for the system of investment treaty arbitration. Considering the recent criticism of the system, and the denunciation by several States of the ICSID Convention and certain BITs,¹³ tribunals should adhere to the general principles governing consent of States to arbitration, in order to avoid creating mistrust amongst States towards the ICSID system of arbitration, which, one should not forget, has much value in providing a neutral forum to settle investment disputes.

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Notes

¹ See, recently, *Kılıç İnşaat İthalat İhracat Sanayi ve Ticaret Anonim Şirketi v. Turkmenistan*, ICSID Case No. ARB/10/1, 2 July 2013 Award and Separate Opinion of Professor William W. Park; *Teinver S.A., Transportes de Cercanías S.A. and Autobuses Urbanos del Sur S.A. v. The Argentine Republic*, ICSID Case No. ARB/09/1, Decision on Jurisdiction and Separate Opinion of Dr. Kamal Hossain, 21 December 2012; *Daimler Financial Services AG v. Argentine Republic*, ICSID Case No. ARB/05/1, Award, 22 August 2012, and Dissenting Opinion of Judge Charles N. Brower and Opinion of Professor Domingo Bello Janeiro;

² *Garanti Koza LLP v. Turkmenistan*, ICSID Case No. ARB/11/20, 3 July 2013, Decision on the Objection to Jurisdiction for Lack of Consent and Dissenting Opinion of the Decision on the Objection to Jurisdiction for Lack of Consent.

³ See however for the attempt by a Claimant to invoke the MFN clause in order to use a more favourable definition of 'investor' in a third party BIT, which was ultimately rejected by the Tribunal: *Metal-Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, 4 October 2013 Award.

⁴ *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, Jan 25, 2000, para. 63.

⁵ Emphasis in the dissenting opinion.

⁶ See for an overview: UNCTAD, *Most-Favoured Nation Treatment* (UNCTAD Series on Issues in International Investment Agreements II), (New York and Geneva: United Nations, 2010), pp. 73-84 available at http://unctad.org/en/Docs/diaeia20101_en.pdf.

⁷ See for instance, *Teinver v. The Argentine Republic*, see above note 2, paras. 182-186.

⁸ In *RosInvestCo*, the Tribunal accepted extending its jurisdiction based on the MFN clause, but did not discuss nor accept the possibility of 'importing' consent to ICSID Arbitration (*RosInvestCo. U.K. v. Russia*, Arbitration under Stockholm Chamber of Commerce, Case no: Arbitration V 079 / 2005, Award on Jurisdiction of October 2007, paras. 128 ff).

⁹ *Daimler v. Argentine Republic*, see above note 2, para. 200 (emphasis in the original).

¹⁰ ICJ, 'Anglo-Iranian Oil Co. case (jurisdiction)', Judgment of 22 July 1952, *I.C.J. Reports* 1952, p. 93.

¹¹ Para. 204.

¹² Para. 5.

¹³ See, for example, ICSID News Release, 'Venezuela Submits a Notice under Article 71 of the ICSID Convention', January 26, 2012, at <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement100> (last visited 4 December 2014).

news in brief

UNCITRAL launches new transparency registry

The UNCITRAL Secretariat has established a transparency registry¹ that will function as a repository for the publication of information and documents in treaty-based investor-State arbitration. This follows the entry into force of the UNCITRAL Rules on Transparency in treaty-based investor-State arbitration on April 1, 2014.²

The registry will contain information on the commencement of an arbitration, and make available a wide range of documents, including transcripts of hearings; orders, decisions and awards of the arbitral tribunal; and submissions to the tribunal.

The UNCITRAL Rules on Transparency are an integral part of the UNCITRAL arbitration rules and will apply on a default basis to UNCITRAL investor-State arbitrations conducted under investment treaties concluded after April 1, 2014.

The UNCITRAL arbitration rules are among the most common rules for settling investor-State arbitration, and had long been criticized for their secretive nature.

Indonesia terminates bilateral investment treaty with the Netherlands

In March the Dutch Ministry of Foreign Affairs announced that Indonesia has decided to terminate its bilateral investment treaty with the Netherlands. Indonesia has faced a number of treaty-based claims in recent years.

The Dutch Ministry stated:

"Indonesia has informed the Netherlands that it has decided to terminate the Bilateral Investment Treaty (official title: Agreement between the Government of the Republic Indonesia and the Government of the Kingdom of the Netherlands on Promotion and Protection of Investment) per July 1, 2015.

From that date onwards the provisions of the Agreement will continue to apply only to investments made prior to that date, for a period of fifteen years. The Indonesian Government has mentioned it intends to terminate all of its 67 bilateral investment treaties. The Netherlands is discussing the matter with the Indonesian authorities."³

The Netherlands' portfolio of nearly a 100 BITs is one of the largest in the world. It has also been the focus of particular controversy. Together with a favourable tax regime, Dutch BITs have been accused of forming a strategy to attract so-called mail box companies (i.e. business with no real economic activity in the country).

Germany balks at investor-State arbitration in the Transatlantic Trade and Investment Partnership

Germany's Ministry of Economy announced in March that it opposed investor-State dispute settlement provisions in the EU-US trade pact that is currently under negotiation, according to a report in the *Financial Times*.⁴

Opposition to investment arbitration by civil society groups has swelled in Europe, leading the Commission to open a public consultation on the matter (see the next story item).

Germany had previously approved a mandate for the European Commission to negotiate on investor-State arbitration, along with other EU member states. But speaking to the German parliament, Brigitte Zypries, a junior economy minister, explained that the German government now believes that "US investors in the EU have sufficient legal protection in the national courts."

According to the *Financial Times*, Ignacio Garcia Bercero, the EU's chief negotiator, and Dan Mullaney, the US lead negotiator, declined to comment on Germany's position.

Germany's stance on investor-State comes as a surprise; the country has the largest portfolio of BITs in the world. It also has the distinction of having signed the first ever BIT in 1959, with Pakistan.

