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The Impact of Investment Treaties on Governance of Private Investment in Infrastructure

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The Impact of Investment Treaties on Governance of Private Investment in Infrastructure

Lise Johnson

European University Institute
Robert Schuman Centre for Advanced Studies
Global Governance Programme

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EUI Working Paper **RSCAS** 2014/32

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Abstract

Governments are increasingly turning to the private sector to provide the capital, resources and/or know-how necessary for development and operation of infrastructure. In some cases, the involvement by the private sector will trigger coverage by an international investment treaty that overrules, and can override, the domestic law and contract that would otherwise be applicable to the project. This paper discusses the circumstances affecting when an investment treaty will apply and also highlights some of the ways that investment treaties can impact governance of infrastructure development and operation. While focusing on the relationship between investment treaties and investments in infrastructure, this paper is also relevant for the connections between investment treaties and other activities involving investor-state contracts (or quasi-contractual relationships) such as investments in the extractive industries.

Keywords

BITs; Investor-State Arbitration; Infrastructure; Foreign Investment; FDI

I. Introduction^{*}

Investment in infrastructure is a prerequisite of sustainable development. The type and availability of transportation networks, energy, telecommunications, water and sanitation services not only affect economic competitiveness, productivity and efficiency, but also impact quality of life, health, and the human and natural environment.¹

While governments have traditionally been responsible for developing and providing infrastructure services as a public good, this is changing, and the private sector is increasingly playing a greater role.² Driven by difficulties in accessing the necessary capital to invest in development of infrastructure and a lack of technology, skills and know how necessary for the projects, governments have been stepping aside and delegating greater rights and powers to private entities, privatizing some activities and operations outright, or involving private entities through various contractual and regulatory mechanisms.

One key challenge faced by governments seeking quality investment in infrastructure is how to attract investors. Although investments in infrastructure potentially provide investors with stable and long-term returns, the long lives and incomplete nature of many infrastructure contracts, the often significant capital required of investors, the highly regulated nature of infrastructure services, and the public – and political – interests regarding the price and operation of those activities, are factors that cumulatively make investors wary about these types of investments.

A country's legal environment can assuage investors' specific concerns about possible losses arising out of changes in the legal framework governing investments in infrastructure. Generally, such investments will bear the risk of general modifications in the laws, regulations and policies impacting performance of infrastructure operations as those are deemed ordinary commercial risks. Yet in circumstances such as where the government abuses its sovereign authority, and/or breaches its contractual obligations, the investor will want to be able to seek legal recourse against the government, and will want to ensure that there are avenues for such relief.

Concerns that domestic laws and procedures do not adequately provide these avenues have been cited as factors chilling investment in infrastructure and other activities. In order to assuage those fears, some investors seek political risk insurance (PRI) that can compensate them for, inter alia, regulatory expropriations or breach of contract.³ Investors in recent years have secured political risk insurance over roughly ten percent of foreign direct investments (FDI) they have made.⁴ Reasons cited by investors for not obtaining PRI include the perception that risk is manageable without such coverage, that potential losses are limited, and that they are not adequately familiar with the product.⁵

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¹ Studies examining the role of infrastructure as an essential element of sustainable development are prevalent. For a review of the linkages, see, e.g., Energy Access and Security in Eastern Africa: Status and Enhancement Pathways (United Nations Economic Commission for Africa 2014), pp. 8-11.

² Notwithstanding the government's traditional dominance of these industries, there is also a long history of private sector involvement in infrastructure development and services. See, e.g., David W. Gaffey, *Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships in the United States*, 39 Public Contract L. J. 351 (2010).

³ See Multilateral Investment Guarantee Agency (MIGA), MIGA WIPR Report (2010), pp. 55-56.

⁴ See Multilateral Investment Guarantee Agency (MIGA), WIPR Report (2010), p. 54. The ratio of PRI to FDI was approximately 25 percent in 1985, had fallen to a low of roughly 5 percent in the late 1990s, and then rose to hover around its current level. *Id.*

⁵ See *id.* p. 61. In a survey of investors in conflict-affected and fragile countries, MIGA found that only 13 percent of survey respondents reported seeking PRI, and a smaller number ultimately secured it. Respondents primarily gave (1) manageability of risks and (2) limited nature of potential losses, as reasons for not securing PRI. Investors in the extractive industries were the least likely to obtain political risk insurance. *Id.*

One specific factor that may be buttressing investors' views that they do not need to purchase PRI is the growth in investment treaties. These agreements, which are concluded between states and that require each state party to provide investors from the other state party certain standards of treatment and protections –provide investors de facto coverage against losses caused by the host-state conduct that is arguably broader than coverage provided under PRI and that does not require payments of any premiums.

One narrative explaining why states – particularly capital importing states – conclude investment treaties is that, by providing international guarantees against abuse at the domestic level, these instruments give foreign investors the comfort they need in order to make large-scale and long-term investments in the host country. In this sense, investment treaties are considered to provide the signal and the safeguards that can be crucial for attracting infrastructure investment. To date, however, the evidence is inconclusive on whether an investment treaty actually influences an investor's decision to invest in a particular location.⁶

Nevertheless, assuming that host states benefit from investment treaties due to those agreements' roles in encouraging capital injections, investment treaties also present potential significant costs for host states. The key sources of these costs are expanded legal obligations, enhanced options for investors to claim damages, and the associated high costs of arbitration.

This paper covers those issues, discussing how investment treaties might impact the rights and balances between states and investors involved in the development and operation of infrastructure projects. The key message for states is that domestic law is not the governing law for issues of deference, standards of proof, standards of liability, or rules on damages. As a result, and as has been evidenced by investment disputes, even if a state takes action in good faith and that action is consistent with domestic law and the infrastructure contract, a tribunal deciding an investment-treaty dispute may nevertheless strictly scrutinize the government's conduct, find it liable, and order it to pay damages to the investor for breach of the investment treaty.⁷ Moreover, even if the government is ultimately successful, the proceedings through which tribunals make these determinations can be hugely resource intensive. Such arbitrations often stretch on for years and generally require each side to spend millions of dollars litigating.

Over the roughly 15 years in which investors have been bringing treaty-based investor-state arbitrations, many of the disputes have arisen out of infrastructure investments. Indeed, infrastructure-related investments appear to comprise roughly 35% of those disputes.⁸ The fact that such a significant

⁶ For a recent review of studies examining the impact of investment treaties on flows of foreign direct investment (FDI), see, e.g., Lauge N. Skovgaard Poulsen, Jonathan Bonnitcha, & Jason Webb Yackee, Costs and Benefits of an EU-USA Investment Protection Treaty, Report submitted to the United Kingdom Department for Business Innovation and Skills, April 2013, pp. 15-18. When looking at the impact investment treaties have on investors' decisions, decisions regarding whether and where to invest must be separated from decisions regarding how to structure that investment. As discussed below in Section III, investors might structure or restructure their holdings in order to take advantage of treaties by changing the location of their home country, not the host country.

⁷ The fact that international standards can and do trump domestic law inconsistent with those standards is, alone, not surprising in the realm of international law. But what is surprising is that when deciding whether and how international treaty standards should override domestic law, and what damages to order, tribunals do not always accord states the deference typically said to be a feature of international law, much less the level of deference common for reviewing allegations of harms to economic interests of business entities, as opposed to violations of the cogens rights and non-derogable rights of individuals. See, e.g., Caroline Henckels, *Balancing Investment Protection and Sustainable Development in Investor-State Arbitration: The Role of Deference in Yearbook on International Investment Law and Policy 2012-2013* (Oxford University Press, forthcoming 2014) (discussing standards of review applied by tribunals in treaty-based investor-state arbitrations).

⁸ This figure is derived from ICSID's statistics regarding cases registered under the ICSID Convention and Additional Facility Rules. The disputes captured as being "infrastructure-related" are those classified as relating to investments in the following economic sectors: information and communication (6%); water, sanitation and flood protection (6%); transportation (10%); and electric power and other energy (13%). Other investments that are not captured within the 35%

share of investors' claims under investment treaties are connected with infrastructure investments reinforces the importance of the focus of this paper: analyzing just what rights and protections investors are benefitting from under investment treaties compared with what they would be entitled to under otherwise applicable domestic law; and, correspondingly, what obligations and liabilities states have assumed.

Structurally, the paper proceeds as follows: First, Section II provides a brief overview of investment treaties on the basis that some readers will not be particularly familiar with these instruments and their important features. Section III then goes into more detail on the scope of the agreement, describing just what types of investments and investors are covered, and what this means for infrastructure-related investments. Section IV discusses treaty standards in more detail, providing a foundation for the rest of the paper, which analyzes how those standards impact and present potential liability for government conduct in seeking bids, awarding contracts, and governing projects and project companies.

These sections of the paper – Sections V through VII – aim to provide useful guidance for government officials thinking about how investment treaties might unduly limit their policy space and negotiating freedom, and how the agreements might overly expand state liability to private parties. Rather than look at the investment treaty-infrastructure investment relationship on a treaty-standard-by-treaty-standard basis, the paper takes an issue-by-issue approach in order to better illustrate some of the practical tensions.

Some issues fall outside the scope of this paper, including a closer examination of how investment treaties impact contract termination, contractual dispute settlement mechanisms, and how investment treaties might shift parties' calculations regarding whether to informally resolve disputes or proceed to costly and lengthy arbitration. Those issues are nevertheless important to consider when assessing the relative costs and benefits of investment treaties in the specific context of infrastructure investments and more generally.

Finally, while the paper focuses on infrastructure investments, it is also relevant for a broader set of investments where there is an underlying contractual or quasi-contractual relationship between the investor and state such as investments in the extractive industries. Like infrastructure investments, investments in the extractive industries give rise to a significant share (approximately 30%) of investor-state disputes.⁹ Indeed, because the standards and analysis applied by tribunals in the context of extractives-related disputes are often also applicable in disputes arising out of infrastructure investments, this paper considers both. To strictly narrow the discussion to infrastructure disputes would risk ignoring important trends and lessons applicable to those cases.

(Contd.) _____

but that may be related to infrastructure include investments in services and trade (4%), construction (7%), and finance (7%). The ICSID Caseload Statistics (Issue 2014-1), p. 12. There are two important caveats to this estimation: First, because the basis of consent to arbitrate these disputes may be an investment treaty, domestic law, or contract, it is unclear that the 35% figure holds for just treaty-based disputes. *Id.* p. 10. Another issue with the 35% figure is that disputes arising under the ICSID Convention and Additional Facility Rules represent only a portion of investment-treaty arbitrations. Other disputes not counted in these figures thus include arbitrations administered by the Permanent Court of Arbitration or ad hoc tribunals using arbitration rules developed by the United Nations Commission on International Trade Law.

⁹ These include investment arbitrations under the ICSID Convention and Additional Facility Rules. Twenty-six percent of those disputes have been in oil, gas and mining, while four percent have been in agriculture, fishing and forestry. The caveats to the data explained in note 8 also apply here. ICSID Caseload Statistics (Issue 2014-1), p. 12.

PART ONE: SCOPE AND CONTENT OF INVESTMENT TREATIES

II. Overview of Investment Treaties

Before launching into a discussion of the connections between investment treaties and infrastructure investments, this Section provides an overview of the salient features of those treaties, and the mechanisms through which they are interpreted and applied. It introduces the concepts that will be examined and elaborated upon in greater detail throughout the paper.

In short, investment treaties are agreements concluded between states that require their state parties to provide covered foreign investors and investments certain standards of treatment. They commonly also enable foreign investors to sue their “host states” (i.e., the foreign countries in which they are making the investment) directly in international arbitration for breach of the treaty.

While the exact content may vary from treaty to treaty, the large majority of investment treaties share a set of core provisions. These are (1) the obligation to treat foreign investors fairly and equitably (the “FET” obligation); (2) the obligation to provide foreign investors “full protection and security”; (3) the obligation not to expropriate foreign investment except under certain conditions, including the payment of compensation; (4) the obligation not to treat covered foreign investors less favorably than foreign investors from third countries (the “most-favoured nation” or “MFN” obligation); (5) the obligation not to treat covered foreign investors less favorably than domestic investors (the “national treatment” obligation); and (6) the obligation to allow foreign investors to freely transfer money in and out of the country.

Other provisions that may be included are clauses in which states commit to abide by “any obligation” owed to a foreign investor or investment outside the treaty (the “umbrella clause”); restrictions on the government’s ability to impose performance requirements on foreign investors such as obligations to procure goods or services locally; and requirements to publish laws, regulations and decisions affecting foreign investments.

The majority of investment treaties only impose these standards “post-establishment” – i.e., after the foreign investor has already established or acquired its investment in the host state – but some also extend protections to investors that are “making” or “seeking to make” investments.

The treaties also often include exceptions to all or some of the obligations. These exceptions, however, are generally limited to protecting states’ abilities to take measures to protect their “national security” or “essential security” interests. Exceptions such as those that can be found in trade agreements like the WTO’s General Agreement on Tariffs and Trade and the General Agreement on Trade in Services, which expressly shield measures aimed at advancing specified policy goals (e.g., measures necessary to protect human, animal or plant life or health),¹⁰ are generally absent from or limited in investment treaties.

As noted above, states usually give their treaty commitments added force by allowing investors to sue states for breach of the treaties even though they are not party to those inter-state agreements. An investor can initiate international arbitration against its host state alleging that the state has violated its treaty obligations and owes the investor some form of remedy (generally monetary damages or compensation) as a result. The cases are decided by private arbitrators, normally a panel of three, with each side appointing one arbitrator and the third being appointed by agreement of the arbitrators, the parties, or another individual or entity.¹¹

¹⁰ General Agreement on Tariffs and Trade, Oct. 30, 1947, art. XX(b).

¹¹ The precise methods used to appoint arbitrators, and to govern other aspects of the arbitration, will be governed by the treaty, applicable arbitration rules, relevant domestic law at the seat of arbitration, and agreements of the disputing parties.

The number of these treaty-based investor-state disputes has grown significantly over roughly the past 15 years: The first investment-treaty arbitration was filed in 1987. By the end of 2012, over 500 such cases had been filed against roughly 100 different respondent host states.¹²

The awards produced in these arbitrations are largely shielded from judicial review or scrutiny and are relatively easy to enforce as compared to a foreign court judgment. This is due primarily to two treaties – the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the “Washington Convention” or “ICSID Convention”)¹³ and the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”).¹⁴

The ICSID Convention only allows losing parties to seek “annulment” of awards through an appeal to an “ad hoc committee” of three arbitrators in a proceeding that will be governed by the ICSID Convention. The bases on which that committee can actually annul awards are confined to five narrow grounds: “that the Tribunal was not properly constituted;”¹⁵ “that the Tribunal has manifestly exceeded its powers;”¹⁶ “that there was corruption on the part of a member of the Tribunal;”¹⁷ “that there has been a serious departure from a fundamental rule of procedure;”¹⁸ or “that the award has failed to state reasons on which it is based.”¹⁹ For any award under the ICSID Convention that is not annulled, the ICSID Convention requires its state parties to recognize that award as binding and “enforce the pecuniary obligations imposed by [it] within its territories as if it were a final judgment of a court in that State.”²⁰ By limiting disputing parties’ challenges against awards to the intra-ICSID annulment procedure, and imposing strict requirements on its state parties to recognize and enforce ICSID awards, the ICSID Convention greatly insulates disputes – and their outcomes – from oversight by or challenge in domestic courts.

