International Investment Law and the Extractive Industries Sector

Lise Johnson
Jesse Coleman

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International Investment Law and the Extractive Industries Sector

Since the 1990s, international investment law has been rapidly evolving, resulting in a complex web of over 3,000 investment treaties. These treaties have been used to challenge a wide range of host state actions and inactions that have allegedly negatively affected foreign investors or investments. Those challenges, in turn, expose host states to potentially significant financial costs, and can restrict the ability of such states to maximize the benefits, and limit the environmental and social harms, that can result from the exploitation of natural resources. This briefing note provides an introduction to international investment law, with a view to assisting stakeholders in grasping the diverse and significant implications of this body of law for the governance of investments in the extractive industries sector.

What is international investment law and why does it matter for the extractive industries?

International investment law plays a central role in governing investments in the extractive industries sector. Formed through a complex web of over 3,000 investment treaties concluded by countries around the world, it is typically regarded as one of the fastest-developing areas of public international law.

Investment treaties are international agreements concluded between states that impose obligations and restrictions on countries regarding their treatment of foreign investors.
and foreign-owned investments. These treaties are designed to limit the freedom of “host states” to act (or not act) in certain ways that harm the rights or interests of foreign investors who seek to invest, or who have invested, in the country’s territory. Consequently, when a state has signed an investment treaty, that state’s ability to adopt, revise, repeal, and enforce laws and policies that affect foreign investors or investments is made subject to the state’s obligations under that treaty. The treaty’s obligations generally apply to all branches of government (e.g., legislative, executive, and judicial) at all levels of the state (e.g., local, municipal, state/provincial, and federal).

The impacts that investment treaties can have on domestic governance of foreign investments are varied and significant. Investment treaties have been used to challenge a wide range of actions and inactions that have allegedly negatively affected foreign investors or investments, including changes in tax regimes; changes in environmental, healthcare, and other public interest laws or enforcement of those laws; decisions to modify or remove incentives or subsidies; and decisions to revoke, not renew, or not grant permits for activities requiring government authorization.

One area in which the impact of investment treaties is especially pronounced is in the domestic governance of extractive industries. Good governance of this sector requires a significant degree of state involvement in order to maximize the benefits, and to limit the environmental and social harms, that can result from the exploitation of natural resources. To maximize the benefits and minimize the costs of extractive industry investments, a robust framework of economic, environmental, and social laws and policies must be established, and must also be able to evolve over time in order to respond to changing circumstances, technologies, and best practices.

As is described further below, several efforts by states to develop and refine their domestic legal frameworks governing extractive industry investments -- whether through legislative instruments, court decisions, contract provisions, or administrative actions -- have been challenged under investment treaties. Those challenges, in turn, expose host states to potentially significant costs in terms of litigation expenses and/or liabilities.¹ For investments in the extractive industries in particular, the sums at stake can be staggering, diverting resources away from other domestic priorities.² It is therefore crucial for host states that have signed or are negotiating investment treaties to understand the implications of those agreements, and to shape their treaty policies (or the policy decision not to conclude investment treaties) in a manner that leaves them the flexibility to ensure that they can effectively regulate extractive industry (and other) investments.

**How big is this issue?**

Due in particular to a frenzy of treaty-signing activity during the 1990s, the number of investment treaties jumped from under 400 in 1990 to over 3,300 in 2015.³ These figures include bilateral investment treaties (BITs), multilateral agreements (such as the Energy Charter Treaty), and certain free trade agreements (FTAs), which increasingly include specific chapters on investment.

![Figure 1: Cumulative number of investment treaties, 1980-2015](image)

In recent years, the pace of investment treaty-negotiations has slowed, but still continues to grow by approximately one agreement signed every two weeks.⁴

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¹ See “How are investment treaties enforced?” at p. 6 below.
² See Table 2 “Examples of Awards and Expenses for Litigation and Arbitration in Extractive Industry ISDS Cases” at p. 11, and Annex: Examples of ISDS Cases Concerning the Extractive Industries Sector at p. 14 below.
³ These figures reflect agreements that were signed and/or in force by the close of 1990 and 2015 respectively, per the United Nations Conference on Trade and Development (UNCTAD) International Investment Agreements Navigator, accessible at [http://investmentpolicyhub.unctad.org/IIA](http://investmentpolicyhub.unctad.org/IIA).
Moreover, there has been a rise in the negotiation of “mega-treaties” such as the Trans-Pacific Partnership (TPP) and Trans-Atlantic Trade and Investment Partnership (TTIP), which involve a number of countries; in total, 88 countries participated in the negotiation of seven “mega-treaties” in 2014.\(^5\) Thus, while treaty signing may have slowed, the influence of international investment law continues to grow.

How does international investment law relate to the regulation of extractive industries?

Foreign investors have relied on investment treaties to challenge a range of government conduct with regard to the establishment, approval, operation, and termination of investments in extractive industries. As of September 2015, 667 known treaty-based investor-state dispute settlement (ISDS) cases had been lodged; at least 16% of these cases concerned investments in extractive industries, making this sector the second most disputed in international investment arbitration (see Figure 2).\(^6\)

Of the 229 known treaty-based cases that were pending as of September 2015, 45 related to the extractive industries (or just shy of 20%). These cases include 27 related to mining and quarrying, and 18 related to the extraction of crude petroleum and gas.

A significant majority of extractives cases are filed against developing countries, where nascent regulatory frameworks can be subject to change as governments seek to find the correct balance between attracting investment and encouraging sustainable development. Ninety percent of extractives cases were brought against a country with a GNI of less than $12,736 (and 84% of the pending extractives cases as of September 2015).\(^7\)

Among the cases concerning investments in the extractive industries sector, the following types of government acts and omissions have been challenged by investors:\(^8\)

- New and stronger environmental regulations (e.g. Glamis Gold, Ltd. v. United States; Lone Pine Resources Inc. v. Canada);
- Termination of contracts with investors (e.g. Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Ecuador 2012);
- Revocation/ termination of permits authorizing investors’ operations (e.g. The Renco Group, Inc. v. Peru; Gold Reserve Inc. v. Venezuela);
- Decisions not to grant permits (e.g. Pac Rim Cayman LLC v. El Salvador, Clayton and Bilcon of Delaware Inc. v. Canada);
- Changes to fiscal regimes (including changes in interpretations of and enforcement strategies for existing laws and regulations) (e.g. Occidental Exploration and Production Company v. Ecuador 2004; Perenco Ecuador Limited v. Ecuador);
- Requirements to purchase local goods and services/invest in research and development (e.g., Mobil Investments Canada, Inc. v. Canada);

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\(^6\) This analysis is based on the information available through UNCTAD’s Investment Dispute Settlement Navigator, accessible at http://investmentpolicyhub.unctad.org/ISDS (updated as of September 1, 2015).