European Commission launches public consultation on investment provisions in TTIP

The European Commission has invited the public to comment on its approach to investment protection and investor-State dispute settlement provisions in negotiations with the United States over the Transatlantic Trade and Investment Partnership Agreement (TTIP).

According to the Commission, "the key issue ... is whether the EU's proposed approach for TTIP achieves the right balance between protecting investors and safeguarding the EU's right and ability to regulate in the public interest."

The Commission is seeking feedback through a detail questionnaire available online.⁵ The consultation is open until July 6, 2014.

Campaigners from the Seattle to Brussels Network have criticized what they label a "mock consultation."⁶ In a statement from the network, Marc Maes of the Belgian development organisation 11.11.11 said the "Commission's so-called reform agenda does nothing to address the basic flaws of the investor-state dispute settlement system. Foreign companies will continue to have greater rights than domestic firms and citizens. And international tribunals consisting of three for-profit lawyers will continue to decide over what policies are right or wrong, disregarding domestic laws, courts and democracy."

Notes

1 <http://www.uncitral.org/transparency-registry/registry/index.jspx>

2 <http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf>

3 <http://indonesia.nlembassy.org/news/2014/03/bilateral-investment-treaty%5B2%5D.html>

4 <http://www.ft.com/intl/cms/s/0/cc5c4860-ab9d-11e3-90af-00144feab7de.html?siteedition=uk#axzz2znbA2zGj>

5 http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179

6 <http://globalarbitrationreview.com/news/article/32531/public-consultation-opens-eu-us-treaty/>

awards & decisions

ICSID tribunal finds jurisdiction over mining license dispute involving British and Australian companies in Indonesia

Churchill Mining Plc v. Republic of Indonesia ICSID Case No. & Planet Mining Pty Ltd v. Republic of Indonesia, ICSID Case No. ARB/12/14 and ARB/12/14 and 12/40

Matthew A J Levine

An ICSID tribunal has accepted jurisdiction over the consolidated claims of affiliated coal mining companies which invested in a massive deposit on the Indonesian island of Kalimantan.

The tribunal found that the consent clause in the Australia–Indonesia BIT requires a further separate act, and that it was crystallized in regulatory approvals. In the United Kingdom–Indonesia BIT, the tribunal found a standing consent clause.

In both cases the tribunal found that the investment had been granted admission in accordance with the relevant domestic law pursuant to the BITs.

Background

Churchill, a British company, and Planet, an Australian company controlled by Churchill, own 95 per cent and 5 per cent of the shares, respectively, in the Indonesian foreign direct-invested company PT Indonesian Coal Development (PT ICD). Between 2005 and 2010 PT ICD, together with various Indonesian companies, had developed the East Kutai Coal Project (EKCP). The EKCP is estimated to contain the second largest coal deposit in Indonesia and the seventh largest in the world.

In 2005, the Indonesian Investment Coordinating Board (BKPM) authorized PT ICD to conduct business in the mining sector as a foreign direct-investment company (2005 BKPM Approval). The 2005 BKPM Approval contained an ICSID arbitration agreement.

In 2006, Churchill and Planet acquired all of the shares in PT ICD from its founders. Later in 2006, this transaction and the resulting change in PT ICD's shareholding were approved by the BKPM (2006 BKPM Approval). The 2006 BKPM Approval incorporated by reference the terms of the 2005 BKPM Approval, including the ICSID arbitration agreement.

Between 2007 and 2009, Churchill and Planet's Indonesian partners were granted licenses related to the surveying, exploration, and exploitation of the EKCP. At the same time, the local authority had apparently already granted exploration licenses over a substantially overlapping area to another group of companies. In May 2010, further to a letter from Indonesia's Ministry of Forestry, the local authority revoked the exploitation licenses held by Churchill and Planet's Indonesian partners.

Standard for finding Indonesia's consent to arbitration

As a threshold issue, the tribunal observed that under the ICSID Convention consent must be expressed in writing but there is no additional requirement that it be "clear and unambiguous" or proven through "affirmative evidence". The tribunal's assessment of whether consent was expressed in either the UK-Indonesia BIT (UK BIT) or the Australia–Indonesia BIT (Australia BIT) was therefore made pursuant to the general rules on treaty interpretation found in Articles 31-32 of the Vienna Convention on the Law of Treaties (VCLT).

No standing offer to arbitrate between Australia and Indonesia

In examining whether Indonesia had consented to arbitration in the Australia BIT, the tribunal noted that "[i]n a nutshell,

the question is whether paragraph 4 qualifies paragraph 2." Taken in isolation paragraph 2 would entitle Planet to institute ICSID proceedings; however, the words "consent in writing ... within forty five days" in sub-paragraph 4(a) suggested that consent is not crystallized in the treaty and that a separate act is needed. The tribunal felt that it would have to reduce sub-paragraph 4(a) to a mere administrative formality in order to find advance consent, and that this would be doing violence to the plain meaning of the treaty's language. At this first stage in its analysis the tribunal therefore leaned towards not finding standing consent.

The tribunal found that the relevant context led to the conclusion that Article XI does not contain Indonesia's standing consent. In doing so, it rejected the claimant's argument regarding 4(b), which states that "if the parties to the dispute cannot agree whether conciliation or arbitration is the more appropriate procedure, the investor affected shall have the right to choose." Planet argued that the use of "or" between sub-paragraphs 4(a) and 4(b) is consistent with 4(a) being a mere formality, because if Indonesia fails to provide consent under (a) then the investor has the right to choose between conciliation and arbitration under (b). The tribunal found the inclusion of "or" rather than "and"—which is used in every other known BIT by Australia—to be a drafting error.

The tribunal found the object and purpose of the Australia BIT to be neutral for interpretative purposes. It concluded that Article XI does not contain Indonesia's advance consent to ICSID proceedings, and that this is confirmed by the supplementary means of interpretation raised by the Parties, i.e. doctrinal writings and treaty practice.