The New York Convention, in comparison, allows a greater, but still limited, role to domestic courts. Losing parties may challenge the awards in the courts of the country where the award was made, or where recognition or enforcement is sought.²¹ It also provides that state parties may refuse to enforce or recognize awards if doing so “would be contrary to the public policy of that country.”²² The ICSID Convention has no such “public policy” provision.

These arbitral decisions issued under investment treaties and enforced through the New York and Washington Conventions can result in significant liability for states; but it is challenging for states to know just precisely what type of conduct will trigger claims or require them to pay damages. A number of factors drive this uncertainty. For one, the obligations are generally vaguely stated, leaving much room for interpretation. Additionally, many of the awards, and a large portion of the briefs revealing the facts and arguments behind those awards, are not publicly available, hindering the ability of national and local government officials charged with implementing the treaties to understand just how they are being interpreted and applied. Additionally, there is currently no formal system of precedent or overarching appellate mechanism designed to promote consistency across decisions. However, even if there were such mechanisms, there would still necessarily be limitations to the

¹² UNCTAD, Recent Developments in Investor-State Dispute Settlement, Issues Note No. 1, May 2013, p. 1.

¹³ 17 UST 1270, TIAS 6090, 575 UNTS 159.

¹⁴ 330 UNTS 38; 21 UST 2517; 7 ILM 1046 (1968).

¹⁵ ICSID Convention, Art. 52(1)(a).

¹⁶ *Id.*, Art. 52(1)(b).

¹⁷ *Id.*, Art. 52(1)(c).

¹⁸ *Id.*, Art. 52(1)(d).

¹⁹ *Id.*, Art. 52(1)(e).

²⁰ ICSID Convention, Art. 54(1).

²¹ New York Convention, Art. V.

²² New York Convention, Art. V(2)(b).

consistency that could be obtained given that tribunals in these investor-state arbitrations are interpreting and applying not just one instrument binding on all countries, but potentially any of the thousands of different bilateral and multilateral treaties that countries have signed.

While these factors combine to make it nearly impossible to say precisely what investment treaties mean, one can identify what they have meant in specific cases, and what they may be interpreted to mean in future disputes. Uncertainty arises both in terms of the treaties' scope, as well as their substantive obligations and the remedies available for breach.

The next Section addresses the first issue of scope, discussing the question of what "investors" and what "investments" investment treaties cover, emphasizing in particular how treaty text and arbitral decisions are relevant for investors and investments relating to infrastructure development.

III. Scope – Coverage of Infrastructure Investments

Whether an investment treaty will cover an infrastructure project and its investors depends in large part on the treaty's definition of covered "investments" and "investors" and how tribunals have interpreted those terms. Because of the key role of those terms in serving as the gateway to treaty protection, this section provides an overview of the concepts and some of the main factors that may lead to, or preclude, treaty coverage.

A. Covered Investments

1. Asset-based and Enterprise-based Definitions

Most investment treaties define covered "investments" in a broad, open-ended manner as "any" or "every kind" of asset, and provide an illustrative list of the types of assets that may fall under that umbrella. The agreement signed in 2006 between China and India is an example. It states:

Investment means every kind of asset established or acquired, including changes in the form of such investment, in accordance with the national laws of the Contracting Party in whose territory the investment is made and in particular, though not exclusively, includes:

- (i) movable and immovable property as well as other rights such as mortgages, liens or pledges;
- (ii) shares in and stock and debentures of a company and any other similar forms of participation in a company;
- (iii) rights to money or to any performance under contract having a financial value;
- (iv) intellectual property rights, in accordance with the relevant laws of the respective Contracting Party;
- (v) business concessions conferred by law or under contract, including concessions to search for and extract oil and other minerals;²³

Other treaties use a similar asset-based definition but narrow it by (1) providing an exhaustive, rather than illustrative list of covered assets; (2) specifically excluding certain assets; and/or (3) explaining that "investments" should generally possess certain characteristics. The agreement signed in 2012 between China and Canada employs each of those three types of limitations. It defines an "investment" as:

- (a) an enterprise;
- (b) shares, stocks and other forms of equity participation in an enterprise;

²³ Agreement between the Government of the Republic of India and the Government of the People's Republic of China for the Promotion and Protection of Investments, Art. 1(b) (signed November 21, 2006).

- (c) bonds, debentures, and other debt instruments of an enterprise;
- (d) a loan to an enterprise
- (i) where the enterprise is an affiliate of the investor, or
- (ii) where the original maturity of the loan is at least three years;
- (e) notwithstanding sub-paragraphs (c) and (d) above, a loan to or debt security issued by a financial institution is an investment only where the loan or debt security is treated as regulatory capital by the Contracting Party in whose territory the financial institution is located;
- (f) an interest in an enterprise that entitles the owner to share in the income or profits of the enterprise;
- (g) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution;
- (h) interests arising from the commitment of capital or other resources in the territory of a Contracting Party to economic activity in such territory, such as under
- (i) contracts involving the presence of an investor's property in the territory of the Contracting Party, including turnkey or construction contracts, or concessions to search for and extract oil and other natural resources, or
- (ii) contracts where remuneration depends substantially on the production, revenue or profits of an enterprise;
- (i) intellectual property rights; and
- (j) any other tangible or intangible, moveable or immovable, property and related property rights acquired or used for business purposes;²⁴

It then narrows the definition by stating:

but "investment" does not mean:

- (k) claims to money that arise solely from
- (i) commercial contracts for the sale of goods or services, or
- (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by sub-paragraph (d); or o (l) any other claims to money, that do not involve the kinds of interests set out in sub-paragraphs (a) to (j);²⁵

The agreement then provides an additional qualification, noting that for an investment to be a "covered investment", it must be "an investment in [the territory of one Contracting Party] of an investor of the other Contracting Party ... and which involves the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk."²⁶

A third, smaller, group of treaties uses an enterprise-based, as opposed to an asset-based, definition. The free trade agreement between the United States and Canada, which has since been superseded by the NAFTA, is an example. It stated:

Investment means:

- (a) the establishment of a new business enterprise, or
- (b) the acquisition of a business enterprise; and includes
- (c) as carried on, the new business enterprise so established or the business enterprise so acquired, and controlled by the investor who has made the investment; and

²⁴ Agreement between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments, Art. 1(1) (signed September 9, 2012).

²⁵ Agreement between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments, Art. 1(1) (signed September 9, 2012).

²⁶ Id., Art. 1(3).

(d) the share or other investment interest in such business enterprise owned by the investor provided that such business enterprise continues to be controlled by such investor.²⁷

A foreign-owned company established by foreign investors in the host state (“Company A”) in order to construct, maintain, and or operate an infrastructure project in that country would likely fall under the definition of an “investment” under any of the three formulations quoted above.

More questions arise as to whether and when other types of foreign-held assets relating to infrastructure investments are covered. For example, a minority, non-controlling shareholding in Company A would appear to fall outside the definition of a covered investment under an enterprise-based definition, but could be covered under asset-based definitions like those quoted above.²⁸ Similarly a loan to Company A by a foreign entity would likely fall outside the enterprise-based definition, but could be covered under an asset-based definition. Even if there was no Company A in the host country, a contract or license held by a foreign individual or entity to provide services in the host country, such as a contract to provide for transmission of electricity, to maintain and operate a toll-road, or to treat water, would also fall outside the enterprise-based definition but could be deemed to fall within many asset-based definitions.²⁹ Indeed, under the asset-based definitions, a wide range of tangible and intangible rights and interests could be classified as protected “investments” under an investment treaty.

Merely holding an “asset” covered by the treaty, however, will not necessarily mean that an investor holds an “investment” within the meaning of the treaty. Claims, rights or interests in an infrastructure-related project in the host country might be assets with economic value, but can still fall out of the scope of covered “investments”. This is because, as the definitions quoted above show, treaties often include additional criteria such as requirements that assets must be “in the territory of” the host state and must be made “in accordance with” that country’s laws. These requirements are additional factors impacting whether an investment treaty will cover all or part of infrastructure development, and are discussed further below.

2. Other Criteria for Covered “Investments”: Territoriality and Legality

i. Territoriality

The majority position on the “territoriality” requirement appears to be that it means what it says: i.e., that for an investment to be in the host country means that there must be an investment or a commitment of capital or other resources located *in* the territory of the host country. Applying this rule, a contract for cross-border sales of goods or services;³⁰ business activities conducted by the investor in the investor’s home state in order to develop and produce products for sale in the host country; and expenditures and efforts in the home country to secure necessary regulatory approvals for exports to the host country³¹ are among the types of economic activities that would likely not meet the “territoriality” requirement.

Nevertheless, there are caveats to the territoriality requirement that may be especially important in connection with infrastructure-related projects in the host country. For one, contracts for a foreign investor to perform services for the host state have been deemed “investments” in cases where at least some of those services have been performed in the host country, even though the majority of the

²⁷ Canada-United States Free Trade Agreement, Art. 1611 (signed

²⁸ For more on the issues raised by protection of minority shareholders, see, e.g., *infra*, Section III(B)(2)..

²⁹ See, e.g., *SGS Société Générale de Surveillance S.A. v. Paraguay*, ICSID Case No. ARB/07/29, paras. 109-117 (citing similar decisions).

³⁰ See *Apotex Inc. v. United States*, Award on Jurisdiction and Admissibility, June 14, 2013, paras. 233-241.

³¹ See, e.g., *Apotex, Inc. v. United States*, paras. 160-176.

services were performed outside of the host state.³² Moreover, in at least some of the cases in which the territoriality requirement has been applied relatively strictly, the governing treaty expressly stated that an “investment” does not mean “claims to money that arise solely from ... commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party.”³³ Not all treaties contain a similar exclusion. While states might have assumed that such contracts would not be considered “investments” and therefore did not need to be explicitly excluded, the failure to clarify the issue can expose them to claims that those contracts are “investments” under a strictly textualist reading of that term as including “any asset”.

A third caveat is that different tribunals have taken different approaches to applying the “territoriality” requirement. Importantly, a small number of tribunals have found the requirement that an investment be made “in” the host country is satisfied if the investment is made *for the benefit of* the host country. This appears to especially be the case where the alleged investment is a financial instrument (as opposed, e.g., to a tradable good). The decision of the majority in *Abaclat v. Argentina*,³⁴ and the subsequent decision of the majority in *Deutsche Bank v. Sri Lanka*,³⁵ are two examples of this approach.

In *Abaclat*, the claimants – who numbered over 180,000 at the time the case was initiated – were Italian individuals and entities who held security entitlements in international sovereign bonds issued by Argentina in the 1990s. The issue was whether those securities, which were purchased by retail investors on secondary markets, denominated in foreign currency, and governed by foreign law,³⁶ constituted investments *in* Argentina. The tribunal determined that they did.

The tribunal reasoned that the test for whether financial instruments are “in” the host country was different from the territoriality test that applied to other types of investments:

With regard to an investment of a purely financial nature, the relevant criteria cannot be the same as those applying to an investment consisting of business operations and/or involving manpower and property. With respect to investments of a purely financial nature, the relevant criteria should be where and/or for the benefit of whom the funds are ultimately used, and not the place where the funds were paid out or transferred. Thus, the relevant question is where the investment funds ultimately made available [sic] to the Host State and did they support the latter’s economic development?³⁷

The tribunal then proceeded to answer that question, stating:

There is no doubt that the funds generated through the bonds issuance process were ultimately made available to Argentina, and served to finance Argentina’s economic development. Whether the funds were actually used to repay pre-existing debts of Argentina or whether they were used in government spending is irrelevant. In both cases it was used by Argentina to manage its finances,

³² SGS Société Générale de Surveillance S.A. v. Paraguay, ICSID Case No. ARB/07/29, paras. 109-117 (and decisions cited therein).

³³ This provision, which is found in Article 1139(i) of the NAFTA, was cited by the tribunal in *Apotex, Inc. v. United States* as being relevant to its determination that the claimant’s activities in its home country related to sales of products in the host country did not constitute an investment in the host country. *Apotex Inc. v. United States*, paras. 230-233.

³⁴ *Abaclat v. Argentina*, Decision on Jurisdiction and Admissibility, August 4, 2011, paras. 343-387.

³⁵ *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/09/2, Award, Oct. 31, 2012.

³⁶ Cf. *Grand River Enterprises Six Nations, Ltd. et al. v. United States*, Award, para. 88, citing *Bayview*, Award on Jurisdiction, paras. 98-99 (“[A] salient characteristic of an investment covered by the protection of NAFTA Chapter Eleven would be that the investment is primarily regulated by the law of a state other than the state of the investor’s nationality, and that this law is created and applied by that state which is not the state which is not the state of the investor’s nationality.”).

³⁷ *Abaclat v. Argentina*, Decision on Jurisdiction and Admissibility, para. 374.

and as such must be considered to have contributed to Argentina's economic development and thus to have been made in Argentina.³⁸

The dissenting arbitrator in *Abaclat* took issue with the tribunal's decision as improperly disregarding the "territoriality" requirement. He noted, however, that it would be a closer question and less of a departure from other arbitral decisions if – rather than being issued as part of a broad plan to raise funds and reduce debt – the bonds had been specifically issued in order to fund a particular project (e.g., an infrastructure investment) in the host country.³⁹ Based on this distinction, bonds, loans and other instruments used specifically to finance infrastructure projects may more easily qualify as investments than other more general or commercial financial instruments. Given the crucial role that infrastructure plays in economic development, there could be strong arguments that bondholders would have protected investments under the "benefits" test if the bond had been issued to fund an infrastructure project.

While relatively recent and undoubtedly controversial, it appears that the majority decision in *Abaclat* has attracted at least some followers. In *Deutsche Bank v. Sri Lanka*, the majority adopted the test developed by the *Abaclat* majority and determined that an oil price hedging contract between Sri Lanka's state-owned oil company and Deutsche Bank was an investment by Deutsche Bank in Sri Lanka, notwithstanding the fact that the contract had been predominantly prepared by branches of Deutsche Bank outside Sri Lanka, was governed by English law, and selected English courts as the proper forum for dispute resolution. The tribunal concluded:

In the present case, it is undisputed that the funds paid by Deutsche Bank in execution of the Hedging Agreement were made available to Sri Lanka, were linked to an activity taking place in Sri Lanka and served to finance its economy which is oil dependent. The Tribunal therefore decides that the condition of a territorial nexus with Sri Lanka is satisfied.⁴⁰

In reaching that finding, the tribunal rejected Sri Lanka's argument that the "purpose of the BIT was not to provide a method of enforcement for transnational debt claims but to protect foreign investment, i.e., inward investment, from regulatory abuse."⁴¹

Based on these decisions, and as clearly illustrated by the *Abaclat* case and its mass of claimants, a government or government entity could find itself subject to treaty claims from a wide range of individuals and entities that directly or indirectly funded an infrastructure project through debt or equity. Additionally, as noted above, contracts for performance of services in the host country relating to development of infrastructure would likely also be covered under the treaty unless the treaty expressly said otherwise.⁴² This would even be the case if a significant portion of the services were performed outside of the host state.⁴³

These broad interpretations of the term "investment" largely derive from tribunals' decisions to apply strict textualist interpretations of the treaties, declining to read in limitations to the scope of the term unless those limitations are expressly stated. An effect of this interpretive approach is that treaties are increasingly growing longer, with drafters adding new language to clearly carve out some types of assets from the agreements' protection. As noted above, some treaties now include provisions stating that cross-border contracts for sales of goods or services are not "investments"; other treaties expressly

³⁸ Id. at para. 378.