\(^7\) This analysis is based on the information available through UNCTAD’s Investment Dispute Settlement Navigator, accessible at http://investmentpolicyhub.unctad.org/ISDS (updated as of September 1, 2015). 10% were brought against low-income countries, i.e. those with a gross national income (GNI) per capita of $1,045 or less in 2014; 32% were brought against lower-middle income countries, i.e. those with a GNI per capita between $1,045 and $4,125 in 2014; and 48% were brought against upper-middle income countries, i.e. those with a GNI per capita between $4,125 and $12,736 in 2014. GNI brackets and country classifications are based on World Bank lending categories for the 2016 fiscal year. For further information, see here: http://data.worldbank.org/about/country-and-lending-groups.

\(^8\) Further information on these and other relevant cases can be found in the Annex, at p. 14 below.
Moratoria on issuing permits (e.g., *Lone Pine v. Canada*; *Pac Rim Cayman LLC v. El Salvador*);
Conduct during negotiation or renegotiation of contracts (e.g., *PSEG v. Turkey*).

**What kinds of protections does international investment law provide?**

Investment treaties impose obligations on the host state regarding its treatment of foreign investors and foreign-owned investments. While the specific protections and obligations created by investment treaties will depend on the text of the relevant treaty, a number of core provisions can commonly be found in investment treaties signed by resource-rich countries. The descriptions below of those core provisions provide general contours regarding the meaning of key treaty obligations. However, there is considerable uncertainty regarding the precise content of these treaty standards; tribunals have adopted different interpretations of the core provisions, and as there is no system of precedent in ISDS, tribunals are not required to aim for consistency in interpreting and applying these standards.

**Non-Discrimination**

The obligation not to discriminate among or between investors is found in almost all investment treaties. It usually consists of two relative standards, which require that the host state treat foreign investors no less favorably than: (1) domestic investors (also referred to as the "national treatment" obligation); and (2) other foreign investors (also referred to as the "most-favored nation", or MFN, treatment obligation).

The national treatment obligation can be used to challenge various measures that intentionally discriminate against foreign investors in favor of domestic individuals and entities, which may include restrictions on foreign ownership of land in all or some areas of the country; restrictions on total or partial foreign ownership of firms engaged in certain sectors or activities; tax rules that differentiate between firms based on the location of their beneficial owners or headquarters; and incentives, subsidies or other privileges that are limited to locally-owned firms (e.g., preferences accorded to firms owned by indigenous peoples, and local procurement schemes). More controversially, the national treatment obligation has also been used to challenge situations of unintentional discrimination, such as when a law - or enforcement of that law - has a negative impact on a foreign investor, but was not designed nor applied to target the investor based on its nationality.

In addition to prohibiting intentional and even unintentional discrimination against covered foreign investors, the MFN obligation has been interpreted to allow covered foreign investors from one country to "import" more favorable provisions from an investment treaty signed between the host state and another country. This can open up an array of options to investors, allowing them to "cherry-pick" preferred provisions from the multitude of agreements that a host state has signed.\(^9\)

**Expropriation**

Expropriation generally falls into two categories: direct and indirect. Direct expropriation involves “the physical taking or nationalization of an enterprise, which usually involves a transfer of ownership to the state.”\(^10\) Indirect expropriation is generally understood as an action or measure taken by the state that has the effect of depriving the investor of the benefit of its investment, while not resulting in the transfer of ownership. Investment treaties typically recognize that governments may lawfully expropriate property, but require that any expropriation must be promptly, adequately, and effectively compensated.

It is usually easy to identify whether there has been a direct expropriation. In such cases, the more difficult question often relates to the appropriate measure of compensation. In contrast, indirect expropriation can be much more difficult to identify, given the fine line that separates an indirect expropriation from the legitimate exercise of a state’s bona fide regulatory power that may result in effects similar to those resulting from expropriation (e.g. elimination of all, or

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10 Ibid, at p. 15.
substantially all, of the value of an investment. Investment tribunals have adopted a variety of different tests to decide whether a measure or series of measures amounts to an expropriation, making it difficult for states to determine how proposed actions will be judged by a tribunal. Notably, even if a state’s domestic legal system governs and requires compensation for indirect expropriations, and a domestic court has determined that a challenged measure does not constitute an indirect expropriation, an ISDS tribunal may still find that the same measure constituted an indirect expropriation under international investment law.

**Fair and Equitable Treatment**

Virtually all modern investment treaties contain a provision requiring the host state to accord “fair and equitable treatment” (FET) to investments. Tribunals have struggled to interpret and apply this vague standard, as most treaties typically give no clear guidance regarding its meaning. Some tribunals have adopted a relatively narrow approach, concluding that states will only be liable if their conduct is egregious and shocking. Others have interpreted the provision much more broadly, establishing a high standard that requires host states not to act in a manner that affects the “basic” or “legitimate expectations” that were taken into account by the foreign investor when making the investment.

Investors have relied extensively on this broad interpretation of FET in challenging the conduct of host states. Indeed, this provision has become a “catch-all” clause, allowing investors to succeed where their other claims (for example in relation to expropriation) fail.

**Umbrella Clause**

Some investment treaties contain a provision, typically referred to as an “umbrella clause”, which can require the host state to comply with certain obligations or commitments owed to (or entered into with) investors or investments. The precise meaning and effect of these provisions, so-named because of their ability to bring various obligations within the “umbrella” of the investment treaty, is the subject of considerable debate. Any clear interpretation of the umbrella clause remains elusive because the specific wording of these clauses often varies from agreement to agreement, and even clauses with identical wording have been given different interpretations by arbitral tribunals. According to some tribunals, investors can use umbrella clauses to enforce any obligation owed by the state, which can include obligations owed under other areas of international law, general domestic law, or under specific investor-state contracts. Other tribunals have interpreted the provision more narrowly, concluding that umbrella clauses only allow an investor to enforce obligations owed specifically to it under an investor-state contract.