UK BIT contains standing offer

In *Churchill* the tribunal found two possible readings of the words "shall assent" in Article 7(1) of the UK BIT. As the plain meaning was inconclusive, the tribunal considered the relevant context and found it to favor Churchill's position "without delivering a fatal blow to Indonesia's interpretation." It also reviewed the object and purpose of the UK BIT, which it found to be of no avail in the actual dispute.

The tribunal noted that under Article 32 of the VCLT it had latitude to consider the following materials that might shed light on the interpretation of "shall assent": (i) doctrinal writings; (ii) case law; (iii) the treaty practice of Indonesia and the United Kingdom with third States, and; (iv) the preparatory materials regarding the negotiation of the UK-Indonesia BIT.

Indonesia had placed significant emphasis on doctrinal writings by prominent commentators, but the tribunal found these to be inconclusive.

As regards treaty practice with third States, the tribunal concluded that the UK's practice is to secure advance consent to international arbitration, including during the 1970s; and, that Indonesia follows a similar practice but clauses adopted in the 1970s show considerable variations. On this basis, the tribunal found that third party treaty practice does not allow for a conclusion on the meaning of "shall assent."

Finally, the tribunal reviewed the *travaux préparatoire* for the UK BIT, which had been found by the claimant during the hearing and placed on the record. The tribunal reached the conclusion that the treaty drafters considered "shall assent" as functionally equivalent to wording such as "hereby consents."

The tribunal accordingly held that Indonesia's standing consent to arbitration is found in the UK BIT.

Regulatory approvals provide consent under the BITs

The tribunal found that the separate act required by the words “shall consent in writing ... within forty five days” in the Australia BIT could be found in the 2005 BKPM Approval (and then incorporated in the 2006 BKPM Approval). In doing so, it addressed each of Indonesia’s objections.

Of particular note, the tribunal found that by virtue of the word “shall,” Indonesia did not have discretion to withhold the separate act of consent. Moreover, in the tribunal’s view the relevant passage “does not exclude the possibility of providing consent in writing prior to the request for arbitration” but instead merely provides a limit.

In *Churchill* the tribunal observed in passing that, had it held that an additional act of consent was required under the UK BIT, it would have found this requirement to be satisfied by the 2005 BKPM Approval as incorporated in to the 2006 BKPM Approval.

Ownership of local operating company is admitted investment

The tribunal also considered the scope of Indonesia’s consent to arbitration with *Churchill* and *Planet*, specifically whether the companies’ investments had been admitted pursuant to the standard set out in the BITs.

The tribunal found both the Australia and UK BITs to require that the investment be admitted in accordance with domestic law. On the facts, the tribunal found that *Churchill* and *Planet* had obtained the necessary approval under relevant Indonesian law.

The tribunal observed that this admission requirement was specific to the moment at which the investment entered Indonesia and had no ongoing effect. It agreed with the claimants that this is “narrower than a traditional legality requirement in the sense that it only demands admission in accordance with the relevant domestic laws and not general compliance with the host State’s legislation.”

The tribunal in both *Churchill Mining Plc v. Republic of Indonesia* and *Planet Mining Pty Ltd v. Republic of Indonesia* was composed of Gabrielle Kaufmann-Kohler (president) Albert Jan van den Berg (claimant’s appointee) and Michael Hwang (respondent’s appointee).

The decision on jurisdiction in *Churchill Mining Plc v. Republic of Indonesia* is available at: <http://www.italaw.com/sites/default/files/case-documents/italaw3103.pdf>

The decision on jurisdiction in *Planet Mining Pty Ltd v. Republic of Indonesia* is available at: <http://www.italaw.com/sites/default/files/case-documents/italaw3104.pdf>

Majority considers early termination of Romanian tax incentives to have violated investors’ legitimate expectations

Ioan Micula, Viorel Micula and others v. Romania, ICSID Case No. ARB/05/20, Award

Diana Rosert

Having ruled that Romania violated the claimants’ legitimate expectations under the fair and equitable treatment (FET) standard of the Sweden-Romania BIT, the majority of an ICSID tribunal has awarded damages amounting to over US\$100 million plus compound interest. While concurring with the overall outcome of the December 11, 2013 award, arbitrator Prof. Georges Abi-Saab issued a separate opinion that provided a different view on FET with respect to legitimate expectations and standards of transparency for state conduct.

Previously, the tribunal’s jurisdictional decision of September 2008 dismissed all of Romania’s objections as to the claimants’ fulfillment of the nationality requirement, the nature and existence of a dispute, as well as the temporal coverage of the dispute by the treaty.

Background

Two Swedish nationals, Ioan and Viorel Micula, and three Romanian food and manufacturing companies—European Food, Starmill, and Multipack—owned by Ioan and Viorel Micula, submitted the dispute with Romania to ICSID arbitration. The claimants alleged that Romania’s decision to prematurely revoke tax incentives for investors in disfavored Romanian regions breached the umbrella clause, the FET obligation and expropriation provisions contained in the BIT.

The tax incentive scheme was put in place by Romania’s Emergency Government Ordinance 24/1998 (EGO 24) which included exemptions from customs duties on imported machinery and raw materials, and exemptions from the payment of corporate profit tax. However, Romania eliminated the incentives in February 2005 before they had reached the 10-year period of validity, specified as April 2009 in government decisions implementing EGO 24. This step was taken in the run-up to Romania’s 2007 EU accession, after the EU Commission determined that the incentive were incompatible with EU law on state aid and made the scheme’s termination a pre-condition for accession. The European Commission, which was given permission to participate in the proceeding as *amicus curiae*, submitted comments on the relationship between the incentive scheme, EU law and BIT obligations and testified on related issues.