³⁹ *Abaclat v. Argentina*, Dissenting Opinion, Oct. 28, 2011, paras. 107-109.

⁴⁰ *Deutsche Bank v. Sri Lanka*, para. 292.

⁴¹ *Deutsche Bank v. Sri Lanka*, para. 224.

⁴² See, e.g., *Apotex Inc. v. United States*, Award on Jurisdiction and Admissibility, June 14, 2013, para. 234 (discussing *Mondev v. United States*, Award, Oct. 11, 2012).

⁴³ See, e.g., *SGS Société Générale de Surveillance S.A. v. Paraguay*, ICSID Case No. ARB/07/29, paras. 109-117 (and cases cited therein).

exclude sovereign bonds and other financial products. The 2008 agreement between Canada and Peru, for example, contains a number of relevant exclusions. It states:

investment means:

(I) an enterprise;

(II) an equity security of an enterprise;

(III) a debt security of an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the debt security is at least three years,

but does not include a debt security, regardless of original maturity, of a state enterprise;

(IV) a loan to an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the loan is at least three years,

but does not include a loan, regardless of original maturity, to a state enterprise;

(V)

(i) notwithstanding subparagraphs (III) and (IV) above, a loan to or debt security issued by a financial institution is an investment only where the loan or debt security is treated as regulatory capital by the Party in whose territory the financial institution is located, and

(ii) a loan granted by or debt security owned by a financial institution, other than a loan to or debt security of a financial institution referred to in (i), is not an investment;

for greater certainty:

(iii) a loan to, or debt security issued by, a Party or a state enterprise thereof is not an investment; and

(iv) a loan granted by or debt security owned by a cross-border financial service provider, other than a loan to or debt security issued by a financial institution, is an investment if such loan or debt security meets the criteria for investments set out elsewhere in this Article.⁴⁴

Of course, this discussion of the meaning of “territoriality” only reflects general patterns that can be observed from publicly available decisions under different treaties. The actual scope of protection authorized in a particular dispute will depend on the language of the treaty and the specifics of the particular case, the identity of the arbitrators, and the persuasiveness of the parties’ legal and factual presentations. Each decision that has been rendered, however, signals a possible similar outcome in a future dispute, thus putting governments on notice of the ways in which a tribunal might deem them to have granted protections to a broader range of “investments” than originally anticipated or intended.

ii. Legality

Another common requirement of an investment is that it must be invested “in accordance with the law” of the host state. The emerging pattern in the cases seems to be that this can remove assets or investments from the treaty’s coverage if they are made through fraud, corruption, or other non-trivial violations of the host state’s law. Other misconduct such as a breach of formalities regarding approval and registration of foreign investment, breach of contract, violations of principles of international law and public policy, and illegality in the operation (as opposed to the making of the investment), are all factors that tribunals are less inclined to view as causing what would otherwise be a covered “investment” to fall outside of the treaty’s protection. This section reviews some of the cases illustrating these issues.

⁴⁴ Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments, Art. 1 (signed November 14, 2006).

a. Investments Established Through Fraud or Corruption

The legality requirement has been applied most clearly in disputes where the investment was secured through bribery, corruption or fraud. A key arbitral decision addressing this issue is *Inceysa v. El Salvador*⁴⁵. In that case, El Salvador's Ministry of the Environment and Natural Resources sought bids to secure service contracts for installation, management and operation of emission inspection and control stations. Roughly two years after securing the contract, the successful bidder, Inceysa, brought a claim against El Salvador alleging the country had failed to perform its part of the bargain and breached the investment treaty between El Salvador and Spain. El Salvador responded that the governing treaty—like many other investment treaties—required investments to be made in accordance with El Salvador's law and, due to Inceysa's illegal conduct when making the investment, it had no rights to bring a treaty claim.

Evidence submitted in the arbitration established to the tribunal's satisfaction that during the bid proceedings, Inceysa had submitted a range of false information that overstated its financial health, exaggerated its experience and capacity to perform the contract, concealed information regarding its affiliation with another bidder, and falsely portrayed the identity and experience of its strategic partner. These misrepresentations and omissions related to the key criteria that the government evaluated when considering the bids, enabling it to secure a contract it otherwise would not have been able to obtain.⁴⁶

According to the tribunal, Inceysa's conduct in the making of the investment violated various rules and principles of international law, including the principles of good faith and international public policy, which were incorporated as part of El Salvador's domestic law. Consequently, it concluded, Inceysa "did not make [the investment] in accordance with Salvadoran law" and was therefore not protected by the treaty.⁴⁷

In another more recent dispute, the tribunal similarly dismissed the case on the ground that the investment had been made in breach of the host state's laws. In this case, *Metal-Tech v. Uzbekistan*, the tribunal found that evidence was sufficient to conclude the claimant had made payments to government officials and their associates when seeking to establish its operations. Such conduct, the tribunal concluded, meant that the investor had made no "investment" under the meaning of the treaty.⁴⁸

b. Limits to the Legality Requirement

Decisions have applied four important limits to the legality requirement. These relate to the seriousness of the violation in the eyes of the tribunal; the source of the legal obligation alleged to be violated; the role of the state in the violation; and the time when the illegal action took place.

First, arbitral decisions indicate that the "legality" requirement will not necessarily bar claims if the alleged breach is a failure to comply with what the tribunal considers to be "trivial" obligations. This may include requirements to comply with formalities relating to registration or approval of foreign investments.⁴⁹

⁴⁵ *Inceysa Vallisoletana S.L. v. El Salvador*, ICSID Case No. ARB/03/26, Award, Aug. 2, 2006.

⁴⁶ See, e.g., *Inceysa v. El Salvador*, paras. 236-37.

⁴⁷ *Inceysa v. El Salvador*, para. 239. In this case, due to the language of the treaty and the tribunal's approach, the issue of legality was relevant to whether the investment was protected by the treaty and whether the tribunal had jurisdiction over the dispute; it was not, however, relevant to the question of whether there was an "investment" in the first place.

⁴⁸ *Metal-Tech Ltd. v. Uzbekistan*, ICSID Case No. ARB/10/3, Award, October 4, 2013.

⁴⁹ See Luke Eric Peterson, "Amidst Thicket of Thai and Indonesian Investment Laws, Confusion as to Admission Requirements Found in Some Southeast Asian Investment Treaties," *Investment Arbitration Reporter* (April 10, 2012). See also *Vanessa Ventures v. Venezuela*, ICSID Case No. ARB(AF)/04/6, Award, Jan. 16, 2013, para. 167 (indicating that compliance with reporting obligations was not required for jurisdiction); *Metal-Tech v. Uzbekistan*, ICSID Case No.

Second, at least one tribunal has held that the host state's "law" does "not extend to purely contractual obligations."⁵⁰ Under that reasoning, an asset acquired or owned in violation of an investor-state contract may not be fatal to that asset's status as an "investment."

This issue was addressed in *Vanessa Ventures v. Venezuela*. Venezuela had run a bid process in order to select a company with the requisite technical and financial capacity and experience to aid the government in pursuing its aim of developing certain mineral resources. Pursuant to that bid process, Venezuela (through its state entity, Corporación Venezolana de Guayana (CVG)) chose Placer Dome to be its majority partner in pursuing the mining project.

Reflecting and protecting the government's interest in ensuring that it knew its partner in the mining venture, and that that partner had the necessary skills and resources, the shareholders' agreements and other contracts governing the mining project barred Placer Dome from transferring its rights or obligations in the project without CVG's prior consent.

Despite those restrictions on transfers, Placer Dome sold its shares to Vanessa Ventures, a company that "had a radically different technical and financial profile from that of Placer Dome", and did so without seeking or obtaining prior consent from Venezuela.⁵¹ After Venezuela learned of the sale and breach of contract, it terminated the agreement and concluded a new mining contract with another company. Vanessa Ventures subsequently brought an investment-treaty arbitration against Venezuela seeking to regain possession over the mining rights.

Venezuela objected that the unauthorized transfer of shares violated Placer Dome's contractual obligations as well as Venezuela's law on public procurement and administrative law. The tribunal, however, rejected those arguments, concluding that the claimant's shareholdings – though obtained through a sale that breached the Placer Dome-CVG contract – did not violate the legality requirement and qualified as an investment under the treaty.⁵² Although the tribunal subsequently rejected all of Vanessa Venture's claims against Venezuela on the merits, the tribunal's approach means that host states may be forced to litigate treaty claims by individuals and entities with which they had no prior dealings, and no intent or desire to contract with in extractives, infrastructure, or other projects.

Notably, the *Vanessa Ventures* tribunal also stated that, in contrast to *Inceysa*, violations of good faith or principles of international public policy are not violations of the "legality" requirement and will not cause an asset to fall outside of an investment treaty's definition of a covered investment.⁵³ The decision thus keeps the "legality" requirement confined to law and regulation enacted by the host state.

Third, tribunals have indicated that if the state or a state-owned entity were involved in or aware of the illegality, the state would be precluded from later denying jurisdiction on the ground that the investment was illegal. This issue arose in *Kardassopoulos v. Georgia*.⁵⁴ In that case, the tribunal determined that the underlying contracts for development of petroleum resources and related infrastructure appeared to have been entered into through *ultra vires* acts of state-owned enterprises (i.e., acts outside the scope of their power or authority) and to be void *ab initio* under Georgian law. It

(Contd.) _____

ARB/10/3, Award, October 4, 2013, para. 165 (stating the legality requirement covers "non-trivial" violations of the law). But see *Philippe Gruslin v. Malaysia*, ICSID Case No. ARB/99/3.

⁵⁰ *Vanessa Ventures Ltd. v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/04/6, Award, Jan. 16, 2013, para. 134.

⁵¹ *Vanessa Ventures v. Venezuela*, para. 153.

⁵² *Vanessa Ventures v. Venezuela*, paras 128-169.

⁵³ See *Vanessa Ventures Ltd. v. Venezuela*, ICSID Case No. ARB(AF)/04/6, para. 164. One of the members of the three-member tribunal, however, did take the view that the tribunal would not have jurisdiction over the investment because the investment was not made in good faith. *Id.* at para. 169.

⁵⁴ *Kardassopoulos v. Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction, July 6, 2007.

concluded, however, that illegality of the contracts under domestic law did not prevent it from taking jurisdiction over a dispute arising out of alleged contract rights. It reasoned:

[E]ven if the [Joint Venture Agreement] and the Concession were entered into in breach of Georgian law, the fact remains that these two agreements were “cloaked with the mantle of Governmental authority”. Claimant had every reason to believe that these agreements were in accordance with Georgian law, not only because they were entered into by Georgian State-owned entities, but also because their content was approved by Georgian Government officials without objection as to their legality on the part of Georgia for many years thereafter. Claimant therefore had a legitimate expectation that his investment in Georgia was in accordance with relevant local laws. Respondent is accordingly estopped from objecting to the Tribunal’s jurisdiction *ratione materiae* under the ECT and the BIT on the basis that the JVA and the Concession could be void *ab initio* under Georgian law.⁵⁵

The tribunal in *RDC v. Guatemala* adopted a similar approach. In that dispute, the respondent state had argued that the private investor’s contracts for development and operation of railways in the country were invalid under domestic law as they were not secured through public bidding as required, and had not received the necessary congressional or presidential approvals. That illegality, Guatemala contended, prevented the contracts from qualifying as covered “investments” made pursuant to domestic law as required by the treaty.⁵⁶ The tribunal rejected those arguments on grounds of fairness. It said:

146. Even if FEGUA’s actions [as the government entity entering into the contracts] ... were *ultra vires* (not “pursuant to domestic law”), “principles of fairness” should prevent the government from raising “violations of its own law as a jurisdictional defense when [in this case, operating in the guise of FEGUA, it] knowingly overlooked them and [effectively endorsed an investment which was not in compliance with its law.”

147. Based on these considerations the Tribunal finds that Respondent is precluded from raising any objection to the Tribunal’s jurisdiction on the ground that Claimant’s investment is not a covered investment under the Treaty or the ICSID Convention.⁵⁷

This limitation to the legality requirement is notable in that it would effectively override some countries’ legal and policy decisions to strictly prevent enforcement of illegal contracts or contracts secured through *ultra vires* conduct. Given the difficulties of rooting out corruption or other impropriety, rules against enforcement can act as prophylactic measures preventing such wrongful and usually opaque conduct. Furthermore, strengthening the force of those rules against enforcement, at least some jurisdictions do not allow private entities to use doctrines of reliance or estoppel to avoid the potentially harsh effects that a contracting party might suffer if its contract is later deemed invalid and without force.⁵⁸ As Guatemala thus argued in *RDC*, binding governments to illegal, *ultra vires*, or improperly secured contracts could “severely and improperly restrict State sovereignty. Taken to the extreme, a bright-line rule that a State is estopped from exercising pre-existing domestic remedies to question the validity of a contract simply because the State had operated under that contract for a period of time could prevent a State from terminating a contract initiated by bribery or corruption.”⁵⁹

⁵⁵ Id. at para. 194.

⁵⁶ *RDC v. Guatemala*, Second Decision on Objections to Jurisdiction, ICSID Case No. ARB/07/23, May 18, 2010, para. 140 (quoting CAFTA, art. 10.28(g)).

⁵⁷ *RDC v. Guatemala*, Second Decision on Objections to Jurisdiction, ICSID Case No. ARB/07/23, May 18, 2010, paras. 146-47 (quoting *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, Award, August 16, 2007, para. 346).

⁵⁸ In the United States, see, e.g., *Office of Personnel Management v. Richmond*, 496 U.S. 419 (1990); *Fed. Crop. Ins. Corp. v. Merrill*, 332 U.S. 380 (1947).

⁵⁹ *RDC v. Guatemala*, ICSID Case No. ARB/07/23, Award, June 29, 2012, para. 197 (quoting Guatemala’s Rejoinder on the Merits, October 21, 2011, para. 185).