**Restrictions on Performance Requirements**

A performance requirement “is a condition that investors must meet in order to establish or operate a business, or to obtain some advantage offered by the host state.” Examples include mandatory or incentive-based requirements that investors: (1) use or accord a preference to local providers of goods or services; (2) make expenditures in the host country on research and development or education and training; or (3) hire a certain number or percentage of local employees. Such requirements can and are often used by host states to establish and strengthen the linkages between foreign investors and the domestic economy that can help encourage technology transfer, increase domestic employment, and promote economic diversification. While World Trade Organization (WTO) law imposes some restrictions on its member states’ use of performance requirements, those restrictions primarily focus on preventing member states’ use of performance requirements in newly drafted treaties: of the treaties concluded in 2014, all omitted such a clause. See UNCTAD, “Recent Trends in IIAs and ISDS” (IIA Issues Note No. 1, February 2015), at p. 3. See e.g. Glamis Gold v. United States, UNCITRAL, Award, June 8, 2009. See e.g. Tecmed v. Mexico, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, para.154 (government conduct must be “free from ambiguity and totally transparent” so that the investor may know all the relevant rules and regulations, and their respective goals, before investing); and Occidental v. Ecuador, Award, July 1, 2004, paras. 185-186, 190-191 (the FET obligation enables review of the correctness of domestic court and/or administrative determinations, and requires “stability and predictability” and “certainly entails an obligation not to alter the legal and business environment in which the investment has been made”).

11 Bernasconi-Osterwalder, Cosbey, Johnson, Vis-Dunbar (n 9), at p. 12.

12 Dunbar (n 9), at p. 27.

13 Bernasconi-Osterwalder, Cosbey, Johnson, Vis-Dunbar (n 9), at p. 12.

14 It seems that states have become increasingly reluctant to include such provisions in newly drafted treaties: of the treaties concluded in 2014, all omitted such a clause. See UNCTAD, “Recent Trends in IIAs and ISDS” (IIA Issues Note No. 1, February 2015), at p. 3.

15 Bernasconi-Osterwalder, Cosbey, Johnson, Vis-Dunbar (n 9), at p. 27.
requirements, those restrictions primarily focus on preventing member states from favoring domestic over foreign-produced goods, and leave member states a considerable amount of policy space to adopt other performance requirements. A growing number of investment treaties, however, impose greater restrictions on states’ use of those policy tools, and allow investors to enforce those restrictions through ISDS. These investment treaty provisions limit the number of options available to states to try to ensure that foreign investment produces development benefits in the host state.

How are investment treaties enforced?
The obligations established by investment treaties can be enforced by investors through investor-state dispute settlement (ISDS) provisions, which are included in the text of most treaties. ISDS allows a vast range of investors to bring claims directly against host states, seeking damages for alleged injuries, typically without either the permission or knowledge of the investor’s own state (the “home state”). This differs from other areas of international law, such as under the WTO’s agreements, in which only states are given the ability to challenge other states for violating their treaty commitments.

ISDS also differs in several important ways from the dispute settlement mechanisms typically found in domestic court systems (see Table 1).

**Table 1: Differences between Proceedings in Domestic Court Systems and in ISDS**

<table>
<thead>
<tr>
<th></th>
<th>Domestic Court System</th>
<th>ISDS</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Who can bring a claim?</strong></td>
<td>Domestic law and/or any relevant contract determine who can bring claims; they can allow, e.g.: - claims by states against investors; - claims by investors against states; and - claims by citizens/communities against investors (and against states regarding a state’s regulation, or failure to regulate, investors).</td>
<td>Only investors, or other shareholders, covered by an investment treaty can bring claims against states. States cannot initiate ISDS claims against investors.</td>
</tr>
<tr>
<td><strong>Who decides the claim?</strong></td>
<td>Judges</td>
<td>Private arbitrators, typically appointed by the parties to the dispute</td>
</tr>
<tr>
<td><strong>Where are cases decided?</strong></td>
<td>In administrative tribunals or courts, located in the host country</td>
<td>In proceedings often conducted outside of the host country. Common sites of arbitration are The Hague, London, Paris, Stockholm, and Washington, D.C.</td>
</tr>
<tr>
<td><strong>Are disputes open to the public? Do they allow public participation?</strong></td>
<td>Court proceedings in domestic legal systems are often open to the public, permitting the public to attend proceedings, access court decisions, and access filings made by parties (though there are also often mechanisms to protect against public disclosure of confidential information). In some systems, interested and/or affected individuals or entities have the possibility to: - make amicus curiae submissions; and/or - join disputes as a party.</td>
<td>Under the vast majority of treaties, ISDS proceedings can be closed to the public. Some tribunals have allowed interested or affected individuals or entities to participate as amicus curiae. Non-parties to the dispute, including individuals or entities that will be affected by its outcome, do not have the right to participate as amicus curiae, or the ability to join the proceedings.</td>
</tr>
<tr>
<td><strong>What substantive law is applied?</strong></td>
<td>Domestic law (which may also incorporate international law).</td>
<td>The law of the treaty, which is the treaty itself and any other applicable law specified in the treaty.</td>
</tr>
</tbody>
</table>
| What procedural law is applied? | Domestic procedural law will apply to address potentially outcome-determinative issues such as:  
- who has standing to bring claims;  
- whether claims are ripe;  
- whether claims are timely or have been filed too late; and  
- whether evidence is admissible. | ISDS proceedings are governed by rules specified in the relevant investment treaty and any applicable rules of arbitration.  
Domestic rules of procedure do not govern ISDS proceedings. |
|---|---|---|
| What are the remedies? | Remedies are generally specified in domestic law or contract, and can include  
- injunctive relief (e.g., telling the government to take or not take a certain action)  
- declaratory relief (e.g., declaring that a particular government action violates domestic law);  
- specific performance (e.g., ordering an investor to comply with the terms of the contract);  
- restitution (e.g., ordering that property be returned to the investor);  
- compensation (e.g., ordering the government to pay the investor for losses caused by the government’s conduct); and  
- punitive damages (e.g., ordering the investor to pay the government an amount that reflects a penalty for wrongful conduct). | Remedies are usually limited to compensation. Some treaties specifically preclude any other remedies. |
| Is there a possibility of appeal? | Domestic legal systems often provide some mechanisms for appeal. Errors of fact and/or law by a lower court or tribunal are common bases for appeal. | Decisions and/or awards are not subject to appeal. They can only be challenged on specific, narrow grounds. Awards generally cannot be challenged on the ground that the tribunal made an error of fact or law. |

**Who and what do investments treaties protect?**

Whether a particular treaty protects a specific investor or investment will depend on the wording of the treaty itself.