Majority dismisses umbrella clause claim for lack of proof

The claimants argued that the incentive scheme fell under the umbrella clause contained in Article 2(4) of the BIT, which elevated the violation of “any obligation” by Romania to a treaty breach. They maintained that the scope of the umbrella clause not only covered obligations arising from contracts, but also those from regulations and legislation. According to the claimants, the incentive scheme gave rise to a “specific obligation” vis-à-vis the claimants, since it applied explicitly to investors in disfavored regions which had to undergo a certification process and assume certain duties themselves (e.g., employing persons from this region). In the claimants’ view, there was “a clear and unambiguous commitment from the Romanian State that the incentives would be granted for 10 years.”

Romania, on the other hand, argued that the umbrella clause was “one of the narrowest used in investment treaties,” since it did not cover mere “undertakings” and did not contain stabilization wording that guaranteed regulatory freeze. The respondent considered that under Romanian law no obligations arose from general legislation such as the incentive scheme, and as such, none could have existed or be violated in the sense of the umbrella clause. The respondent’s main argument was that “[u]nilateral instruments such as laws and regulations, which are per se liable to change, cannot be understood to have been “entered into” with anyone.” It added that the main legislative document— EGO 24—did not even specify the duration of the scheme.

However, the tribunal favored the claimants’ arguments, which asserted that the incentive framework under EGO 24 in conjunction with related government decisions “created a specific entitlement for the Claimants ... to receive the incentives until 1 April 2009.” It then pointed out that the umbrella clause broadly referred to “any obligation” and refrained from defining what was meant by the term. However,

the tribunal sided with the respondent in that the interpretation of the term “obligation” in the treaty depended on whether the incentive framework at issue established obligations under domestic law. The tribunal held that the claimants failed to prove this was the case, even though the framework created an “appearance” of “a vested right giving rise to the corresponding obligation.” Consequently, a majority of the tribunal (Laurent Lévy and Georges Abi-Saab) rejected the claim that Romania violated the umbrella clause.

However, the tribunal also tested a different interpretative approach, which was eventually dismissed by the majority but favored by arbitrator Stanimir A. Alexandrov. That approach assumed that the incentive scheme established a relationship between both parties that implied mutual rights and duties. In other words, it created a legal commitment or obligation, which “by definition” was based solely on Romanian law. The commitment of specific incentives for a specific time “would necessarily be understood as including a promise of stabilization.”

Romania’s violation of legitimate expectations and FET ascertained by majority

Based on the same facts, the claimants alleged that Romania failed to deliver on the claimants’ legitimate expectations of regulatory stability, acted unreasonably and in bad faith when it decided to terminate tax incentives, and failed to act transparently and consistently during this process.

The tribunal first pointed out that the FET standard “does not give a right to regulatory stability *per se*”; rather, the investor “must” expect regulatory changes if no explicit assurances were given by Romania. It confirmed, in line with *Saluka v. Czech Republic*,¹ that the host state’s right to regulate should be taken into account. The tribunal also noted that arbitral practice supported the doctrine of legitimate expectations and agreed with the tribunal in *Duke Energy v. Ecuador*, which deemed legitimate expectations to be an “important element” of FET, but placed under specific limitations (e.g., reasonableness in the broader context).²

To determine whether in the present case legitimate expectations were frustrated, the tribunal assessed the fulfillment of three conditions: first, that the incentive scheme could “reasonably be understood” to have created a promise or assurance by Romania, irrespective of whether this was intended; secondly, that the claimants relied on the incentive scheme “as a matter of fact” when making their investment decisions; and thirdly, that it was “objectively reasonable” for them to do so.

The arbitrators Laurent Lévy and Stanimir A. Alexandrov considered that the incentive scheme indeed created a promise or assurance under the FET clause and implied an element of stabilization, giving rise to investors’ legitimate expectations. The majority reasoned that the scheme involved a “quid pro quo” for investors, since they had to meet conditions to receive tax incentives. It further explained that Romania diverted from its intention to keep the incentive scheme in place for 10 years only due to pressure from the EU. The majority also determined that the incentive scheme was not merely “amended,” but effectively eliminated. Despite the existence of a general right to regulate, the majority determined that Romania was bound to keep its promise to the investors, but its conduct breached it.

Next, the majority found evidence that a “significant part” of the claimants’ investments, particularly those related to the expansion of business, relied on the incentives. It considered this reliance to be reasonable, as the incentives were believed

to be “valid regional operating aid under EU law,” even though this belief turned out to be incorrect at a later stage, namely when the scheme was terminated for its incompatibility with EU state aid law. As all three conditions had been met, the tribunal concluded that Romania’s early termination of the incentive scheme violated the claimants’ legitimate expectations and therefore its actions were “unfair or inequitable.”

However, Romania argued that for a breach of FET to exist it would need to be demonstrated that it acted unreasonably rather than showing that the claimants’ reliance was reasonable. Romania asserted that the termination of the scheme was a reasonable decision taken to comply with EU law. Indeed, the tribunal found that Romania acted reasonably in “pursuit of a rational policy,” responding to the EU’s demands, and not in bad faith. Nonetheless, the majority noted one exception. It deemed it unreasonable that Romania terminated incentives, while it maintained investor duties under the scheme. The tribunal also concluded that Romania’s conduct lacked sufficient transparency to satisfy the FET standard, because Romania failed to alert the investors affected by the termination in a timely fashion. However, arbitrator Georges Abi-Saab disagreed with some of the majority’s findings. He held that the tax incentive scheme did not “by itself” constitute a legal commitment and that it did not contain a stabilization element, whereas both were necessary to substantiate legitimate expectations.

Abi-Saab also pointed out that the incentive scheme was not completely eliminated, since a profit tax exemption continued to be in force until 2009, while the duties of the beneficiaries were, as Romania contended, not implemented. However, he took note of the “legitimate” argument that a radical reduction of the scheme could potentially raise issues of liability.