The fourth limitation on the “legality” requirement is that decisions to date have focused on the issue of “legality” at the time the investment is made. Tribunals have not seemed to view illegal conduct during the operations as impacting whether the asset is a covered investment. To some extent, this may be due to the fact that investment treaties often state the “legality” requirement by saying that the investment must be “made” or “invested” in accordance with the host state’s laws.⁶⁰ Yet the view that the “legality” requirement only applies to the “making” of an investment, and not its subsequent operation, has also been applied in a case when the investment treaty defined “investments” as being “asset[s] owned or controlled ... in accordance with the [host state’s] laws.”⁶¹ Under that approach, issues of illegality during operation can be relevant to matters of admissibility and the merits, but not whether there is a covered “investment” that can support jurisdiction in the first place.

3. ICSID Criteria

To fall under the protection of an investment treaty, a claimant must show that it has a covered investment. Additionally, in order to gain the benefits of the ICSID Convention and the pathways it offers to enforcement, a claimant must establish that it has an investment within the meaning of that treaty. According to some tribunals, the meaning of an investment in the ICSID Convention is flexible and is coextensive with the definition of an investment in the governing investment treaty. This means that if there is an asset that qualifies as an investment under the relevant investment treaty, it will also qualify as an investment under the ICSID Convention.

In contrast, other tribunals have concluded that the ICSID Convention has its own inherent definition of an “investment” which requires a separate objective test to be satisfied. Not only must there be an investment under the governing investment treaty, but there must also be an investment that qualifies as such under the ICSID Convention. Tribunals agreeing that the ICSID Convention does have its own definition of an “investment” nevertheless do not always agree on what that the elements of that definition are.

A few tribunals have required satisfaction of the so-called “*Salini*” test, which is based in part on the premise that, as recognized in its preamble, the ICSID Convention was designed to promote international investment that advanced economic development in the host country. The *Salini* test requires⁶² investments to have four characteristics: (1) entail a substantial commitment or contribution; (2) be of a certain duration; (3) involve an element of risk; and (4) contribute to the host state’s economic development.⁶³ That test, first suggested in *Fedax v. Venezuela*⁶⁴ and then described in *Salini v. Morocco*, has since been followed in other cases including *Joy Mining v. Egypt*,⁶⁵ *Jan de Nul v. Egypt*,⁶⁶ and *Bayindir v. Pakistan*.⁶⁷ The tribunal in *Phoenix Action v. Czech Republic* further

⁶⁰ See, e.g., *Metal Tech Ltd. v. Republic of Uzbekistan*, ICSID Case No. ARB/10/3, Award, October 4, 2013, para. 193 (finding that the treaty only addressed whether the investment was lawfully made, not lawfully operated).

⁶¹ *Vanessa Ventures v. Venezuela*, para. 110 (quoting Article 1(f) of the investment treaty between Venezuela and Canada. In that case, the tribunal stated that “the jurisdictional significance of the ‘legality requirement’ in the definition of an investment ... is exhausted once the investment has been made.” *Id.* at para. 167.

⁶² Some tribunals have suggested that the *Salini* test sets forth required elements, while others note that they are indicative or hallmarks of investments, but not necessarily indispensable. See discussion in *Malaysian Historical Salvors v. Malaysia*.

⁶³ *Salini Construttori SpA v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, July 23, 2001, paras. 51-52. Some also describe the test as including a requirement of profit or return.

⁶⁴ *Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction, July 11, 1997.

⁶⁵ *Joy Mining v. Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction, August 6, 2004, para. 53.

⁶⁶ *Jan de Nul N.V. Dredging International N.V. v. Egypt* (ICSID Case No. ARB/04/13).

⁶⁷ *Bayindir Insaat Turizm Ticaret Ve Senayi A.S. v. Pakistan*, ICSID Case No. ARB/03/29.

elaborated on the criteria for an ICSID investment, stating that it requires consideration of various potentially overlapping elements, which are similar to the *Salini* test: “a contribution in money or other assets;” “a certain duration;” “an element risk;” “an operation made in order to develop an economic activity in the host State;” “assets invested in accordance with the laws of the host State;” and “assets invested bona fide.”⁶⁸

A number of tribunals applying an objective test to determine whether there is an investment under the ICSID Convention have taken a narrower approach than advanced in *Salini* or *Phoenix* by discarding certain criteria. The tribunal in *Metal-Tech v. Uzbekistan*, for example, rejected the *Phoenix* tribunal’s conclusion that good faith and compliance with the host state’s law are necessary to be covered by the ICSID Convention.⁶⁹ Other tribunals have taken issue with and declined to apply the “economic development” criterion.⁷⁰

These issues continue to be frequently disputed. Different arbitrators and tribunals have diverging views on the role of the economic development criterion and other factors, generating uncertainty and prolonged litigation. One relatively recent case illustrating this is *Malaysian Historical Salvors v. Malaysia*. In that case, the sole arbitrator who first heard the case rejected jurisdiction over the dispute. He determined that the agreement between the government and the claimant in which the government had contracted the claimant to locate and salvage the cargo of a British ship that sank off the country’s coast in 1817 did not make “a sufficient contribution to Malaysia’s economic development to qualify as an ‘investment’” under the ICSID Convention or underlying investment treaty.⁷¹ The claimant then sought to have the decision annulled. The majority of the annulment committee accepted the claimant’s position, criticizing the arbitrator’s interpretation of the meaning of an “investment” and the role of the economic development criterion, and annulling the decision. One of the members of the annulment committee dissented, and in doing so pointed to the policy implications of skipping an inquiry into the impacts an investment has on the host state:

[I]t is possible to conceive of an entity which is systematically earning its wealth at the expense of the development of the host State. However, much that may collide with a prospect of development of the host State, it would not breach a condition – on the argument of the [claimant seeking annulment]. Accordingly, such an entity would be entitled to claim the protection of ICSID. Host States which let in purely commercial enterprises would have something to worry about. Correspondingly, ICSID would seem to have lost its way: it is time to call back the organization to its original mission.⁷²

As compared to other types of economic interests and activities, and absent exceptional circumstances such as fraud or corruption in the making of the investment, contracts and foreign direct investment projects for construction, operation and maintenance of infrastructure in the host country would appear to have a relatively easy time in establishing that they contribute to the development of the host state due to the role of infrastructure as a prerequisite and catalyst for economic activity. But one can envision a situation in which even an infrastructure deal winds up constituting a significant net loss for the government, and a drain rather than a contribution to the economy. Nevertheless, tribunals to date have tended not to scrutinize the fairness of underlying transactions when determining whether they constitute investments.

Decisions indicate that the other *Salini* criteria would not be particularly challenging for a foreign entity with an infrastructure concession to meet given that these investments are often long-term,

⁶⁸ Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award, April 15, 2009, para. 114.

⁶⁹ Metal-Tech Ltd. v. Uzbekistan, ICSID Case No. ARB/10/3, Award, October 4, 2013, para. 127.

⁷⁰ See, e.g., Victor Pey Casado and President Allende Foundation v. Chile, ICSID Case No. ARB/98/2, Award, May 8, 2008, para. 232.

⁷¹ Malaysian Historical Salvors v. Malaysia, ICSID Case No. ARB/05/10, Award, May 2007, para. 143.

⁷² Malaysian Historical Salvors v. Malaysia, Dissenting Opinion to Decision on Annulment, April 16, 2009, para. 22.

hugely capital intensive, and can involve the private entity taking on all or most of the business risk of the infrastructure operations. The decision in *Salini* itself illustrates these points: in that case the tribunal found that the claimants' contract with the government to construct a section of the highway in Morocco constituted an investment in the country due to the contractors' contributions of money, know-how, equipment, and salaries to the project, the 32-month term for performance (extended to 36 months), and the various risks of the project, including uncertainties regarding potential cost overruns, force majeure events, and increased expenses or challenges due to potential changes in the legal or regulatory framework. The tribunal also highlighted that the "contribution to the economic development of the Moroccan State cannot seriously be questioned" as the highway served the public interest.⁷³

Long-term loans to or debt issued by a government to finance an infrastructure project would also seem likely to satisfy the *Salini* test. In terms of the "contribution to development" prong, and as noted by the tribunal in *CSOB v. Slovakia*, although such financial instruments are not always investments within the meaning of the ICSID Convention, they can be depending on the activities and projects they fund;⁷⁴ with respect to the other *Salini* criteria – those factors, as they have been applied, are not very demanding.

Indeed, in *Sri Lanka v. Deutsche Bank*, after determining that only three of the *Salini* criteria should be considered (commitment of resources, risk and duration), the tribunal concluded that each was easily met by the hedging contract: It reasoned that even the bank's acts of meeting and corresponding with host state officials and negotiating contracts constituted commitments of resources for the purposes of establishing that there was an ICSID-eligible investment;⁷⁵ additionally, it determined that the risk criterion was satisfied because, under the hedging contract, Deutsche Bank might have to make payments to the government.⁷⁶ It also stated that the "very existence of the dispute" evidenced there was a risk.⁷⁷ Finally, with respect to duration, the tribunal did not deem it significant that Deutsche Bank had the ability to unilaterally terminate the contract and in fact did so after only 125 days;⁷⁸ rather, according to the tribunal, the fact that the contract was negotiated over the course of two years and could have lasted one year gave it an adequate duration for ICSID jurisdiction.⁷⁹

Whether a third set of assets or interests relating to infrastructure investments – contracts for cross-border sales of goods used in connection with the investments, or contracts for services performed outside of the host country -- would satisfy an objective test for an "investment" under the ICSID Convention would be a closer question that would depend on the facts of the particular case and the views of the tribunal deciding it. Quoting the tribunal in *Pantechniki v. Albania*,⁸⁰ the *Deutsche Bank v. Sri Lanka* majority said:

[T]he same product can be an ordinary sale of goods or an investment depending on the attending facts and circumstances of the case: "[i]t is admittedly hard to accept that the free-on-board sale of a single tractor in country A could be considered an 'investment' in country B. But what if there are many tractors and payments are substantially deferred to allow cash-poor buyers time to generate income? Or what if the first tractor is a prototype developed at great expense for the

⁷³ *Salini v. Morocco*, para. 57.

⁷⁴ *Ceskoslovenska Obchodni Banka, A.A. v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, May 24, 1999, paras. 76-88.

⁷⁵ *Deutsche Bank v. Sri Lanka*, para. 300.

⁷⁶ *Deutsche Bank v. Sri Lanka*, para. 302.

⁷⁷ *Deutsche Bank v. Sri Lanka*, para. 301 (quoting *The ICSID Convention: A Commentary* (2nd Ed.), Article 25, para. 163).

⁷⁸ *Deutsche Bank v. Sri Lanka*, para. 304.

⁷⁹ *Id.*

⁸⁰ *Pantechniki SA Contractors & Engineers v. Republic of Albania*, ICSID Case No. ARB/07/21, Award, July 30, 2009.

specificities of country B on the evident promise of amortization? Why should States not be allowed to consider such transactions as investments to be encouraged by the promise of access to ICSID.⁸¹

As those tribunals signaled, investment treaty coverage is not necessarily foreclosed for those contracts as some arbitrators may view them as falling within the agreements' scope.

B. Covered Investors

In order to obtain the benefit of the investment treaty, the investor itself must be covered. Investors, like investments, are often defined broadly in investment treaties to include natural or legal persons.

For natural persons, treaties commonly say they protect those who are "nationals" of the other state party. They may expand that (e.g., by including permanent residents of the other state party), and/or narrow it (e.g., by restricting coverage of dual nationals).⁸²

With respect to legal persons, treaties usually use one of three different approaches: (1) protecting legal persons organized or incorporated under the laws of the other state party; (2) protecting legal persons with their seat in the other state party; and (3) protecting legal persons owned or controlled by investors of the other state party.

Definitions of investors – particularly those covering juridical persons incorporated or organized under the law of the other contracting party – have given rise to a series of legal and policy issues reflected in disputes arising out of infrastructure and other investments. Key questions relate to the connected issues of "treaty shopping" and circumstances under which tribunals will "pierce the corporate veil" and challenges relating to minority shareholders as protected investors.

1. Treaty Shopping and Veil Piercing

Significantly, tribunals have interpreted definitions of "investors" in ways that facilitate their expansive jurisdiction. On the one hand, tribunals have held that – unless expressly instructed otherwise by the treaty – they need not "pierce the corporate veil" and look beyond the direct investor (which may merely be a shell or holding company) in order to determine whether the actual or beneficial owner is an investor covered by the treaty. This means that if an investor in country A wants to make an investment in country B, but there is no investment treaty between countries A and B, the investor from country A can establish an affiliate in a country (Country C) that does have an investment treaty with country B, and make its investment through that affiliate in order to obtain the protection of the investment treaty between countries B and C.⁸³ Because tribunals have expressly permitted this type of treaty planning, investors are reportedly increasingly structuring their investments in order to gain the protections of investment treaties (and favorable tax laws and treaties), routing their investments through third countries in order to benefit from treaties that would otherwise not cover them.

Notably, some tribunals have even declined to pierce the corporate veil where the alleged or actual beneficial owner of the investment in the host country is a legal or natural person of that same country. As an example of this scenario, a person country A establishes an entity in country B, then routes an

⁸¹ *Deutsche Bank v. Sri Lanka*, para. 309 (quoting *Pantechniki v. Albania*, Award, para. 40).

⁸² For more on this see UNCTAD, *Series on International Investment Agreement II: Scope and Definition: A Sequel*, pp. 72-80.

⁸³ See, e.g., *ADC Affiliate Ltd. and ADC & ADMC Management Ltd. v. Republic of Hungary*, ICSID Case No. ARB/03/16 (rejecting the respondent's argument that the investor claimants should not be able to bring a case under the ICSID Convention because, although the direct investors were established in Cyprus, their beneficial owners were Canadian, and Canada was not a party to the ICSID Convention).

investment back into country A through that intermediate entity in country B. In *Tokios Tokelés v. Ukraine*, the tribunal allowed the investor to bring a claim against the Ukraine even though Ukrainian nationals owned 99 percent of the “foreign” claimant’s shares and constituted two-thirds of its management.⁸⁴ The president of the tribunal in *Tokios Tokelés* strongly dissented, evidencing that not all arbitrators (or states) accept the formalistic and expansive view of treaty coverage advanced by the *Tokios* majority.⁸⁵ Nevertheless, other tribunals have adopted the approach taken by the *Tokios* majority, including the relatively recent decision in *KT Asia v. Kazakhstan*, where the “Dutch” claimant in the case against Kazakhstan was a shell company owned and controlled by a Kazakh national.⁸⁶

In contrast to their apparent reluctance to pierce the corporate veil when doing so would *limit* jurisdiction, tribunals have pierced the veil in order to provide protection to indirect investors. To illustrate: If there is no treaty between countries A and B, and a legal entity incorporated in country B invests in country A, it might appear that no investment treaty would protect the investment in country A made by the investor from country B. But if (1) the parent company of the investor incorporated in country B was incorporated in country C, and (2) there was an investment treaty between countries A and C, then that A-C treaty could be used to cover the investment in country A. Cases have held that the fact that the direct investor – the investor in country B – would itself not be covered, would not matter unless the treaty dictated a different outcome. This was the case in *Waste Management v. Mexico*, where a United States company was allowed to bring a claim against Mexico under the North American Free Trade Agreement (NAFTA) even though the investment was made through subsidiaries in a tax haven not party to the treaty.⁸⁷

Some treaties do include provisions restricting such wide approaches to jurisdiction by, for example, requiring investors to have their seat and substantial economic activities in the home state, thereby limiting claims from mailbox companies used to facilitate treaty shopping.⁸⁸ Other treaties only protect “direct” investors.⁸⁹ Yet unless instructed clearly by provisions such as those, tribunals have generally allowed investors to take advantage of their corporate forms and families to maximize the availability of treaty protection – declining to pierce the corporate veil when doing so would deny treaty protection but then piercing it when doing so would bring the investor under the treaty’s coverage. One limit to tribunals’ rather permissive approach to treaty shopping is that they have rejected claims by investors that restructured their investments in order to gain treaty protection *after* the dispute had already arisen.