Often, covered investors are defined simply to include any person who is a national of the home state and any company that is incorporated in the home state (even if that company is a shell company owned by investors from a third state). This broad type of definition can result in host state government measures being challenged by a vast range of individuals and/or entities. A single measure affecting one investment can give rise to multiple claims by different direct and indirect investors in that investment, including by foreign holding companies or shareholders involved in locally incorporated projects. Even if the host state settles a legal dispute...
with the locally incorporated project company, foreign investors and shareholders in that company can still pursue separate legal claims through ISDS. Particularly for developing countries, having to defend multiple suits can constitute a significant drain on host state resources.

Broad definitions of covered investors can also allow for “treaty shopping”: in order to qualify as a covered investor, a company may route its investment through a shell company in order to benefit from the protections of a particular country’s treaty.

“Investments” covered by investment treaties also tend to be broadly defined, with many treaties stating that “any kind of asset” owned or controlled by a foreign investor can qualify as a protected investment. Such a definition can include a parent company’s foreign subsidiary in the host country, but can also include a much broader range of rights and interests including rights granted under a contract, permit, or license; shares in a foreign company; loans to a foreign company or to the host state itself; intellectual property rights; and even “goodwill.” Some states, commentators, and tribunals have taken the position that to qualify as a protected “investment,” an asset must have certain fundamental characteristics, including that it represents a long-term commitment of capital or resources, and makes a significant contribution to the host state’s development. Most tribunals, however, have rejected such arguments, declining to impose any restrictions on the definition of protected “investments” that are not clearly set forth in the treaty itself. 17

What are the practical implications of this regime for governments seeking to regulate investment in extractive industries?

The investor protections created by investment treaties, coupled with the manner in which they have been interpreted and applied by investment tribunals, can result in claims against, and liability for, host states seeking to improve their governance of extractive resources. Efforts by states to renegotiate investor-state contracts, amend their legal frameworks, cancel illegal deals, and adopt performance requirements designed to help leverage extractive industry investments for sustainable development can all give rise to risks of expensive arbitrations under investment treaties.

Renegotiation of investor-state contracts: Investment contracts for extractive industry projects often run for terms of 10-30 years or more; over that time horizon, there is a great deal of political, geological, and market uncertainty, and a high likelihood of changed circumstances. Consequently, these contracts are often renegotiated at the request of the investor, state, or both. Investment treaties may impose burdensome obligations on or limit host-state conduct (but not investor conduct) with respect to renegotiations. 18 As a result, host states may find themselves effectively bound to the original terms of outdated deals that do not align with their interests, while investors retain greater powers and flexibility to seek renegotiations or terminate contracts when the original contracts no longer serve their interests.

17 Bernasconi-Osterwalder, Cosbey, Johnson, Vis-Dunbar (n 9), at p. 10.

18 See, e.g., PSEG v. Turkey, ICSID Case No. ARB/02/5, Award, January 19, 2007; Saluka Investments BV v. Czech Republic, Partial Award, March 17, 2006; Teco Guatemala Holdings, LLC v. Republic of Guatemala, ICSID Case No. ARB/10/23, Award, December 19, 2013; Impreglio S.p.A. v. Argentina, ICSID Case No. ARB/07/17, Award, June 21, 2011; Vivendi v. Argentina (II), ICSID Case No. ARB/03/19, Award, April 9, 2015; Siemens AG v. Argentina, ICSID Case No. ARB/02/8, Award, February 6, 2007; AES v. Hungary (II), ICSID Case No. ARB/07/22, Award, September 23, 2010; RDC v. Guatemala, ICSID Case No. ARB/07/23, Second Decision on Objections to Jurisdiction, May 18, 2010; Biwater Gauff (Tanzania) Limited v. United Republic of Tanzania, ICSID Case No. ARB/05/22, Award, July 24, 2008.
Box 1: Asymmetric obligations in PSEG v. Turkey

The dispute concerned the development of a mining and power plant project, for which a preliminary contract had been initiated by the Ministry of Energy and Natural Resources following their approval of the investor’s feasibility study. While awaiting completion of the next step in the contract’s government approval process, the investor revised its mining plan and made several changes to its proposed project which would increase the government’s potential liability and reduce the government’s tax revenue, rendering the project less attractive for the government. Although the preliminary contract was approved (based on the original feasibility study), the government sought to renegotiate the contract due to some of the investor’s changed plans. Ultimately, the renegotiations failed. The ISDS tribunal concluded that, although the government had not behaved in “bad faith”, the government had acted “negligent[ly]”, and its “attitudes and policies” regarding the project had changed during its interactions with the investor. According to the tribunal, this was sufficient to constitute a breach of the FET obligation. The tribunal ordered the government to compensate the investor for costs expended from the submission of its feasibility study through continued negotiations to develop the project, i.e. pre-contract and pre-project expenses. Turkey was thus required to pay the investor US$ 9 million plus interest, and bear 65% of the US$ 21 million in arbitration costs.

Reduced flexibility to develop and implement the necessary legal framework: New laws or measures adopted by governments to govern extractive industry investments, including by increasing taxes or strengthening environmental protection, have been challenged under investment treaties on the ground that they indirectly expropriated the investor’s property or violated the FET provision. Court or administrative decisions interpreting and applying such laws in ways that negatively impact foreign investors (including administrative decisions to revoke, not grant, or not renew permits) have also been challenged under investment treaties.