Furthermore, the dissenting arbitrator suggested Romania’s assertion that it acted reasonably, and in response to the necessities arising out of EU accession, could have received more weight as a factor “precluding responsibility” for what the majority considered a frustration of legitimate expectations. Abi-Saab also disagreed that the government was guilty of a “lack of transparency,” rather considering it “slackness” or “negligence” in communicating with the investors.

Having found a breach of FET, the tribunal found it redundant to assess whether Romania also violated BIT Article 2(3) through unreasonable and discriminatory measures or Article 4(1) through expropriation without compensation, explaining that these alleged breaches relied on the same facts and, if proven, would lead to the same damages calculations.

Compensation awarded for investors’ increased costs and lost profits

The tribunal awarded to all five claimants collectively 376 million Romanian Leu (approximately US\$117 million) for increased costs of raw materials and lost profits on sales of finished goods, plus compound interest. The tribunal ordered each party to bear half of the arbitration costs and its own legal costs. While the investor claimed damages of up to 2.7 billion Romanian Leu (US\$836 million), the tribunal rejected several items in the calculation of damages for lack of sufficient evidence and came to a lower estimation of lost profits than claimed by the investors.

The tribunal was composed of Laurent Lévy (presiding arbitrator), Stanimir A. Alexandrov (claimants’ nominee) and Georges Abi-Saab (respondent’s nominee). The award is available at <http://italaw.com/sites/default/files/case-documents/italaw3036.pdf>

The separate opinion of Georges Abi-Saab is available at <http://italaw.com/sites/default/files/case-documents/italaw3037.pdf>

Guatemala found liable for breaching minimum standard of treatment under CAFTA-DR

Teco Guatemala Holdings LLC v. Guatemala, ICSID Case No. ARB/10/17, Award

Yalan Liu

An ICSID tribunal has found Guatemala liable under the free trade agreement between the Dominican Republic, the United States and Central American countries (CAFTA-DR) for failing to accord the minimum standard of treatment to a US investor. In the December 19, 2013 award, Guatemala was ordered to pay US\$21.1 million in damages plus compounded interest, as well as the claimant's legal costs valued at US\$7.5 million.

The claimant, Teco Guatemala Holdings LLC (Teco), complained of the treatment received by a local company (EEGSA), in which it held a 30 per cent stake, at the hands of the National Commission of Electric Energy (CNEE), Guatemala's state electricity regulator.

In addition to Teco's ICSID case, earlier claims had been brought based on similar facts: EEGSA initiated several cases against CNEE in the Guatemalan courts, alleging CNEE breached the domestic electricity laws. While the last two court decisions were rendered in favour of EEGSA, the Constitutional Court later reversed them. Also, Teco's consortium partner, Iberdrola, filed an ICSID case against Guatemala under the Spain-Guatemala BIT, which the tribunal rejected for jurisdictional reasons.

Background

The dispute between EEGSA and CNEE related to the procedure and methodology for calculating electricity tariffs, which EEGSA argued had been set too low, causing it economic damage.

CNEE sets the electricity tariffs applied to end consumers, which in turn determines how electricity distributors like EEGSA are reimbursed. According to the General Electricity Law, the key component for calculating tariffs for each distributor is through a study prepared by the distributor's consultant. The studies apply the terms of reference, containing guidelines on methodology and deadlines for delivery, which CNEE prepares and reviews every five years. In case of disagreements between CNEE and a distributor, an expert commission is to be established to advise on a resolution.

In 2007 and 2008, EEGSA and CNEE disagreed at various steps of the process. First, EEGSA objected to the terms of reference submitted to it by CNEE, claiming that they were in breach of the electricity law. Conflicts also arose when EEGSA's consultant was preparing the tariff study and when the expert commission was being set up. After the delivery of the expert commission's report, CNEE dissolved the commission against the protest of EEGSA. CNEE then adopted tariffs based not on the EEGSA revised consultant's study, but at a lower level based on the recommendation of its own consultant.

EEGSA brought several court actions against CNEE; however it withdrew the first case and the court suspended another. The last two cases were decided in favour of EEGSA in the first instance, but the Constitutional Court later reversed those decisions. In the present ICSID case, the claimant alleged that Guatemala's conduct violated its obligation to afford minimum standard of treatment, in particular fair and equitable treatment, under the CAFTA-DR.

Guatemala's jurisdictional objections not upheld by the tribunal

Guatemala challenged the tribunal's jurisdiction on the grounds that the claim was a "mere regulatory disagreement" over the interpretation of Guatemalan laws, which had already been resolved by the Guatemalan courts. According to Guatemala, the claimant was asking the tribunal to "act as an appellate court of third or fourth instance in matters governed by Guatemalan law."

The tribunal disagreed, however, explaining that there was an "international dispute," rather than only a domestic one, over which it had jurisdiction. The tribunal further explained its task was not to review the rulings of Guatemalan courts under Guatemalan law but rather apply international law to the facts in dispute.

As such, the tribunal ruled that the Guatemalan courts' proceedings could not deprive it of jurisdiction to decide an international dispute under international law. However, it acknowledged that it would have to apply Guatemalan law to some of the regulatory aspects of the dispute and "may have to" defer to the decisions of the Guatemalan courts. The tribunal nevertheless emphasized the distinctive nature of its task: to assess CNEE's conduct under CAFTA-DR.

Guatemala also pointed out that Iberdrola's ICSID claim against Guatemala—based on similar facts—was declined on jurisdiction,³ and argued that the Iberdrola decision should be given deference. However, the tribunal emphasized that it "cannot and will not" rely on the findings of the Iberdrola tribunal for deciding its jurisdiction because the present dispute involved different parties, treaties as well as differently presented legal arguments and evidence.

CAFTA's minimum standard of treatment is given content

The merits phase of the arbitration centered on CAFTA-DR's minimum standard of treatment (MST), which equates fair and equitable treatment with MST under customary international law.