As is discussed further below, this expansive approach of treaty protection is significant because the treaties can have powerful impacts on the respective rights and responsibilities of the host state and foreign investors, particularly in cases where there is an underlying investor-state contract or quasi-contractual instrument such as a permit or license.

⁸⁴ *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, April 29, 2004, paras. 21-56.

⁸⁵ *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Dissenting Opinion, April 29, 2004. The dissent argued that the majority’s approach was inconsistent with the object and purpose of the ICSID Convention.

⁸⁶ *KT Asia Investment Group BV v. Republic of Kazakhstan*, ICSID Case No. ARB/09/8, Award, October 17, 2013; See also Jarrod Hepburn, “ICSID Tribunal in *KT Asia v. Kazakhstan* Case Finds that Investment Acquired for Nominal Price Fails to Meet BIT’s Definition,” *Investment Arbitration Reporter* (November 6, 2013).

⁸⁷ *Waste Management v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, April 30, 2004, paras. 77-85.

⁸⁸ See, e.g., *Alps Finance and Trade AG v. Slovak Republic*, Award, March 5, 2011, pp. 70-74.

⁸⁹ See, e.g., *HICEE BV v. Slovak Republic*, PCA Case No. 2009-11, Partial Award, May 23, 2011, pp. 36-54.

2. Special Challenges Relating to Minority Shareholders

Treaties generally do not include language that specifically excludes minority shareholders such as portfolio investors from coverage. Tribunals, in turn, have largely declined to read limits into the treaties that would exclude claims by non-controlling minority shareholders. Indeed, in addition to permitting claims by minority shareholdings based on interference with their shares or rights as shareholders, tribunals have also permitted derivative claims by minority shareholders seeking relief for damages to the company in which they have an equity investment.

Permitting such investors to bring treaty-based actions seeking to recover damages for an enterprise's losses can have significant practical implications for the state as well as non-parties to the dispute. For one, allowing these actions could subject countries to multiple claims arising out of the same set of facts. Depending on the number of shareholders, the numbers of potential claimants bringing separate disputes could be staggering.

A second issue is that allowing minority non-controlling shareholders to bring claims can enable them to challenge government actions that the company has chosen not to contest through litigation (e.g., due to potentially high costs of the proceedings and low chance of success, potential for counterclaims, danger of adverse publicity and reputational harm, or alternative opportunities for informal settlement), or has otherwise challenged and resolved. If, for example, a government requests a renegotiation of an investor-state contract, and the company agrees, thereby reducing its profits and the value of its shares but helping maintain the deal, minority non-controlling shareholders may bring a treaty-based claim against the government alleging that the renegotiation was accomplished through government pressure applied in breach of the investment treaty. Similarly, if a company pursues a domestic avenue for dispute settlement, and obtains a court judgment providing relief, a minority non-controlling shareholder lacking standing under the host country's domestic law to challenge the government's conduct toward the enterprise could nevertheless try to package the issue as a treaty dispute and independently pursue relief under the agreement for damage to the enterprise and a drop in share value.

The tribunal in *GAMI v. Mexico* addressed this issue and concluded that, contrary to the positions taken by Mexico and the United States,⁹⁰ minority non-controlling shareholders can bring claims for harms to the enterprise irrespective of whether the enterprise itself has pursued or secured relief through other channels. The tribunal held that the fact that the Mexican company, GAM, sought and secured relief before Mexican courts did not prevent the US company, GAMI, which held just over 14% in GAM, from separately pursuing relief and remedies under the investment chapter of the NAFTA. The tribunal stated:

[T]he fact that GAMI is only a minority shareholder does not affect its right to seek the international arbitral remedy. Does this conclusion need to be reconsidered because of the initiatives of other shareholders in GAM? The owners of the other 85.82% shares might for reasons of their own have chosen not to cause GAM to seek relief before the Mexican courts. (They might simply have been defeatists. Or they might have made their separate peace with the Government and abandoned any complaint in return for offsetting benefits.) That would not disentitle GAMI [from being able to pursue its own NAFTA claim].⁹¹

Minority non-controlling shareholders thus are not bound by the corporate decisions taken by the firm, and may adopt their own litigation strategies for addressing alleged harms suffered by the companies in which they hold equity.⁹²

⁹⁰ See *GAMI Investments, Inc. v. Mexico*, Submission of the United States, June 30, 2003.

⁹¹ *GAMI v. Mexico*, Award, November 15, 2004, para. 37.

⁹² See also *Sempra v. Argentina*, ICSID Case No. ARB/02/16, Award, September 28, 2007, paras. 220-228.

A third issue is that permitting shareholders to collect damages for harms to the company could result in those shareholders obtaining funds owed to the company and inappropriately jumping ahead of secured and other creditors that might otherwise have had higher priority claims to those sums.

Because of these and other issues, such claims by shareholders against third parties alleging harms to the corporation are often barred in domestic law unless special circumstances are present, such as when a shareholder suffers a separate and distinct injury as compared to other shareholders, or where a special duty such as a contractual duty is owed by the third party to the shareholder. Yet, although there have been some exceptions,⁹³ tribunals have not similarly applied those domestic law limits.

IV. Once an Investment is Covered – General Rules Regarding Government Conduct

As noted above, there is a group of core obligations commonly found in investment treaties:

- the obligation to treat foreign investors fairly and equitably (the “FET” obligation);
- the obligation to provide foreign investors “full protection and security”;
- the obligation not to expropriate foreign investment except under certain conditions, including the payment of compensation;
- the obligation not to treat covered foreign investors less favorably than foreign investors from third countries (the “most-favoured nation” or “MFN” obligation);
- the obligation not to treat covered foreign investors less favorably than domestic investors (the “national treatment” obligation); and
- the obligation to allow foreign investors to freely transfer money in and out of the country.

Some treaties, though a lesser share, also include so-called “umbrella clauses” and restrictions on performance requirements.

While investors may allege breach of all of these standards in a given claim, the most common ground on which they succeed is the FET claim, which has become a type of “catch-all” provision for allegations of wrongful government conduct. This section thus discusses the content of that provision, then describes the meaning of the obligations on expropriation, the requirement to provide full protection and security, the non-discrimination obligations, and the umbrella clause. Although it is outside the scope of this paper to provide a comprehensive or nuanced treatment of these standards, it does outline the important contours. Sections V, VI and VII follow by describing in more detail how these treaty obligations have been applied in various disputes arising out of different phases and activities relating to infrastructure (and similar) investments.

A. FET

Allegations that the host state has breached the FET obligation are now a standard feature of investors’ claims, and appear to be the most common grounds upon which investors prevail. In less than fifteen years, the standard has morphed from one that had been largely ignored in investment treaties, to one that now serves as a type of “catch-all” cause of action for investors claiming to be aggrieved.⁹⁴ To date, the FET standard has supported *successful* claims for such conduct as a government decision not

⁹³ See, e.g., *PSEG v. Turkey*, paras. 182-194. In that decision, the tribunal rejected claim by a US company with interests in the project company incorporated by PSEG in Turkey. The tribunal stated, in relevant part, that “[g]iven the corporate structure of the project, only PSEG as the investor and the Project Company as the conduit for this investment can be considered legally linked to the Turkish Government for the purpose of the Contract and the operation of the Treaty, including the consent given to arbitration. Other equity holders do not have an interest separate from these entities and consequently cannot claim on their own.” *Id.* para. 191.

⁹⁴ UNCTAD, *Series on International Investment Agreements II: FET*, p. 43 (2012).

to renew a one-year permit for a hazardous waste facility in response to public concerns about the proximity of that facility to the local population;⁹⁵ a government's decision not to accept a tender for a radio frequency (despite a reservation in the treaty allowing the government to limit market access of foreign investors when awarding tenders in that sector);⁹⁶ a government's decision to terminate a contract (irrespective of the fact that termination was in compliance with the contract's terms and provisions of domestic law);⁹⁷ government efforts to seize and auction assets to recover unpaid tax liabilities (although the tribunal declined to find that those actions breached domestic law);⁹⁸ and efforts by government tax officials to interpret and apply new tax legislation (notwithstanding the tribunal's determination that the government actions were taken in good faith based on their understanding of the law's requirements).⁹⁹

Assessing potential liability under the FET standard is particularly difficult as the content of the FET obligation is infamously vague, and tribunals' views vary widely with respect to (1) what it requires (e.g., due process, transparency, protection of investors' legitimate expectations, stability of the legal framework), and/or (2) what standard of review to apply when assessing breach. In some cases, the standard of review has been rather deferential to states, only finding violations where government conduct is "egregious", "shocking"¹⁰⁰ or "grossly subvert[s] a domestic law or policy for an ulterior motive,"¹⁰¹ and being resistant to expand the content of the obligation to include requirements to ensure transparency and legal stability. In other cases, however, tribunals have applied much stricter scrutiny to governments' statements regarding the underlying facts and issues, and have also applied rather low thresholds for finding liability.

1. Varied Decisions on the Meaning of the Obligation

To illustrate the spectrum along which these decisions fall, on one end there is *Glamis v. United States*, in which the tribunal affirmed the relevance of the so-called *Neer* doctrine setting "egregious" conduct as the threshold for liability. The *Glamis* tribunal stated that

... to violate the customary international law minimum standard of treatment codified in Article 1105 of the NAFTA, an act must be sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons—so as to fall below accepted international standards and constitute a breach of Article 1105(1).¹⁰²

The *Glamis* tribunal acknowledged that conceptions of what constitutes egregious and shocking conduct might have changed and continue to evolve since the 1926 *Neer* award, but that it was the claimant's burden to establish such growth in the content of the minimum standard of treatment under customary international law (MST). The tribunal ultimately concluded that the *Glamis* claimant did not meet that burden.

In contrast, readings of the FET standard that are more exacting of governments and less demanding on claimants can be found in decisions such as *Tecmed v. Mexico*, *Occidental v. Ecuador*, and *Micula v. Romania*. In *Tecmed*, for instance, the tribunal stated that the FET obligation

⁹⁵ *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003.

⁹⁶ *Lemire v. Ukraine*, ICSID ARB/06/18, Award, Mar. 28, 2011.

⁹⁷ *Occidental Exploration and Production Co. v. Ecuador*, ICSID Case No. ARB/06/11, Award, Oct. 5, 2012.

⁹⁸ *RosInvest Co. v. Russia*, SCC Arbitration V (079/2005), Award, Sept. 12, 2010.

⁹⁹ *Occidental Exploration and Production Co. v. Ecuador*, LCIA Case No. UN 3467, Award, July 1, 2004.

¹⁰⁰ *Glamis Gold v. United States*, UNCITRAL, Award, June 8, 2009, para. 616.

¹⁰¹ *Cargill v. Mexico*, ICSID Case No. ARB(AF)/05/2, para. 103.

¹⁰² *Glamis Gold v. United States*, UNCITRAL, Award, June 8, 2009, para. 22.

... requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.¹⁰³

In *Occidental v. Ecuador*, the tribunal similarly stated that the FET standard imposed requirements of stability and predictability, and “certainly” imposed an “obligation not to alter the legal and business environment in which the investment has been made.”¹⁰⁴ More recently, in *Micula v. Romania*, the tribunal took the view that the FET obligation requires obligations of transparency, regulatory stability, protection of the investor’s legitimate expectations, adherence to contractual obligations, compliance with procedural rules and due process, and treatment in good faith.¹⁰⁵

2. The Relationship between FET and the Minimum Standard of Treatment

One factor that has influenced some tribunals’ interpretations of the FET obligation is their view of the relation between the FET standard and the minimum standard of treatment (MST) under customary international law (MST). The MST is a floor below which conduct is not to fall, and is based on the general and consistent practices of states “accepted as law.”¹⁰⁶ Establishment of the MST requires two elements: (1) evidence of state practice of sufficient “density, in terms of uniformity, extent and representativeness;”¹⁰⁷ and (2) *opinio juris*, meaning that states follow the practice out of a sense of legal duty. While examining the content of the MST is outside the scope of the present note, it has been said to apply in only three areas – namely, the administration of justice, the treatment of aliens in detention, and the provision of full protection and security.¹⁰⁸

There are two general directions tribunals have taken regarding the relationship between the FET obligation and the floor set by the MST. One is that the FET standard does not simply codify the MST, but is an autonomous standard that is independent of and goes beyond the MST. Pursuant to this approach, tribunals contend that a breach of the FET standard may be found for conduct that is not sufficiently egregious or outrageous to constitute a violation of the MST.

The other approach is that the FET obligation is the same as the MST owed to aliens under customary international law. Under this view, when including the FET obligation in their treaties, states were merely incorporating the MST standard. In other words, the FET obligation encompasses the MST but does not go beyond it.

¹⁰³ *Tecnicas Medioambientales Tecmed S.A. v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003), para. 154.

¹⁰⁴ *Occidental v. Ecuador*, LCIA Case No. UN 3467, Award, July 1, 2004, para. 191.

¹⁰⁵ *Micula v. Romania*, ICSID Case No. ARB/05/20, Award, December 11, 2013, pp. 138-233.

¹⁰⁶ Statute of the International Court of Justice, Art. 38(1)(b).

¹⁰⁷ Jean-Marie Henckaerts & Louise Doswald-Beck, *Customary International Humanitarian Law*, Vol. 1: Rules (Cambridge University Press, 2009), p. xlv (citing International Law Association, Final Report of the Committee on the Formation of Customary (General) International Law, Statement of Principles Applicable to the Formation of General Customary International Law, Report of the Sixty-Ninth Conference, London, 2000, commentary (b) to Principle 12, p. 731).

¹⁰⁸ OECD, Working Papers on International Investment, No. 2004/3, Fair and Equitable Treatment Standard in International Investment Law, 2004, p. 9, n.34.