Similarly, actions taken by governments to enforce laws against foreign investors have triggered investment treaty claims on the grounds that the measures were tantamount to expropriations, violated the FET obligation, or discriminated against the foreign investors. Under investment treaties, the fact that a measure was adopted in good faith and for a legitimate, public interest purpose generally does not operate as a defense to claims, nor does the fact that a measure is consistent with (or even required under) domestic law. Consequently, governments attempting to develop, refine, strengthen, and enforce their legal frameworks governing extractive industries may face exposure to claims and liability when those actions negatively affect the rights, or even the mere “expectations”, of foreign investors.

Illegal investments or contractual provisions: Where a host-state government enters into an investment contract in breach of the law, for example through an ultra vires act of the government (i.e. one that was beyond its power or authority), such a contract will often be deemed void ab initio (or void “from the beginning”), voidable, or unenforceable in domestic legal systems (irrespective of whether the government was knowingly or negligently at fault). Some ISDS tribunals have, however, determined that when a state or state-owned entity is involved in or aware of the illegality of a particular investor-state contract, the government is estopped or precluded from later arguing that the illegality rendered the contract null and void and unenforceable under the investment treaty. By binding governments to illegal or ultra vires contracts, tribunals can override domestic law norms and give legal force to rights that would not otherwise exist under the domestic legal framework.

20 See, e.g., Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18, Decision on Jurisdiction, July 6, 2007; RDC v. Guatemala. Note that some tribunals have determined that an investor cannot benefit from the protections of an investment treaty if there is evidence that the investor procured its investment through fraud or corruption. Tribunals have otherwise bound governments to contracts whose illegality arises from other grounds, including ultra vires conduct.
21 See, e.g., Burlington v. Ecuador; The Renco Group, Inc. v. Republic of Peru, ICSID Case No. UNCT/13/1.
22 See e.g. Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18, Decision on Jurisdiction, July 6, 2007; RDC v. Guatemala. Note that some tribunals have determined that an investor cannot benefit from the protections of an investment treaty if there is evidence that the investor procured its investment through fraud or corruption. Tribunals have otherwise bound governments to contracts whose illegality arises from other grounds, including ultra vires conduct.
Similarly, investment contracts may contain provisions (e.g., broad stabilization provisions or arbitration clauses), governed by the host state’s law, which a domestic court would deem void or unenforceable on the basis that the provisions are contrary to public policy, domestic law, or another ground. Investment tribunals, however, do not have the same mandate or authority to develop and/or apply domestic law and consequently may bind a host state government to contractual provisions that would be invalid and unenforceable under that state’s domestic law.

**Limits on tools to leverage investment for sustainable development:** The restrictions placed by many investment treaties on the use of performance requirements remove an essential means for host governments to try to ensure that the development resulting from investment is sustainable and socially inclusive, benefiting not only the investor but also the citizens of the host state. Investment tribunals have further strengthened restrictions on performance requirements by adopting broad interpretations of their scope (see Box 2).

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**Box 2: Broad interpretations of restrictions in Mobil v. Canada**

Following the discovery of oil fields off the coast of Newfoundland, Canada, the government put in place a legal regime designed to require investors engaging in development of the offshore resources to make expenditures for research and development (R&D) and education and training (E&T) in the local province. These and other requirements were enacted in the 1987 “Accord Act”. When Canada concluded the North American Free Trade Agreement (NAFTA), it listed the Accord Act as an exception to the treaty’s restrictions on performance requirements. The NAFTA also included within that exception any “subordinate measure adopted or maintained under the authority of and consistent with the [Accord Act]”. Pursuant to the Act, Canadian officials subsequently issued guidelines that sought to impose additional and stronger requirements with regard to company expenditures on R&D and E&T. Mobil objected, arguing that the new guidelines violated the NAFTA’s prohibitions on performance requirements, and were not covered by the NAFTA’s exceptions. The ISDS tribunal agreed, adopting a broad view of the restrictions on performance requirements contained in the NAFTA, and a correspondingly narrow view of the relevant exceptions thereto.

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“Internationalization” of host-state obligations: The ability of an “umbrella clause” to bring a domestic law or contractual issue under the umbrella of an investment treaty has a number of legal and practical consequences. It can, for instance:

- Remove disputes regarding breach of domestic law or investor-state contracts from domestic courts that would otherwise have the authority to interpret the relevant legal provisions and decide those cases: this, in turn, reduces the role of domestic courts in developing and shaping the law;

- Affect who is entitled to defend the case: in ISDS disputes, arbitration proceedings are often handled by a particular government entity at the federal level that may be different from the local, state, provincial or federal government entity whose conduct gave rise to the dispute; the different government entities may have different perspectives regarding which arguments to raise, and whether and on what terms to settle the dispute;

- Affect who can gain access to information about or participate in the dispute: ISDS typically takes place in proceedings outside of the host state and often in a foreign language; the proceedings often are not transparent, and provide only limited avenues for other stakeholders, such as affected citizens, to follow and make submissions in disputes;

- Alter the substantive rules that would be applied to decide the case and the remedies available for breach;

- Affect the availability of appeals: while domestic proceedings often allow court decisions to be appealed to one or more courts of higher authority, investor-state proceedings do not similarly permit such challenges.