Guatemala argued that only "extreme and outrageous" state conduct could contravene the MST. However, the tribunal, nodded instead to the claimant's interpretation of MST, which drew from *Waste Management v. Mexico (II)*.⁴ Accordingly, the tribunal ruled that the MST in the CAFTA-DR is "infringed by conduct attributed to the State and harmful to the investor if the conduct is arbitrary, grossly unfair or idiosyncratic, is discriminatory or involves a lack of due process leading to an outcome which offends judicial propriety." It explained that this interpretation had been confirmed by other arbitral tribunals, including *Waste Management v. Mexico (II)* and *Glamis Gold v. US*,⁵ as well as "authorities" (three literatures in international law).⁶ In addition, the tribunal considered that the principle of good faith was also a part of MST.

The claimant argued that fair and equitable treatment under the MST was breached if its legitimate expectations were frustrated by state actions. Guatemala contended that legitimate expectations did not apply in the MST context. The tribunal did not deem investors' legitimate expectations to be an independent component of MST, but rather implied by non-arbitrary state conduct. What mattered was whether the challenged conduct was arbitrary, opined the tribunal. As such, the tribunal considered there was no need to deal with the claimant's argument on legitimate expectations.

CNEE's disregard of the expert commission's report and imposed tariffs found arbitrary and contrary to due process

Turning to the facts of the dispute, the tribunal found that CNEE had acted arbitrarily and contrary to the fundamental principles of due process in administrative proceedings when it unilaterally fixed the electricity tariff based on a study of its own consultant without providing reasons for disregarding the expert commission's report.

In assessing the CNEE's administrative conduct under the CAFTA-DR, the tribunal nevertheless turned to examining whether the conduct was consistent with Guatemalan law. The tribunal found that CNEE had violated Guatemala's regulatory framework for setting and reviewing tariffs. Specifically, the tribunal determined that Guatemalan law required disagreements between the regulator and distributor should be resolved with regard to the advisory view of an independent expert commission. Such an interpretation of Guatemalan law, noted the tribunal, was also held by the Guatemalan Constitution Court in the previous domestic proceedings.

Next, the tribunal explained how the breaches of domestic law related to international treaty obligations, stating that "both the regulatory and the minimum standard of treatment in international law obliged the CNEE to act in a manner that was consistent with the fundamental principles on the tariff review process in Guatemalan law." The tribunal then ruled the CNEE's conduct was arbitrary and breached the due process in administrative matters, which repudiated the fundamental principles in the domestic law and, as a result, constituted a breach of MST in CAFTA-DR.

The tribunal was composed of Mr. Alexis Mourre (president), Prof. William W. Park (claimant's nominee), and Dr. Claus von Wobeser (respondent's nominee).

The decision is available here: <http://www.italaw.com/sites/default/files/case-documents/italaw3035.pdf>

Bolivia found in breach of UK-Bolivia BIT for nationalizing an electricity generator without compensation

Guaracachi America, Inc. (U.S.A.) and 2. Rurelec plc (United Kingdom) v. Plurinational State of Bolivia, UNCITRAL, PCA Case No. 2011-17, Award
Oleksandra Brovko

In a January 31, 2014 ruling a tribunal has found Bolivia in breach of the UK-Bolivia BIT and liable for some US\$35.5 million in damages in a case involving the nationalization of an electricity generator. The case also included a claim by a US claimant under the US-Bolivia BIT; however, that claim was dismissed for lack of jurisdiction, after the tribunal found that the claimant could be denied benefits under the treaty.

Background

In the early 1990s Bolivia introduced a number of reforms to its energy sector, including changes to its legal framework which resulted in the privatization of small state-owned enterprises through international public tenders.

In this context, a US company, Guaracachi America, Inc. (GAI), and a British company, Rurelec Plc., invested in the Bolivian state-owned company Empresa Electrica Guaracachi S.A. (EGSA). The new legal framework stipulated the reorganization of vertically integrated companies into generation, transmission and distribution companies, and EGSA was one of the three new generation companies.

In 2007, however, Bolivia abruptly changed course and moved to nationalize the entire electricity sector. As a result, the claimants' 50.0001 per cent shareholding in EGSA was nationalized.

"Joinder" v. "consolidation" of claims

Bolivia objected to the consolidation of GAI and Rurelec's claims given that they fell under different BITs. Bolivia argued that neither the dispute resolution clauses of the US-Bolivia BIT nor the UK-Bolivia BIT contain Bolivia's consent to settle disputes jointly on the basis of a treaty other than the one applicable to such foreign investors. Thus, the tribunal lacks "*rationae voluntatis*" on the grounds that no two claims can be joined or consolidated without the express consent of the State.

However, the claimants drew a distinction between "consolidation" and "joinder" of claims. Specifically, the claimants argued that the consolidation of claims is a procedural device that provides for combining two or more proceedings with the result that the other tribunal ceases to exist. From the claimants' standpoint, in the present proceedings claims were not "consolidated" given that the two claimants decided to jointly submit several claims in the context of single proceeding. In addition, the claimants argued that in multi-party arbitrations claims are often submitted jointly under different legal instruments. It is therefore a procedural rather than jurisdictional question, argued the claimants.

Siding with the claimants, the tribunal decided that the submission of identical claims under different BITs in a single arbitration does not require the express consent of Bolivia; the key point is that Bolivia has provided its consent to arbitration in the case of disputes involving investors from both the US and the UK.

Protection of Rurelec's indirect investment

Rurelec made its investment via intermediaries incorporated under the laws of the British Virgin Islands. Bolivia argued that firstly, such indirect investments are not protected by the UK-Bolivia BIT and, secondly, Rurelec must prove that it acquired an indirect ownership interest in EGSA prior to the dispute.

The tribunal decided that Rurelec had made an indirect acquisition of EGSA before the date of nationalization. Moreover, indirect investments are also protected under the UK-Bolivia BIT given its broad definition of investment. As such, the tribunal concluded that the fact that Rurelec does not directly own shares of EGSA does not mean that it does not own such shares within the meaning of the BIT.