A growing number of states have expressly tied the FET to the MST standard in their treaties or in subsequent interpretive statements. The NAFTA parties launched this trend in July 2001 when, in response to concerns regarding the potential breadth of the FET standard triggered by a few early investor-state disputes, the NAFTA Free Trade Commission, a body established under the treaty, issued the following interpretive note:

Minimum Standard of Treatment in Accordance with International Law

Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).¹⁰⁹

Notably, there is evidence that such practice of expressly tethering the FET standard to the MST standard will lead the tribunal to interpret the scope of the FET obligation (and potential liability thereunder) as being narrower than under a treaty without such an express reference. Statistics gathered by UNCTAD suggest that inclusion of language aligning the FET obligation to the MST can improve states' chances of successfully defending claims.¹¹⁰

It must be remembered, however, that even when states did not explicitly tie the FET standard to the MST in their treaties, and/or have not subsequently issued interpretive statements seeking to clarify that relationship, that does not mean that those states *intended* to bind themselves to a higher autonomous standard embodied by the FET that went beyond what the MST requires.¹¹¹ Various tribunals have nevertheless read treaties' silence on the MST to mean that the FET is not limited in scope to that customary international law standard.¹¹²

Some decisions appear to indicate that the difference between FET and the MST is not significant in practice. To some extent, this has arisen from a view of the "minimum" standard being an evolving concept that has expanded over time to approximate if not subsume what might previously have only been barred under a more exacting FET standard.¹¹³ It has also resulted from the fact that tribunals have not always strictly required claimants to prove the existence of state practice and *opinio juris* on a specific issue.¹¹⁴ These approaches can effectively unwind the narrow approach to liability under the MST that states might have intended to incorporate in their treaty standards.

B. Expropriation

Investment treaties generally recognize that states may take or expropriate private property but specify that, in order for those expropriations to be lawful, they must be done for a public purpose, in a non-discriminatory manner, effected in accordance with due process, and accompanied by payment of compensation.¹¹⁵

¹⁰⁹ NAFTA Free Trade Commission, Notes of Interpretation of Certain Chap. 11 Provisions (31 July 2001).

¹¹⁰ UNCTAD, FET, *supra* n. 95, at pp. 60-61.

¹¹¹ See also UNCTAD, FET, *supra* n. 95, at pp. 21-22.

¹¹² See, e.g., *Mytilineos v. Serbia* (not public; with author).

¹¹³ See, e.g., *RDC v. Guatemala*, ICSID Case No. ARB/07/23, Award, June 29, 2012, paras. 216-219; UNCTAD, FET, *supra* n. 95, at pp. 59-60.

¹¹⁴ See *RDC v. Guatemala*, Award, paras. 216-219; cf. *Glamis Gold v. United States*, UNCITRAL, June 8, 2009, para. 628.

¹¹⁵ For more on this issue see, e.g., UNCTAD, "Expropriation: A Sequel," Series on International Investment Agreements II (2012), pp. 27-56.

Whether the treaties explicitly say so or not, they have been interpreted to cover both direct expropriations (e.g., nationalizations of physical property and businesses) and indirect expropriations (i.e., measures that, although they leave the investors title over their property, interfere with or impact their rights of ownership, use or control to such an extent that the measures are the equivalent of a direct expropriation).

Expropriation claims have figured in a number of infrastructure-related cases as investors have claimed, with varying degrees of success, expropriation of their physical property, concession agreements, rights of management, particular contractual guarantees, or other rights or interests.

1. “Sole-Effects Test” and Police Powers Doctrine

Some investors have argued¹¹⁶ and tribunals have found¹¹⁷ that the so-called “sole-effects test” must be used in order to determine whether there has been an expropriation. Under this test, “the effect of the measure ends the inquiry: if the investor has been substantially deprived of its property rights, the measure will be considered expropriatory” irrespective of the form or nature of the measure or the public purpose behind it.”¹¹⁸

The “sole-effects test”, however, appears to be the minority approach taken by tribunals; and states are increasingly including language in their treaties making clear that that test should not govern.¹¹⁹ The trend is away from that standard and toward an approach under which tribunals consider an additional range of factors, including the extent to which the challenged measure interferes with the investor’s legitimate expectations, and the nature, purpose and character of that measure.¹²⁰ States and commentators have also argued, and tribunals have similarly determined that the effect of the measure – even if severe – will not constitute an expropriation if it is a valid exercise of the government’s “police powers”. Under the “police powers” doctrine, non-discriminatory measures of general applicability that are designed and applied for legitimate public purposes do not constitute indirect expropriations, irrespective of their impact on the investment.¹²¹ UNCTAD has identified several types of acts that have been seen to be covered by this doctrine:

(a) forfeiture or a fine to punish or suppress crime; (b) seizure of property by way of taxation; (c) legislation[, regulation and judicial decisions] restricting the use of property, including planning, environment, safety, health and the concomitant restrictions to property rights; and (d) defence against external threats, destruction of property of neutrals as a consequence of military operations and the taking of enemy property as part payment of reparation for the consequences of an illegal war.¹²²

¹¹⁶ See, e.g., *Pacific Rim. V. El Salvador*, ICSID Case No. ARB/09/12, Claimant’s Memorial on the Merits and Quantum, March 29, 2013, para. 635.

¹¹⁷ *Compania del Desarrollo de Santa Elena, SA v Republic of Costa Rica*, ICSID Case No. ARB/96/1, Final Award, February 17, 2000, p. 192; *Burlington v. Ecuador*, Award, para. 396.

¹¹⁸ *Pacific Rim. V. El Salvador*, ICSID Case No. ARB/09/12, Claimant’s Memorial on the Merits and Quantum, March 29, 2013, para. 635. Notably, the claimant cited only one case in support of its view that the “sole-effects” test was the “orthodox” approach, and that case was a decision of the US-Iran claims tribunal, as opposed to an investment treaty disputes. See *id.* n. 1015 (citing *Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFAA Consulting Engineers of Iran*, 6 IRAN-U.S. CL. TRIB. REP. 219, 225-26 (1984)).

¹¹⁹ UNCTAD, *Expropriation: A Sequel*, supra n.116, p. 63.

¹²⁰ See, e.g., UNCTAD, *Expropriation: A Sequel*, supra n.116, pp. 57-77.

¹²¹ See discussion in UNCTAD, *Expropriation: A Sequel*, supra n.116, pp. 79-86.

¹²² UNCTAD, *Expropriation: A Sequel*, supra n.116 p. 79.

2. Level of Interference and Denominator Issue

Over time, tribunals have adopted a relatively consistent approach whereby they hold that the level of interference with an investment must generally be total or near total in effect and duration in order to constitute an expropriation. While this seems to set a high bar for liability, the degree of interference will vary depending on what the tribunal views as the appropriate denominator of the investment.

Various tribunals have stressed that it is important to view the investor's investment in the host country "as a whole".¹²³ Under this approach, an investment in development of oil resources, for example, consists not only of rights under production sharing contracts – even if those are the most valuable assets – but also shareholdings in the project company, infrastructure, equipment, and other tangible property related to and employed in the project, contributions of money and other assets, and physical possession of the relevant exploitation areas.¹²⁴ In other cases, however, the tribunal has taken a narrow view to identifying the relevant right or investment. *Biwater v. Tanzania* is an illustration.¹²⁵ there, the tribunal isolated the investor's right to "normal contract termination" procedures as the relevant property right (as opposed to the entirety of the investor's investment in the host country or the entire bundle of rights held under the contract), and then determined that the government's interference with that specific right constituted an expropriation.¹²⁶

3. "Expropriation Light" through FET

Importantly, measures that lack the severity necessary to render them expropriatory may nevertheless be deemed to violate the FET standard. Consequently, the FET obligation is sometimes described as "expropriation light". A narrowing of the expropriation obligation thus has not necessarily translated into a narrowing of state liability, as it has been accompanied by growth in the numbers of claims and successes under the FET standard.

C. Non-Discrimination – National Treatment and MFN Obligations

The great majority of investment treaties contain obligations to provide foreign investors/investments MFN treatment and national treatment. MFN treatment means that the host state is to treat the investor/investment of the home state no less favourably than it treats investors/investments from other countries. National treatment means that the host state is to treat the foreign investor/investment from the home state no less favourably than it treats domestic investors/investments.

Depending on how they are interpreted and applied, these obligations can potentially limit host states' authority to draw important distinctions between different investors or investments, even when done for non-discriminatory motives. Factors relevant to the impact these provisions have on domestic policy space include (1) whether a breach requires intent to discriminate against foreign investors/investments on account of their nationality; (2) how much latitude is given to governments to determine when foreign investors/investments are in "like circumstances" with their domestic counterparts, and therefore may not be given less favourable treatment; and (3) the role of the MFN provision in expanding treaty rights. These issues are discussed in more detail below.

¹²³ See, e.g., *Burlington v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, December 14, 2012, paras. 257-260 (siting other decisions).

¹²⁴ *Id.*, para. 260.

¹²⁵ *Biwater Gauff v. Tanzania*, ICSID Case No. ARB/05/22, Award, July 24, 2008.

¹²⁶ *Id.*, para. 489.

1. Discrimination “on account of” foreign nationality

Governments may have a number of valid reasons for treating individuals or entities differently. When enforcing laws and policies, for example, resource constraints preventing action against all offenders, the desire to “set examples” or target the worst offenders, and legitimate changes in policies may all be reasons why a government agency will pursue enforcement against one entity before (or without) pursuing similar action against another. These actions may harm a particular foreign firm relative to its domestic or other foreign competitors in the host country. Similarly, based on their design, certain measures may have unintended discriminatory impacts. By specially regulating a particular process or production method uniquely used by a particular foreign investor or investors, a measure may disadvantage their investments in the host country. If, as argued by a number of investors in cases to date, such selective enforcement or disparate impacts are deemed to constitute improper discrimination, the national treatment provisions may unduly restrict governments’ abilities to differentiate between investors or investments for legitimate non-intentionally discriminatory grounds.

Notably, a number of tribunals have held that an investor-claimant need not establish that the government *intended* to discriminate against it *on account of its nationality* in order for a breach of the non-discrimination obligation to be found.¹²⁷ Additionally, although some states such as Canada and the United States that have argued that discrimination must be “on account of” nationality in order to be barred under treaties’ national and MFN provisions, they have nevertheless given some indications that they do *not* believe an intent to discriminate must necessarily be shown. Pursuant to this standard, a mere disparate impact on a foreign investor may not be *sufficient* to establish liability under the non-discrimination obligations, but proof of discriminatory intent is also not *necessary*.

2. Identifying “Likeness”

Not all differentiation between investors and investments is illegitimate discrimination. Differences between investors/investments can appropriately warrant different treatment. The key issue is whether there are in fact differences that justify distinguishing between investors/investments and subjecting some to separate treatment, or whether investors/investments are in “like circumstances” such that no distinctions should be drawn.

The concept of “likeness” is difficult to discern in practice, and requires a case-by-case analysis of factors that may vary in the context of any particular dispute.¹²⁸ In some cases, the tribunal’s “like circumstances” analysis has been used to limit liability under the non-discrimination obligations and affirm that governments are able to implement measures distinguishing between investors and investments in appropriate cases, such as when different investment projects pose different threats to environmental protection, or serve different policy aims.¹²⁹ *Parkerings v. Lithuania*¹³⁰ and *UPS v.*

¹²⁷ Siemens v. Argentina, Award, 6 Feb. 2007, para. 321; Occidental Exploration and Production Co. v. Ecuador, Award, 1 July 2004, para. 177; S.D. Myers v. Canada, Award, 13 Nov. 2000, paras. 252-54. But see Methanex v. United States, Award, 3 August 2005, Section. IV, ch. B, para. 12 (“In order to sustain its claim under Article 1102(3), Methanex must demonstrate, cumulatively, that California intended to favour domestic investors by discriminating against foreign investors and that Methanex and the domestic investor supposedly being favored by California are in like circumstances.”).

¹²⁸ See, e.g., the pending dispute in Pacific Rim Cayman v. El Salvador, ICSID Case. No. ARB/09/12; Methanex Corp. v. United States, Final Award, 3 August 2005; S.D. Myers v. Canada, Partial Award, 13 November 2000.

¹²⁹ See, e.g., Parkerings-Compagniet AS v. Republic of Lithuania, ICSID Arb. Case No. ARB/05/8, Award, 11 Sept. 2007, paras. 392-396 (looking at environmental, cultural, economic and legal aspects of the investments when determining whether investors were in “like circumstances”).

¹³⁰ Id.

*Canada*¹³¹ are examples. In other cases, however, tribunals have lumped together investments/investors into rather broad groups, and have found that efforts by the government to differentiate among members of those groups violate the non-discrimination standards. In *Occidental v. Ecuador*, for example, the tribunal determined that all companies engaged in exports were in “like circumstances”, irrespective of those companies’ sectors or exports.¹³²

In addition to the factors a tribunal examines when assessing whether investments/investors are in “like circumstances,” the *level of deference* accorded by tribunals to governments’ own “like circumstances” analyses and consequent line drawing is highly relevant to the impact an investment treaty’s non-discrimination provisions will have on domestic policy.

3. Using the MFN Obligation to “Import” Treaty Protections

Some investor-state arbitrations filed and decided to date indicate that the MFN may be effectively ratcheting-up investors’ treaty protections and states’ treaty obligations by allowing investors to “import” those commitments on matters of scope, procedure, and substance from other agreements to which the host state is a party, altering the balance struck in carefully crafted and negotiated investment treaties.¹³³ Pursuant to this approach, an investor can scan the investment treaties (or potentially other treaties) the host state is party to, select more favourable clauses and protections in those other agreements, and use the MFN provision to benefit from those provisions that the governing treaty alone would have provided the investor. Some arbitral decisions have even suggested that when “importing” these enhanced rights and protections, the investors can unhinge them from their associated limitations and exceptions. This arguably enables investors to create a “super treaty” of strong protections that no country has been actually willing to conclude, but that the investors can craft by piecing together a patchwork of only the most favourable provisions of existing agreements.

Another issue with the MFN provision is that it can prevent countries from being able to reform and revise their treaty practice. If for instance, a country decided in 2013 to omit the FET obligation from its investment treaties due to the difficulty in assessing or controlling liability under that provision, investors covered under post-2013 investment treaties could nevertheless seek to use their agreements’ MFN provisions to pull in FET provisions from pre-2013 agreements.

D. Umbrella Clauses

The umbrella clause generally states that the host state must abide by any obligation entered into or owed to a covered foreign investor and/or investment. Key questions relevant to its impact on the host state are those relating to the scope and nature of “obligations” that are covered, the range of investors and/or investments entitled to invoke that obligation, and the type of conduct (i.e., commercial and/or sovereign) that it covers. The broader each is, the broader is the host state’s potential liability.

Umbrella clauses are particularly important in investments in infrastructure as there will commonly be some type of instrument – a specific contract, authorization, permit or license – between the government and investor relating to the project and setting forth various rights of and obligations owed to the investor and/or investment (as well as rights of and obligations owed to the state or state entity). An investor or investment may be able to use the treaty’s umbrella clause to enforce those rights and

¹³¹ *UPS v. Canada*, Award, 24 May 2007, paras. 173-181 (reasoning that in light of the “objectives and operations” of the government program at issue, the investors were not in “like circumstances”).

¹³² *Occidental v. Ecuador*, LCIA Arb. Case No. UN 3467, Award, 1 July 2004, paras. 168-173.