**Financial liability:** The financial implications of ISDS can be significant. Host-state respondents stand to suffer financially whether they win or lose, owing to the substantial costs of arbitral proceedings (see Table 2).
<table>
<thead>
<tr>
<th>Case Name and Number</th>
<th>Amount respondent state ordered to pay to claimant</th>
<th>Amount expressed as a percentage of host state GDP&lt;sup&gt;23&lt;/sup&gt;</th>
<th>Amount in legal/expert fees and arbitration costs borne by the host state</th>
</tr>
</thead>
</table>
| Khan Resources v. Mongolia (PCA Case No. 2011-09) | Damages: USD 80 million, plus interest  
Litigation and arbitration fees and costs: USD 9 million | Damages: 0.67% GDP | Unknown |
Litigation and arbitration fees and costs: USD 9.8 million | Damages: 0.23% GDP | USD 17.8 million |
| Tidewater Investment SRL and Tidewater Caribe, C.A. v. Venezuela (ICSID Case No. ARB/10/5) | Damages: USD 46.4 million  
Litigation and arbitration fees and costs: USD 2.5 million | Damages: 0.012% GDP | USD 9.5 million |
| Gold Reserve Inc. v. Venezuela (ICSID Case No. ARB(AF)/09/1) | Damages: USD 713 million, plus interest  
Litigation and arbitration fees and costs: USD 5 million | Damages: 0.19% GDP | USD 13 million in legal/expert fees and costs  
¼ of the costs of the arbitration: Unknown |
| Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Ecuador (II) (ICSID Case No. ARB/06/11) | Damages: USD 1.1 billion, plus interest<sup>24</sup>  
Litigation and arbitration fees and costs: USD 5 million | Damages: 1.09% GDP | Arbitration proceedings: Unknown  
Annulment proceedings: USD 5.1 million |
| Yukos Cases ((1) Hulley Enterprises Ltd. v. Russian Federation (PCA Case No. AA 226); (2) Veteran Petroleum Limited v. Russia (PCA Case No. AA 228); and (3) Yukos Universal Limited (Isle of Man) v. Russia (PCA Case No. AA 227)) | Damages: USD 50 billion, plus interest  
Litigation and arbitration fees and costs: USD 71.5 million | Damages: 2.69% GDP | USD 27 million |
| Vannessa Ventures Ltd v. Venezuela (ICSID Case No. ARB(AF)/04/6) | None – state prevailed in dispute | N/A | Over USD 15 million |


<sup>24</sup> This amount was reduced in annulment proceedings from an original award of USD 1.8 billion, plus interest.
What can host-state governments do to address these challenges?
The means available to address the challenges described in this briefing note will depend on the specific circumstances of each state. With regard to new treaties, it is critically important that states thoroughly consider their reasons for signing investment treaties, and carefully define the scope and content of these agreements in order to protect their ability to regulate in the public interest. With regard to existing treaties, states have three primary options for reform: (1) termination of the relevant treaty (or treaties),\(^\text{25}\) (2) negotiation of amendments to the treaty, and (3) proactively clarifying their interpretations of vague and potentially expansive treaty provisions.\(^\text{26}\)

In all cases, states should be cognizant of the varied and significant implications of international investment law for the governance of investments in the extractive industries sector, and of the ways in which this rapidly expanding body of law can influence whether, when, and how foreign investment in this sector contributes to sustainable development.


Additional Resources
Websites and Tools

www.ccsi.columbia.edu - the Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is the only university-based applied research center and forum dedicated to the study, practice and discussion of sustainable international investment.

www.resourcegovernance.org - the Natural Resource Governance Institute (NRGI) helps people to realize the benefits of their countries’ endowments of oil, gas and minerals through technical advice, advocacy, applied research, policy analysis, and capacity development.

http://investmentpolicyhub.unctad.org/IIA - the United Nations Conference on Trade and Development (UNCTAD) has developed an International Investment Agreements Navigator, providing access to many of the more than 3,000 investment treaties in existence.

http://investmentpolicyhub.unctad.org/ISDS - UNCTAD recently launched a revamped Investment Dispute Settlement Navigator, allowing users to search for and access documents relating to investment disputes.

www.italaw.com - database that provides access to investment treaties and documents relating to investment disputes.

www.iisd.org/itn/ - news and commentary on developments in international investment law, from the International Institute for Sustainable Development (IISD).

www.iareporter.com - news and analysis service focusing on international arbitrations between foreign investors and their host governments.

http://icsid.worldbank.org/ - the International Centre for Settlement of Investment Disputes’ (ICSID) website, which allows users to learn more about ICSID arbitrations and search for cases.

www.resourcecontracts.org - an online repository of publicly available mining and petroleum investor-state contracts, developed by CCSI, the World Bank, and NRGI.

Publications


### Annex: Examples of ISDS Cases Concerning the Extractive Industries Sector

<table>
<thead>
<tr>
<th>Case Title</th>
<th>Year initiated</th>
<th>Respondent state</th>
<th>Home State of investor</th>
<th>Legal Instrument</th>
<th>Arbitration Rules</th>
<th>Outcome/Status of proceedings</th>
<th>Brief description of investment</th>
<th>Summary of claim</th>
<th>Damages awarded in favor of investor(s) (excl. interest, fees and costs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lone Pine Resources Inc. v. Canada (ICSID Case No. UNCT/15/2)</td>
<td>2013</td>
<td>Canada</td>
<td>United States of America</td>
<td>NAFTA</td>
<td>UNCITRAL</td>
<td>Pending</td>
<td>Rights under oil and gas exploration permits held by a wholly-owned Canadian subsidiary.</td>
<td>Claims arising out of the revocation by the Government of Quebec of claimant's permits for petroleum and natural gas exploration in the Utica shale gas basin, including beneath the St. Lawrence River.</td>
<td>Case pending</td>
</tr>
<tr>
<td>Khan Resources Inc., Khan Resources B.V. and Cauc Holding Company Ltd. v.</td>
<td>2011</td>
<td>Mongolia</td>
<td>Canada; Netherlands; British Virgin Islands</td>
<td>Energy Charter Treaty</td>
<td>UNCITRAL</td>
<td>In favor of the investor</td>
<td>Majority shareholding in Mongolian joint venture subsidiary that held uranium mining and exploration licenses in Mongolia.</td>
<td>Claims arising out of Mongolia’s cancellation of claimant's mining and exploration licenses for a uranium deposit located in the Dornod province in northeastern Mongolia.</td>
<td>USD 80 million</td>
</tr>
<tr>
<td>the Government of Mongolia and Monatom Co., Ltd.</td>
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<tr>
<td>The Renco Group, Inc. v. Republic of Peru (ICSID Case No. UNCT/13/1)</td>
<td>2011</td>
<td>Peru</td>
<td>United States of America</td>
<td>Peru-United States FTA</td>
<td>UNCITRAL</td>
<td>Pending</td>
<td>Interests in the mining project of La Oroya held through a wholly-owned affiliate; rights under certain stock transfer agreement and guaranty agreement.</td>
<td>Claims arising out of alleged arbitrary and unfair application of government measures and contracts related to interests in the mining operations in La Oroya, which Renco owned through its wholly-owned affiliate, Doe Run Peru S.R. LTDA.</td>
<td>Case pending</td>
</tr>
<tr>
<td>Anatolie and Gabriel Stati,</td>
<td>2010</td>
<td>Kazakhstan</td>
<td>Moldova, Republic of; Energy Charter</td>
<td>SCC</td>
<td></td>
<td>In favor of the investor</td>
<td>Rights under certain subsoil use</td>
<td>Claims arising out of the alleged campaign of</td>
<td>USD 497 million net (USD 508)</td>
</tr>
</tbody>
</table>