Lack of jurisdiction due to the exercise of the denial of benefit clause

Article XII of the US-Bolivia BIT provides for the denial of the treaty's benefits to a company in case two conditions are met: 1) companies owned by nationals of a third state (GAI's shareholder has always been domiciled in the British Virgin Islands); and 2) companies that do not carry out any substantial business activities in the territory on the US. Referring to this article, Bolivia asserted that GAI is no more than a "mailbox company" and as such does not benefit from the BITs protections.

The claimants' countered that a denial of benefits in this case would run contrary to the principles of stability, certainty and good faith. Furthermore, the claimants argued that the denial of benefits clause cannot be applied retroactively, *i.e.*, once the investment has been made, since the purpose of such provision is to give the host State the opportunity to alert investors in advance that they are no longer granted protection under the BIT, thereby protecting their legitimate expectations.

With regard to the second requirement of Article XII, GAI emphasized that it had conducted substantial commercial

activities in the US, having maintained offices and held meetings in the country.

However, the tribunal ultimately decided that it lacked jurisdiction to consider GAI's claim in light of conditions set out under Article XII. The tribunal was not persuaded that Bolivia in the course of the privatization imposed any requirement to establish GAI as a single purpose vehicle for public tender of EGSA. Moreover, GAI was not precluded to own any other assets other than EGSA shares. Finally, insufficient evidence was provided that GAI carried out substantial business activities in the US.

The tribunal noted that Bolivia denied the benefits of the BIT after both parties had given their consent to arbitration; however, in tribunal's point of view, the denial of benefits cannot be equated to the withdrawal of prior consent to arbitration.

With regard to the timing of the denial of benefits, the tribunal agreed that the denial would usually be notified whenever an investor decides to invoke one of the benefits under BIT, commenting that it would be odd for a State to scrutinize whether the requirements of the above Article XII are met in relation to an investor with whom it has no dispute.

Finally, the tribunal understood that such a ruling put an investor in a fragile position, since the investor would never know at which point the benefits would be denied. However, in the tribunals' view, such denial would not come as a total surprise given that the investor was cognizant of Article XII and anyway used an investment vehicle controlled by the third state with no substantial business activities.

Failure to pay just and effective compensation

The claimants also argued that Bolivia violated Article 5(1) of the UK-Bolivia BIT, which stipulates the conditions for lawful expropriation. These requirements are promptness, adequacy and/or fairness of compensation and due process.

The claimants asserted that the valuation process of EGSA was neither transparent nor participatory. The claimants' financial statements, approved by the Board of Directors following the positive assessment of PWC, showed EGSA's profits amounted to US\$5.8 million in 2010. However, Bolivia retained an independent consulting firm to perform the statutory audit. This audit determined that EGSA had a \$2.3 million loss—and it was on the basis of this audit that Bolivia maintained it had no obligation to provide compensation. In the claimants' view, the audit arranged by the Bolivian government had the sole purpose of reducing EGSA' apparent value.

However, the tribunal was not convinced that Bolivia acted willfully and intentionally to obtain an expert valuation with negative values for EGSA. Moreover, the tribunal concluded that there is no rule of customary international law obliging an expropriating state to grant the expropriated investor a right to take part in the valuation process. However, the expropriation was still found unlawful since no compensation was paid. Therefore, the main question before the tribunal was the quantum of the compensation.

Following the discussion of different valuation methods, the tribunal also considered the issue of interest rates. The claimants relied on Article 5 of the UK-Bolivia BIT, which establishes the standard of compensation for lawful expropriation, and required to apply the principle of "full reparation" (i.e., the interest at a normal commercial or legal rate). However, the tribunal rejected to apply the EGSA' weighted average cost of capital (WACC) as of May 2010 as the applicable rate given that post-May 2010 period was marked with negative changes to fundamentals that make up

the WACC. Instead, the tribunal used the annual interest rate reported on the Bolivian Central Bank website for commercial loans in May 2010.

As the result, the amount of compensation constitutes USD 28,927,582 increased by annual composed interest rate of 5.6% on that amount since May 2010 until the date of payment in full. Each party bears its own legal costs.

Dissenting opinion of co-arbitrator Manuel Conthe

In the view of arbitrator Conthe, Bolivia failed to comply with due process requirement. In his view, expropriation is an administrative act that limits the rights of an investor. Therefore, it must meet three minimum procedural requirements: it must be reasoned; these reasons must be formally communicated to the investor; and the investor, having being notified of such reasons, has a right to be heard.

In Conthe's opinion, Bolivia breached the UK-Bolivia BIT not because it underestimated the value of EGSA, but because it failed to comply with the minimum requirements of due process. Given valuation report was never communicated to Rurelec, it was deprived of its right to make comments on it. Moreover, in arbitrator's Conthe view, due to the violation of due process requirements, the tribunal should have ordered Bolivia to pay legal costs, at least partially.

The tribunal was composed of Dr José Miguel Júdece (president), Mr. Manuel Conthe (claimants' appointee) and Dr. Raúl Emilio Vinuesa (respondent's appointee).

The award is available at: <http://www.italaw.com/sites/default/files/case-documents/italaw3051.pdf>

Dissenting opinion of Manuel Conthe is available at: <http://www.italaw.com/sites/default/files/case-documents/italaw3059.pdf>

Notes

¹ *Saluka Investments B.V. v. The Czech Republic*, UNCITRAL, Partial Award, para. 305.

² *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award, para. 340.

³ *Iberdrola Energia S.A. v. Republic of Guatemala*, ICSID Case No. ARB/09/5, Award, August 17, 2012. The tribunal concluded that the claimant did not demonstrate the international nature of the dispute as opposed to a dispute of Guatemalan national law. Since the claimant failed to show that its allegations, if found to be true, would constitute treaty breaches, the tribunal decided not to assume jurisdiction under ICSID and the Spain-Guatemala BIT. It also rejected a denial of justice claim, determining, amongst others, that a decision of the Constitutional Court raised none of the issues alleged by the claimant.