¹³³ See, e.g., *Maffezini v Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, 25 Jan. 2000.

obligations in addition to or instead of any other agreed forum or remedy;¹³⁴ the state, in contrast, does not have the ability to similarly initiate umbrella clause actions under the treaty and thus would be limited to bringing contract-based claims pursuant to the contractually specified procedure or otherwise applicable law.¹³⁵

1. Relevance of Privity

One important question litigated in investment disputes is that of who can invoke the umbrella clause and claim it is an obligee of the host state or host state entity? Must there be privity between the investor/claimant and the respondent state or state entity? The majority position¹³⁶ on seems to be that privity is required, meaning that the investor that is covered by the investment treaty cannot use the umbrella clause to enforce an obligation owed to one of its corporate affiliates,¹³⁷ or owed to it by a “public entity distinct from the state.”¹³⁸

But decisions also go the other way, allowing claimants to enforce contractual obligations in the absence of privity, such as when those obligations are owed to the claimant’s corporate parents, subsidiaries, or other affiliates.¹³⁹ Tribunals have allowed veil piercing in this context thereby expanding the claims investors can bring against states while generally disallowing it when doing so narrows jurisdiction.¹⁴⁰

2. Generality of Obligation

Some decisions have determined that umbrella clauses protect more than contractual or quasi-contractual obligations owed by a stated toward a specific investor or investment, but may also cover a broader set of state obligations¹⁴¹ such as “unilateral commitments arising from” the host state’s law.¹⁴²

¹³⁴ An exclusive forum selection clause in a contract, permit, or other document might not prevent the claimant from bringing purely contract-based claims under the treaty if there is an umbrella clause covering the obligation. See generally, e.g., *SGS v. Paraguay*, ICSID Case No. ARB/07/29, Decision on Jurisdiction, February 12, 2010, and Award, February 10, 2012.

¹³⁵ A state may, however, raise a contractual or quasi-contractual issue as a defense to an investor’s umbrella clause claim; moreover, some tribunals have allowed states to bring counter-claims. That approach, however, is not yet widespread nor will it necessarily be accepted. Two recent decisions reached opposite results on the issue: *Roussalis v. Romania*, ICSID Case No. ARB/06/2, Award, December 7, 2011, paras. 859-877 (in which the majority found there was no jurisdiction over counterclaims); and *Goetz v. Burundi*, ICSID Case No. ARB/01/2, Award, June 21, 2012, para. 281 (finding jurisdiction over counterclaims).

¹³⁶ This is based on the tribunal’s finding in *Burlington v. Ecuador*,

¹³⁷ See, e.g., *Burlington Resources, Inc. v. Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, paras. 233-234; *Azurix v. Argentina*, Award, July 14, 2006, para. 384; *Siemens v. Argentina*, Award and Separate Opinion, February 6, 2007, para. 204; and *CMS Gas Transmission Company v. Argentina*, Decision of the Ad Hoc Committee on the Application for Annulment, September 25, 2007, para. 95.

¹³⁸ *Gustav Hamester v. Ghana*, Award, June 18, 2010, para. 580.

¹³⁹ *Continental Casualty Company v. Argentina*, Award, September 5, 2008, para. 297; *CMS v. Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction, July 27, 2008.

¹⁴⁰ See *supra*, Section II(B)(1).

¹⁴¹ See, e.g., *Continental Casualty v. Argentina*, paras. 297-302; *LG&E Energy Corp. v. Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, October 3, 2007, para. 175.

¹⁴² *Continental Casualty v. Argentina*, para. 301. The tribunal in *Continental Casualty* limited its holding by saying that not all provisions found in law would constitute obligations enforceable under the umbrella clause. Rather, there must be some measure of specific – e.g., the law must govern a particular business sector and be addressed to foreign investors in that sector. The tribunal in *SGS Société Générale de Surveillance S.A. v. Paraguay*, ICSID Case No. ARB/07/29,

3. Nature of Conduct Constituting Breach

The umbrella clause can and has been used to challenge conduct that is sovereign and commercial in nature.

i. Sovereign Conduct

Decisions addressing umbrella clause challenges to sovereign conduct indicate that laws, decrees, regulations, judicial decisions or other government actions or omissions that intentionally or incidentally interfere with contractual or other obligations owed to the investor or investment can breach the standard.

Thus, when the existence of an obligation or commitment is found, whether that obligation is under law or contract, a government's subsequent change to its legal regulatory framework can give rise to a breach of the umbrella clause irrespective of such potentially exculpatory considerations as whether that change to the legal or regulatory framework was a measure of general applicability taken in good faith and with only incidental, rather than intentional, impacts on the investor.

In this sense, liability under the umbrella clause can overlap with liability under the FET obligation as tribunals have increasingly read the latter to provide similar protections as the former. More specifically, as discussed further below, tribunals have said that general changes in the law that interfere with a "specific commitment", or contractual or "quasi-contractual" promise to an investor can be a breach of the FET obligation even when those changes were a result of measures of general applicability and not taken in bad faith or designed to hurt the specific investor or investment. Thus the FET obligation has played the role of an umbrella clause provision, with both clauses allowing challenges of sovereign acts that interfere with contract performance irrespective of whether the relevant action was taken in bad faith or was an abuse of law.

ii. Commercial Conduct and Impact on Contractual Forum Selection Clauses

While some tribunals, states and commentators have contended that only sovereign conduct can give rise to a breach of the umbrella clause provision,¹⁴³ many others have asserted that the provisions can also be used to address purely commercial conduct.¹⁴⁴

One issue that has arisen with tribunals using the umbrella clause to take jurisdiction over pure contract claims under the treaty is whether and how that affects or is affected by an exclusive forum selection clause in that contract. According to some tribunals, exclusive contractual forum selection clauses do not waive, override or otherwise affect investors' rights to use the umbrella clause to bring contract claims under the treaty.¹⁴⁵ Yet other tribunals have adopted a different approach, holding that investors are generally bound by the contractually chosen forum, but may bring a claim under the

(Contd.) _____

Decision on Jurisdiction, February 12, 2010, para. 167, more vaguely stated that the provision applies to all commitments "whether established by contract or by law, unilaterally or bilaterally, etc."

¹⁴³ SGS Société Générale de Surveillance S.A. v. Pakistan, ICSID Case No. ARB/01/13, Decision on Jurisdiction, August 6, 2003, paras. 166-167.

¹⁴⁴ See, e.g., SGS v. Paraguay, Decision on Jurisdiction, paras. 167-168; SGS v. Paraguay, Award, February 10, 2012, paras. 71-73; SGS v. Philippines, ICSID Case No. ARB/02/6, Decision on Jurisdiction, January 29, 2004, paras. 114-28; Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC B.V. v. Paraguay, ICSID Case No. ARB/07/9, Decision on Jurisdiction, paras. 134-42.

¹⁴⁵ See, e.g., SGS v. Paraguay, Decision on Jurisdiction, paras. 142, 167, 172-173; SGS v. Paraguay, Award, para. 75;

treaty if unable to secure justice through that route,¹⁴⁶ or if the contract clearly reflects the contracting parties' intent to waive treaty-based claims.¹⁴⁷

PART TWO: INTERPLAY BETWEEN SUBSTANTIVE STANDARDS OF TREATY PROTECTION AND GOVERNANCE OF PRIVATE INVESTMENT IN INFRASTRUCTURE

V. Entering into the Deal – Tenders and Negotiations

Contracts for infrastructure development are awarded through tenders, negotiations, or a combination of the two. These pre-project activities can require great expenditure of time and resources. During these phases, expectations begin to be developed that may later be met, or frustrated. And when it is the latter, disputes can arise. Not surprisingly, a number of investment arbitrations have dealt with this pre-deal phase, pronouncing on the circumstances under which states can be liable for deals that do not materialize, and to would-be partners who are not selected for a particular project. Additionally, cases have addressed circumstances in which conduct by a state or state entity during the tender and negotiation phase may later come back to haunt the government when the deal does not go as the investor had expected.

In essence, as is illustrated in more detail below, these disputes reveal notable differences in the degrees of scrutiny tribunals will apply to a host state's laws and conduct – a factor impacting liability that is difficult to control and even more difficult to correct given limited avenues for review of arbitral awards. Additionally, the disputes suggest a need for governments to be careful not to overpromise and to clearly communicate disclaimers, reservations, reasoning and stances. Following these guidelines in practice, however, may be difficult and resource-intensive, and can potentially put governments at a disadvantage when trying to negotiate deals.

The six disputes examined in this section have arisen out of tenders and negotiations where the foreign investor seeks relief for its denied applications or failed projects: *Lemire v. Ukraine*¹⁴⁸ (tenders for radio frequencies); *Parkerings v. Lithuania*¹⁴⁹ (tender for development and operation of parking infrastructure and operations); *F-W Oil v. Trinidad and Tobago*¹⁵⁰ (tenders and negotiations for a contract to develop offshore oil resources); *PSEG v. Turkey*¹⁵¹ (negotiations for development of a mine and electricity generation project); and *Nordzucker v. Poland*¹⁵² (negotiations for purchase of state-owned companies through privatization process); *Mihaly v. Sri Lanka*¹⁵³ (negotiations for development of power plant).

¹⁴⁶ BIVAC v. Paraguay, ICSID Case No. ARB/07/9, Further Decision on Objections to Jurisdiction, October 9, 2012, May 29, 2009, paras. 287-292; SGS v. Pakistan, Decision on Jurisdiction, para. 168.

¹⁴⁷ See Aguas del Tunari v. Bolivia, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, October 21, 2005, para. 119; see also SGS v. Paraguay, Decision on Jurisdiction, para. 180.

¹⁴⁸ Joseph Charles Lemire v. Ukraine, ICSID Case No. ARB/06/18, Award, March 28, 2011. See also Lise Johnson, "Majority Tribunal Defends Decision in Lemire v. Ukraine," *Investment Treaty News* (July 12, 2011).

¹⁴⁹ Parkerings-Compagniet AS v. Republic of Lithuania, ICSID Case No. ARB/05/8, Award, Sept. 11, 2007.

¹⁵⁰ F-W Oil Interests, Inc. v. Republic of Trinidad and Tobago, ICSID Case No. ARB/01/14, Award, March 3, 2006.

¹⁵¹ PSEG v. Turkey, ICSID Case No. ARB/02/5, Award, January 19, 2007.

¹⁵² Nordzucker v. Poland, Partial Award, December 10, 2008; Second Partial Award, January 28, 2009; and Third Partial and Final Award, November 23, 2009.

¹⁵³ Mihaly International Corp. v. Sri Lanka, ICSID Case No. ARB/00/2, Award, March 15, 2002.

A. Liability for Rejected Bids

Two cases involving claims for state liability arising out of rejected bids or proposals are *Lemire* and *Parkerings*. They illustrate both that foreign individuals and entities can use investment treaties to contest adverse decisions; and that, although outcomes are difficult to predict, tribunals seem to want some showing that the government had legitimate reasons for its decisions.

Lemire involved the claims of a US investor that had established a company in Ukraine in the mid-1990s to invest in that country's recently privatized radio broadcasting industry. According to *Lemire*, he had discussed his business plans with members of the government entity responsible for granting broadcasting licenses and those members, in turn, had encouraged his efforts. After successfully obtaining some radio frequencies early in his operations, *Lemire* contended that from 1999 through 2008 the Ukrainian government frustrated his "legitimate expectations" by repeatedly and improperly rejecting his roughly 200 applications to acquire additional broadcasting licenses and develop several nationwide radio networks. *Lemire* asserted that the manner in which the government ran its tenders and its decisions to award licenses to other bidders violated the FET obligation in the investment treaty between the United States and Ukraine.

Notably, although *Lemire* could have pursued domestic remedies to challenge the tender decisions, and had previously successfully brought other claims against the government before Ukrainian courts, he chose not to pursue that path to contest the allegedly wrongful tender processes and decisions, deciding instead to challenge the government's administrative conduct through arbitration under the treaty.¹⁵⁴ The relevant remedies offered by the two different litigation strategies seem to have influenced that strategic choice: under domestic law, the remedy for an improper tender would be the set aside of the tender decision and a repeat of the tender process under which the claimant would presumably have had no greater chance of success; under the treaty however, the claimant could and did seek compensation including the future lost profits he expected to receive had he had obtained his sought-after licenses.¹⁵⁵

In its defense, the government asserted that the state entity responsible for the tender processes justifiably awarded frequencies to other applicants. The government explained that *Lemire's* company lacked the necessary resources and capabilities to prevail in its applications, and that other bidders were more qualified. It noted that in one of the bids *Lemire* claimed to have wrongfully lost, his company had not even participated in the tender. Additionally, according to Ukraine, even if the tender processes suffered from some irregularities, *Lemire* could not establish he would have been successful in his applications "but for" those problems.

The majority of the arbitrators sided with *Lemire* on his FET claim. Looking first to the meaning of the FET obligation, they determined it represented a heightened "autonomous" standard that guaranteed foreign investors better treatment than they were entitled to under customary international law.¹⁵⁶

Applying that standard, the tribunal concluded that the tender process was irregular, arbitrary, and discriminatory, and ultimately frustrated *Lemire's* "undoubtedly ... legitimate expectations" that he would be able to expand his investment in Ukraine's broadcasting industry (even though he had no formal business plan detailing that aim).¹⁵⁷ Three key factors appeared to lead the tribunal to its conclusion: first was its view that the processes were "tainted by interferences from other political organs of [the state], including the President of Ukraine,"¹⁵⁸ second was the fact that the government

¹⁵⁴ Id. at para. 274.

¹⁵⁵ Id. at para. 281.

¹⁵⁶ Id. at paras. 256-264.

¹⁵⁷ Id. at paras. 268-69.