The information and descriptions contained in this Annex were sourced from UNCTAD’s Investment Dispute Settlement Navigator, accessible at [http://investmentpolicyhub.unctad.org/ISDS](http://investmentpolicyhub.unctad.org/ISDS).
<table>
<thead>
<tr>
<th>Case Title</th>
<th>Country/Region</th>
<th>Treaty/Investment Agreement</th>
<th>仲裁机构</th>
<th>Status</th>
<th>Claims</th>
<th>Awarded Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ascom Group S.A., Terra Raf Trans Trading Ltd v. Republic of Kazakhstan (SCC Case No. Case No. 116/2010)</td>
<td>Romania; Gibraltar</td>
<td>Treaty</td>
<td></td>
<td></td>
<td>contracts held by Ascom's local operating companies, KPM and TNG; capital contributions for oil exploration and development; assets and infrastructure related to oil field operations, including a Liquid Petroleum Gas plant.</td>
<td>harassment by the Kazakh State which culminated with the abrupt cancellation of oil and gas exploration contracts held by claimant's local operating companies, followed by the seizure of its Kazakh assets.</td>
</tr>
<tr>
<td>Tidewater Investment SRL and Tidewater Caribe, C.A. v. Bolivarian Republic of Venezuela (ICSID Case No. ARB/10/5)</td>
<td>Venezuela, Bolivarian Republic of</td>
<td>Barbados-Venezuela BIT</td>
<td>ICSID</td>
<td>In favor of the investor</td>
<td>Marine support services to the oil industry in Venezuela under contracts concluded between SEMARCA, an enterprise owned by Tidewater, and Venezuelan state-owned companies.</td>
<td>Claims arising out of the government's enactment of a law reserving to the State the assets and services related to primary activities of hydrocarbons and the seizure of claimants' marine support services operations and assets in Lake Maracaibo and the Gulf of Paria, including fifteen vessels.</td>
</tr>
<tr>
<td>Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador (PCA Case No. 2009-23) (II)</td>
<td>Ecuador</td>
<td>United States of America</td>
<td>USCITRAL</td>
<td>Pending</td>
<td>Oil exploration and production rights in Ecuador's Amazon region through concession contracts concluded with the government.</td>
<td>Claims arising out of Texaco's historical participation as a minority member of a consortium with Ecuador and Ecuador's oil company Petroecuador that explored for and produced oil under concession contracts, and the government's alleged misconduct in subsequent litigation proceedings against Texaco for environmental remediation.</td>
</tr>
<tr>
<td>Case Name</td>
<td>Year</td>
<td>Country (Claimant)</td>
<td>Country (Respondent)</td>
<td>Treaty</td>
<td>Arbitration</td>
<td>Outcome</td>
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<tr>
<td>Gold Reserve Inc. v. Bolivarian Republic of Venezuela (ICSID Case No. ARB(AF)/09/1)</td>
<td>2009</td>
<td>Venezuela, Bolivarian Republic of Venezuela</td>
<td>Canada</td>
<td>ICID AF BIT</td>
<td>In favor of the investor</td>
<td>Mining rights held indirectly by claimant in Venezuela under the mining concessions known as the “Brisas Concession” and the “Unicornio Concession” for the extraction of gold, copper and molybdenum.</td>
</tr>
<tr>
<td>Pac Rim Cayman LLC v. Republic of El Salvador (ICSID Case No. ARB/09/12)</td>
<td>2009</td>
<td>El Salvador</td>
<td>United States of America</td>
<td>CAFTA ICSID</td>
<td>In favor of the state</td>
<td>Sole ownership of certain Salvadoran mining companies that held rights conferred by exploration licenses, authorizations and permits, including the right to a mining exploitation concession in the area known as “El Dorado”; related capital expenditures.</td>
</tr>
<tr>
<td>Bilcon of Delaware et al v. Government of Canada</td>
<td>2008</td>
<td>Canada</td>
<td>United States of America</td>
<td>NAFTA UNCITRAL</td>
<td>Pending</td>
<td>Ownership and control of the Canadian company Bilcon of Nova Scotia and a lease agreement entered by this company for the property on which a quarry and marine terminal were to be developed.</td>
</tr>
<tr>
<td>Case Description</td>
<td>Year</td>
<td>Country of Origin</td>
<td>Country of Destination</td>
<td>Agreement</td>
<td>Case Status</td>
<td>Claim Details</td>
</tr>
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<td>---------------------------------------------------------------------------------</td>
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</tr>
<tr>
<td><strong>Burlington Resources, Inc. v. Republic of Ecuador (ICSID Case No. ARB/08/5)</strong></td>
<td>2008</td>
<td>Ecuador</td>
<td>United States</td>
<td>United States- Ecuador BIT</td>
<td>ICSID</td>
<td>Pending</td>
</tr>
<tr>
<td><strong>Perenco Ecuador Limited v. Republic of Ecuador (Petroecuador) (ICSID Case No. ARB/08/6)</strong></td>
<td>2008</td>
<td>Ecuador</td>
<td>Bahamas</td>
<td>Ecuador- France BIT</td>
<td>ICSID</td>
<td>Pending</td>
</tr>
<tr>
<td><strong>Mobil Investments Canada Inc. and Murphy Oil Corporation v.</strong></td>
<td>2007</td>
<td>Canada</td>
<td>United States</td>
<td>NAFTA</td>
<td>ICSID AF</td>
<td>In favor of the investor</td>
</tr>
<tr>
<td>Case Details</td>
<td>Year</td>
<td>Country 1</td>
<td>Country 2</td>
<td>Tribunal</td>
<td>Awarding Authority</td>
<td>Description</td>
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<tr>
<td>Government of Canada (ICSID Case No. ARB(AF)/07/4)</td>
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<td></td>
<td></td>
<td>Management and Development Co. and Terra Nova Oil Development Project, engaged in two petroleum development projects off the coast of the Province of Newfoundland and Labrador in which the claimants had invested; particularly, the imposition of research and development expenditure requirements by the Canadian province of Newfoundland.</td>
</tr>
<tr>
<td>Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador (PCA Case No. 34877)</td>
<td>2006</td>
<td>Ecuador</td>
<td>United States of America</td>
<td>US-Ecuador BIT</td>
<td>UNCITRAL</td>
<td>Oil exploration and production rights in Ecuador’s Amazon region through concession contracts concluded with the government.</td>
</tr>
<tr>
<td>Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador (ICSID Case No. ARB/06/11) (II)</td>
<td>2006</td>
<td>Ecuador</td>
<td>United States of America</td>
<td>Ecuador-United States BIT</td>
<td>ICSID</td>
<td>Participation contract for the exploration and exploitation of hydrocarbons.</td>
</tr>
</tbody>
</table>