⁴ *Waste Management Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award, April 30, 2004

⁵ *Glamis Gold v. United States of America*, UNCITRAL, Award, June 8, 2009

⁶ Grierson-Weiler and Laird "Standards of Treatment", Chapter 8, *The Oxford Handbook of International Investment Law*, Oxford University Press, 2008, pp. 270-271; MacLachlan, Shore, and Weininger "Treatment of Investors", Chapter 7, *International Investment Arbitration*, Oxford University Press, 2007, pp 226 et seq.

resources and events

Resources

Recent Development's in Investor-State Dispute Settlement

United Nations Conference on Trade and Development, April 2014

UNCTAD's annual review of investor-State dispute settlement cases, part of the IIA Issues Notes series, provides up-to-date statistical data on treaty-based ISDS cases as well as an overview of arbitral decisions issued in 2013. According to the note, 57 new cases were initiated in 2013, just below the record number of new claims recorded in 2012. The total number of known treaty-based cases reached 568. The overwhelming majority of these cases (85 per cent) have been brought by investors from developed countries. Together, claimants from the EU and the United States account for 75 per cent of all disputes. In 2013, investors challenged a broad range of government measures, including changes related to investment incentive schemes (such as 13 cases against Czech Republic and Spain regarding the changes in the renewable-energy policies); alleged breaches of contracts; alleged direct or de facto expropriation; revocation of licenses or permits; regulation of energy tariffs; allegedly wrongful criminal prosecution; land zoning decisions; invalidation of patents; and legislation relating to sovereign bonds. ISDS tribunals issued 37 known decisions last year, 23 of which are in the public domain. Of these, approximately 43 per cent were decided in favour of the State and 31 per cent in favour of the investor. Approximately 26 per cent of cases were settled. Finally, the growing number of ISDS cases and the broad range of policy issues they raise have turned ISDS into a "hot topic". The public discourse about the usefulness and legitimacy of ISDS continues to gain momentum, especially in the context of important IIA negotiations that are currently taking place. The note is available here: <http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=718>

Reform of Investor-State Dispute Settlement: In Search of a Roadmap

Transnational Dispute Management, 2014

This TDM Special Issue features over 65 papers that explore reforms to investor-state dispute settlement. Divided into eight sections, chapter one sets the stage for reforms; chapter two focuses on methodological approaches to reform of the ISDS system; chapter three examines regional experiences with ISDS; chapter four discusses strengthening the role of states, both in interpreting existing treaty language and through revising specific treaty text or negotiating new treaties; chapter five focuses on reform of ICSID as the cornerstone of the current ISDS system; chapter six discusses the development of an appeals mechanism, whether treaty-based or through a multilateral facility such as an appeal facility proposed by ICSID; chapter seven addresses momentum in the push for expanded investor-State mediation; and chapter eight discusses the role that arbitral tribunals can play to contribute to a reform of the system from within. The series is available here: <http://www.transnational-dispute-management.com/journal-browse-issues-toc.aspx?key=52>

Understanding Agricultural Investment Chains: Lessons to Improve Governance

Lorenzo Cotula and Emma Blackmore, International Institute for Environment and Development, March 2014

Drawing on 10 case studies of recent large-scale land deals, this report aims to improve understanding of the investment chains that underpin the deals, and to identify pressure points for effective public action to ensure that investments respond to local and national development agendas and promote inclusive sustainable development. The report argues

that properly implementing the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security is an important step in that direction.

A Response to the European Commission's December 2013 Document "Investment Provisions in the EU-Canada Free Trade Agreement (CETA)"

Nathalie Bernasconi-Osterwalder, Howard Mann, International Institute for Sustainable Development, March 2014

On December 3, 2013, the European Commission issued a document concerning the investment provisions in the EU-Canada free trade agreement (CETA) explaining how the CETA protects the right to regulate. In this paper IISD examines the assertions made by the European Commission against the actual text of the draft CETA Investment Chapter dated November 21, 2013 on the substantive provisions and the draft investor-state dispute settlement provisions as of February 4, 2014. In the end, the authors conclude that the actual draft legal texts in the public domain fail to meet a number of the European Commission's stated objectives.

Events 2014

May 8

INVESTMENT TREATY FORUM: 22ND PUBLIC CONFERENCE - INVESTOR-STATE ARBITRATION AND BEYOND, British Institute of International and Comparative Law, London, UK, <http://www.biiicl.org/events/view/-/id/779/>

May 10-11

STEPPING AWAY FROM THE STATE: UNIVERSALITY AND COSMOPOLITANISM IN INTERNATIONAL AND COMPARATIVE LAW, Cambridge Journal of International and Comparative Law, Cambridge, UK, <http://cjlcl.org.uk/conference-registration/>

May 22

INTERNATIONAL ARBITRATION SYMPOSIUM, Center for International Legal Studies, Salzburg, Austria, http://www.cils.org/home/conference.php?ConferenceID=269&s_ConferenceLocale=&

June 9 - 20

EXTRACTIVE INDUSTRIES AND SUSTAINABLE DEVELOPMENT EXECUTIVE TRAINING, Vale Columbia Center on Sustainable International Investment, New York, United States, <http://www.vcc.columbia.edu/content/extractive-industries-and-sustainable-development-executive-training>

June 16 - 20

FIFTIETH ANNIVERSARY OF UNCTAD, UNCTAD, Geneva, Switzerland, <http://unctad.org/en/Pages/MeetingDetails.aspx?meetingid=437>

October 13-16

WORLD INVESTMENT FORUM 2014: INVESTING IN SUSTAINABLE DEVELOPMENT, UNCTAD, Geneva, Switzerland



Investment Treaty News Quarterly is published by the International Institute for Sustainable Development. The views expressed in this publication do not necessarily reflect those of the IISD or its funders, nor should they be attributed to them.

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