<sup>28</sup> This amount was reduced in annulment proceedings from an original award of USD 1.8 billion to USD 1.1 billion, plus interest.
<table>
<thead>
<tr>
<th>Case Title</th>
<th>Year</th>
<th>Country 1</th>
<th>Country 2</th>
<th>Treaty</th>
<th>Arbitration Body</th>
<th>In Favor Of</th>
<th>Claim Description</th>
<th>Award</th>
</tr>
</thead>
<tbody>
<tr>
<td>Veteran Petroleum Limited v. The Russian Federation (PCA Case No. AA 228)</td>
<td>2005</td>
<td>Russian Federation</td>
<td>Cyprus</td>
<td>Energy Charter Treaty</td>
<td>UNCITRAL</td>
<td>In favor of the investor</td>
<td>Shareholding in the Russian-incorporated Yukos Oil Company OJSC. Claims arising out of a series of actions undertaken by the respondent against Yukos Oil Company, including arrests, large tax assessments and liens, and the auction of the main Yukos facilities, among others, which allegedly led to the bankruptcy of the company and eliminated all value of claimant's shares in Yukos.</td>
<td>USD 8.2 billion</td>
</tr>
<tr>
<td>Yukos Universal Limited (Isle of Man) v. The Russian Federation (PCA Case No. AA 227)</td>
<td>2005</td>
<td>Russian Federation</td>
<td>United Kingdom</td>
<td>Energy Charter Treaty</td>
<td>UNCITRAL</td>
<td>In favor of the investor</td>
<td>Shareholding in the Russian-incorporated Yukos Oil Company OJSC. Claims arising out of a series of actions undertaken by the respondent against Yukos Oil Company, including arrests, large tax assessments and liens, and the auction of the main Yukos facilities, among others, which allegedly led to the bankruptcy of the company and eliminated all value of claimant's shares in Yukos.</td>
<td>USD 1.8 billion</td>
</tr>
<tr>
<td>Ioannis Kardassopoulos v. Georgia (ICSID Case No. ARB/05/18)29</td>
<td>2005</td>
<td>Georgia</td>
<td>Greece</td>
<td>Georgia-Greece BIT; Energy Charter Treaty</td>
<td>ICSID</td>
<td>In favor of the investor</td>
<td>Co-ownership of a Panamanian company that had executed a joint venture agreement with a state-owned</td>
<td>USD 15.1 million</td>
</tr>
</tbody>
</table>

29 UNCTAD classifies this case under the "Transportation and storage" sector.
<table>
<thead>
<tr>
<th>Case Title</th>
<th>Year</th>
<th>Country 1</th>
<th>Country 2</th>
<th>Treaty/Protocol</th>
<th>Resolution</th>
<th>Decision</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vanessa Ventures Ltd v. Bolivarian Republic of Venezuela (ICSID Case No. ARB(AF)/04/6)</td>
<td>2004</td>
<td>Venezuela, Bolivarian Republic of Venezuela</td>
<td>Canada</td>
<td>ICSID AF</td>
<td>In favor of the state</td>
<td>Majority shareholding in a company holding a mining concession for gold and copper.</td>
<td>Claims arising out of the government's retraction of claimant's mining rights in Las Cristinas in the south east of Venezuela, one of the world's greatest undeveloped sources of gold, under the allegation that claimant's purchase of the shares was illegal.</td>
</tr>
<tr>
<td>Glamis Gold Ltd. v. United States of America</td>
<td>2003</td>
<td>United States of America</td>
<td>Canada</td>
<td>NAFTA</td>
<td>In favor of the state</td>
<td>Publicly-held corporation engaged in the mining of precious metals.</td>
<td>Claims arising out of certain federal government actions and California state measures regarding open-pit mining operations, allegedly resulting in injuries to a proposed gold mine in Imperial County, California.</td>
</tr>
<tr>
<td>Occidental Exploration and Production Company v. Republic of Ecuador (LCIA Case No. UN3467) (I)</td>
<td>2002</td>
<td>Ecuador</td>
<td>United States of America</td>
<td>UNCITRAL</td>
<td>In favor of the investor</td>
<td>Rights under a participation contract for the exploration and exploitation of hydrocarbons.</td>
<td>Claims arising out of resolutions issued by the Ecuadorian tax authority denying applications for VAT refunds by Occidental, and requiring the return of the amounts previously reimbursed in connection with a participation contract entered into by the claimant with Petroecuador, a state-owned corporation of Ecuador, to undertake oil</td>
</tr>
<tr>
<td>Name</td>
<td>Year</td>
<td>Country 1</td>
<td>Country 2</td>
<td>Agreement</td>
<td>Jurisdiction</td>
<td>Description</td>
<td>Award</td>
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<tr>
<td>PSEG Global Inc. and Konya Ilgin Elektrik Üretim ve Ticaret Limited Sirketi v. Republic of Turkey (ICSID Case No. ARB/02/5)</td>
<td>2002</td>
<td>Turkey</td>
<td>United States of America</td>
<td>Turkey-United States BIT ICSID</td>
<td>In favor of the investor</td>
<td>Rights and expectations under a contract for the construction of a mine and power plant; assets of project company, including associated intangible property, licenses and permits.</td>
<td>USD 9 million</td>
</tr>
</tbody>
</table>

UNCTAD classifies this case under the “Electricity, gas, steam and air conditioning supply” sector. The authors of this paper have changed the descriptions of the investment and case from what was included in UNCTAD’s database.