¹⁵⁸ Id. at paras. 214, 288-292.

entity running the bids did not record or publish its evaluation of required criteria or the reasons for its decisions (nor was it required to do so under the law), preventing it from countering Lemire's arguments that the decision-making was improper;¹⁵⁹ and third was the absence of any requirement in law, regulation or practice for companies bidding for tenders to disclose their ultimate and beneficial owners – a factor that, according to the tribunal, “clearly represent[ed] a shortcoming of the system”.¹⁶⁰ The tribunal concluded that “[w]hile none of the above features alone stigmatizes the entire process as arbitrary, there is a risk that the shortcomings may end up mutually reinforcing each other.”¹⁶¹

Overall, the decision in *Lemire* reflects heavy scrutiny of Ukraine's laws, regulations and practices, and little deference to administrative processes or decisions. Additionally, by taking a “totality of the circumstances” approach, the tribunal was able to find against the state even though no individual act, omission, or procedural shortcoming, standing alone, would have necessarily supported liability. This approach favors investors as it broadens the grounds on which they can mount successful claims. Ukraine subsequently sought annulment of the award; but in a decision that is not publicly available, the ICSID ad hoc annulment committee rejected that request and allowed the award to stand.¹⁶²

Like the claimant in *Lemire*, the claimant in *Parkerings* sought relief for, inter alia, its rejected investment efforts. In *Parkerings*, the claimant alleged that the government's decision to reject its plans to construct a parking facility in the historic center of Lithuania's capital, Vilnius, and to select a competing bid from another foreign investor, breached the treaty's MFN obligation. The tribunal found otherwise, concluding that the specific features of the two competing projects, and the public opposition to the claimant's proposal in particular, supported the government's decision not to accept the project. The tribunal reasoned:

[D]espite similarities in objective and venue, the Tribunal has concluded, on balance, that the differences of size of Pinus Proprius and BP's projects, as well as the significant extension of the latter into the Old Town near the Cathedral area, are important enough to determine that the two investors were not in like circumstances. Furthermore, the Municipality of Vilnius was faced with numerous and solid oppositions from various bodies that relied on archaeological and environmental concerns. In the record, nothing convincing would show that such concerns were not determinant or were built up to reject BP's project. Thus the City of Vilnius did have legitimate grounds to distinguish between the two projects. Indeed, the refusal by the Municipality of Vilnius to authorize BP's project in Gedimino was justified by various concerns, especially in terms of historical and archaeological preservation and environmental protection. These concerns are peculiar to the extension of BP's project in the Old Town and thus could justify different treatment with Pinus Proprius. In the absence of convincing evidence that Pinus Proprius benefited from a more favourable treatment in terms of administrative requirement, the Arbitral Tribunal finds that the Claimant failed to demonstrate a discrimination concerning the Gedimino car park.¹⁶³

For liability to attach, the tribunal thus required the claimant to provide convincing evidence that the city's concerns regarding and in opposition to its proposed project were pretextual and that the other project was not subject to the same administrative requirements. Its decision in favor of the government thus seems to reflect a deference to the government that is not present in *Lemire*: In *Parkerings*, the claimant clearly had the burden of proving that the rationale behind and outcome of the government's decisions were wrongful, while in *Lemire* the tribunal's decision on liability seemed

¹⁵⁹ Id. at paras. 301-312.

¹⁶⁰ Id. at paras. 313-314.

¹⁶¹ Id. at para. 316.

¹⁶² Michail Dekastros and Luke Eric Peterson, “ICSID Annulment Committees Decline to Annul Arbitral Awards in *Malicorp v. Egypt* and *Lemire v. Ukraine*,” *Investment Arbitration Reporter* (July 10, 2013).

¹⁶³ *Parkerings v. Lithuania*, para. 396.

to hinge in significant part on the government's failure to record and inability to adequately establish the reasoning for its decisions. The cases thus illustrate that foreign investors can use investment treaties as an alternative or additional avenue through which to challenge failed bids or tenders, but also highlight the difficulty in assessing, *ex ante*, what type of conduct will give rise to liability and what proof is necessary to establish breach.

B. Liability for Failed Negotiations

Several cases address circumstances in which bilateral negotiations for public-private infrastructure (and other projects) have collapsed. One example of the circumstances in which this breakdown has led to state liability under an investment treaty is the dispute in *PSEG v. Turkey*.

In 1994, the Turkish parliament passed a law allowing the government to enter into private law contracts for the development of power projects; under this private law model, the power project contracts could include provisions providing for dispute settlement in international arbitration. The contracts could also be entered into without the need for approval by the Turkish Council of State (the "Danistay") that had traditionally been required for concession contracts.

After passage of that new law, PSEG proposed a mining and power plant project to the Turkish Ministry of Mines and, in 1995, secured government approval of its feasibility study. Prior to conclusion of any contract for that project, however, the Turkish Constitutional Court ruled that power projects such as the one proposed by PSEG could not fall under the private law framework, but had to follow the traditional concession contract model and be approved by the Danistay.

The government of Turkey and PSEG subsequently concluded an "Implementation Contract" based on the feasibility study and submitted it for approval to the Danistay in 1996. Nevertheless, while that review and approval process was pending, PSEG was simultaneously seeking changes to the economic terms of the Implementation Contract and feasibility study based on a revised mining plan that it had developed. More specifically, PSEG's updated mining plan reflected higher costs for the mine than had previously been anticipated and PSEG proposed that those costs would be met by increasing the amount of electricity the project would generate and the amount the government would be obligated to buy. Additionally, PSEG proposed structuring the investment through a different corporate vehicle, with the new approach designed to free it from having to pay over USD 250 million in taxes to Turkey over the life of the project.

In March 1998, the Danistay signed off on the Implementation Contract, approving it as a Concession Contract that largely incorporated the economics and other plans envisaged in the Implementation Contract and feasibility study, but striking out a clause providing for ICSID arbitration of disputes. But that approval did enable the project to move ahead as the parties had still not reached agreement on the new terms needed by PSEG in light of the revised mine plan. Key elements of the project such as the plant's generating capacity, the required government take, the company's corporate form, and appropriate tariffs, all remained unsettled.

Ultimately, the situation appears to have become intractable, with the parties unable to agree on terms acceptable to either side. A few final triggers seem to have exacerbated disagreements and brought the collapse of the negotiations. First, after the tax law was changed to remove the roughly USD 250 million tax burden associated with incorporation in Turkey, PSEG nevertheless continued to demand compensation for those alleged tax payments even though it no longer had to make them. Second, when, in January 2000, Turkish law was changed to allow parties to apply for permission to convert concession contracts to private law contracts allowing arbitration, the Ministry of Mines indicated it would only allow PSEG to seek that change if a number of other modifications to the contract were made. Third, changes in domestic law and policy regarding government support of power projects caused the government to back away from issuing a previously contemplated – but not

yet concluded – treasury guarantee that could have resulted in Turkey taking on significant potential costs and liabilities.

After the negotiations collapsed, PSEG initiated arbitration, seeking as damages amounts invested and lost future profits from the project.

The tribunal sided with PSEG on its claim that Turkey’s conduct violated the FET standard. In doing so, it announced a standard that gives broad pre-contractual rights to investors while correspondingly imposing on states significant pre-contractual obligations.

246. The Tribunal is persuaded ...that the fair and equitable treatment standard has been breached, and that this breach is serious enough as to attract liability. Short of bad faith, there is in the present case first an evident negligence on the part of the administration in the handling of the negotiations with the Claimants. The fact that key points of disagreement went unanswered and were not disclosed in a timely manner, that silence was kept when there was evidence of such persisting and aggravating disagreement, that important communications were never looked at, and that there was a systematic attitude not to address the need to put an end to negotiations that were leading nowhere, are all manifestations of serious administrative negligence and inconsistency. The Claimants were indeed entitled to expect that the negotiations would be handled competently and professionally, as they were on occasion.

247. Secondly, there is a breach of the obligation to accord fair and equitable standard of treatment in light of abuse of authority, evidenced in particular, but not exclusively, by the discussion of [PSEG’s application to convert the contract to a private law contract]. As noted above, [the government’s] demands for a renegotiation went far beyond the purpose of the Law and attempted to reopen aspects of the Contract that were not at issue in this context or even within [the government’s] authority.

248. Inconsistent administrative acts are also evident in this case in respect of some matters. ... A witness for the Claimants testified that since 1996 “the various groups determining energy policy in Turkey have not worked harmoniously.”

...

250. Thirdly, the Tribunal also finds that the fair and equitable treatment obligation was seriously breached by what has been described above as the “roller-coaster” effect of the continuing legislative changes. This is particularly the case of the requirements relating, in law or practice, to the continuous change in the conditions governing the corporate status of the Project, and the constant alternation between private law status and administrative concessions that went back and forth. This was also the case, to a more limited extent, of the changes in tax legislation.

...

254... Stability cannot exist in a situation where the law kept changing continuously and endlessly, as did its interpretation and implementation. While in complex negotiations, such as those involved in this case, many changes will occur beyond the control of the government, as was particularly the case with the increased costs, the issue is that the longer term outlook must not be altered in such a way that will end up being no outlook at all. In this case, it was not only the law that kept changing but notably the attitudes and policies of the administration.¹⁶⁴

The tribunal’s decision thus imposed treaty liability on Turkey for “negligent” or inattentive conduct during contract negotiations, and for changes in background law impacting a contract even before the essential terms of that contract had been agreed. The *PSEG* decision instructs that governments may be penalized for letting negotiations drag on when they are ambivalent about projects, and that they might also be found to breach their treaty obligations by shifting policies that cause them to walk away from deals even though those deals had yet to crystallize.

¹⁶⁴ PSEG v. Turkey, paras. 246-250 (internal citations omitted).

C. Requirements for Vesting and Enforceability

As the *Lemire* and *PSEG* show, tribunals have been sympathetic to investors' claims that they have expended considerable resources participating in negotiations and tenders that ultimately fail to produce a contract or project. Yet despite similarly holding such sympathies, other tribunals have declined to find pre-contract and pre-project expenditures constitute "investments", particularly when the government has made clear its intent not to be legally bound by or owe any obligations as a result of those preliminary steps.

The tribunal in *Mihaly v. Sri Lanka* is an example, finding that the claimant had not made an "investment" within the meaning of the investment treaty or ICSID Convention even though it had made significant, but ultimately unsuccessful, efforts to develop a power plant in Sri Lanka. The tribunal explained that the scope of the claimant's rights were clearly limited:

47. Ultimately, there was never any contract entered into between the Claimant and the Respondent for the building, ownership and operation of the power station.

48. It is in this factual setting that the Tribunal has been asked to consider whether or not, the undoubted expenditure of money, following upon the execution of the Letter of Intent, in pursuit of the ultimately failed enterprise to obtain a contract, constituted "investment" for the purpose of the Convention. The Tribunal has not been asked to and cannot consider in a vacuum whether or not in other circumstances expenditure of moneys might constitute an "investment". A crucial and essential feature of what occurred between the Claimant and the Respondent in this case was that first, the Respondent took great care in the documentation relied upon by the Claimant to point out that none of the documents, in conferring exclusivity upon the Claimant, created a contractual obligation for the building, ownership and operation of the power station. Second, the grant of exclusivity never matured into a contract. To put it rhetorically, what else could the Respondent have said to exclude any obligations which might otherwise have attached to interpret the expenditure of the moneys as an admitted investment? The operation of SAEC was contingent upon the final conclusion of the contract with Sri Lanka, thus the expenditures for its creation would not be regarded as an investment until admitted by Sri Lanka.

...

51. It is an undoubted feature of modern day commercial activity that huge sums of money may need to be expended in the process of preparing the stage for a final contract. However, the question whether an expenditure constitutes an investment or not is hardly to be governed by whether or not the expenditure is large or small. Ultimately, it is always a matter for the parties to determine at what point in their negotiations they wish to engage the provisions of the Convention by entering into an investment. Specifically, the Parties could have agreed that the formation of a South Asia Electricity Company was to be treated as the starting point of the admitted investment, engaging the responsibility of the Respondent for the Claimant's failure to complete other arrangements to achieve the milestones by the due date mentioned in the Letter of Extension. The facts of the case point to the opposite conclusion. The Respondent clearly signaled, in the various documents which are relied upon by the Claimant, that it was not until the execution of a contract that it was willing to accept that contractual relations had been entered into and that an investment had been made....¹⁶⁵

To the tribunal, the fact that Sri Lanka had expressly disclaimed any legal obligations arising out of contract negotiations was key. Sri Lanka had entered into a Letter of Intent, Letter of Agreement, and Letter of Extension with the claimant; and, although each of those instruments affirmed the parties' commitments to develop the project, each document also plainly stated that it did not create obligations binding on either party. Based on those facts, the tribunal stated:

59. The Tribunal concludes in regard to the three Letters of Intent, of Agreement and of Extension successively issued by and on behalf of the Government of Sri Lanka in the course of 1993 and 1994 that none of these Letters contains any binding obligation either on Sri Lanka or on the

¹⁶⁵ *Mihaly v. Sri Lanka*, paras. 47-51.

Claimant. As the Tribunal has already stated, in the circumstances of this case, they are not to be treated in any way as signifying acceptance by the host State, Sri Lanka, of such expenditures as constituting an investment within the sense of the Convention. There is no evidence which could contradict the contingent and non-binding character of the three Letters of Intent, of Agreement and of Extension.

60. The Tribunal is of the view that *de lege ferenda* the sources of international law on the extended meaning or definition of investment will have to be found in conventional law or in customary law. The Claimant has not succeeded in furnishing any evidence of treaty interpretation or practice of States, let alone that of developing countries or Sri Lanka for that matter, to the effect that pre-investment and development expenditures in the circumstances of the present case could automatically be admitted as “investment” in the absence of the consent of the host State to the implementation of the project. It should be observed that while the US-Sri Lanka BIT contains provisions regarding the definition of investment and conditions for its admission, they recognize the Parties’ prerogative in this respect.¹⁶⁶

A similar outcome to *Mihaly v. Sri Lanka* can be seen in *F-W Oil v. Trinidad and Tobago*. There, the claimant likewise initiated the investment arbitration in order to challenge dashed expectations from a deal that never materialized. Its claims failed as the tribunal scrutinized the enforceable rights and expectations the claimant actually held regarding the potential project.

F-W Oil had been selected as the winning bidder in a tender for a service contract to develop offshore oil resources. After being awarded the tender, it entered into negotiations with the state-owned oil company, Trinmar, to conclude the deal. Roughly five months after awarding F-W Oil the tender, Trinmar notified F-W Oil that it was withdrawing from the negotiations. Trinmar later launched a new bidding process in which F-W Oil declined to participate (and which was later aborted). The disappointed company sought relief under the investment treaty between the United States and Trinidad and Tobago, asking for a return of sunk costs and payment of lost future profits.

According to the claimant, it had several protected “investments” under the treaty’s wide definition of the term. In particular, the claimant argued that it had made investments under the investment treaty and ICSID Convention through its investment of time, money and expertise in the tender process and during the negotiations; its alleged contractual rights arising under local law as a result of the tender process; and its contribution of intellectual property to the project.¹⁶⁷ The tribunal rejected all of those claims and, in doing so, gave some guidance to states on how they might similarly be able to avoid liability.

Importantly, the tribunal’s reading of the term “investment” led it to conclude that the treaty only covered rights held under domestic law, and not merely expectations or interests:

[T]he notion of an “investment” ..., the axis around which the operation of the BIT revolves, can only realistically be understood as referring to something in the nature of a legal right or entitlement. This appears clearly enough from the extensively itemized definition of “investment” in Article 1(d) quoted above, each item in which is either a form of property or is expressed as a “right”. It is admittedly the case that the definition given in Article 1(d) is on its own terms not exhaustive; it is expressed merely to ‘include’ the forms of investment itemized on the list. The common thread is nevertheless so strong that the Tribunal is unable to conclude that the intention can have been to bring within the scope of the term claims other than those based on proprietary or contractual rights, which, in the Tribunal’s view, corresponds in any event to the whole underlying notion of an “investment”. Further weighty support for this interpretation of the BIT can be drawn from Articles II, III, IV & V, which lay down the main substantive protections to be accorded by each part to “covered investments”, such as national and most-favoured-nation treatment, fair and equitable treatment, full protection and security, protection against arbitrary expropriation, freedom to make transfers, and so forth. It would be difficult, or even impossible, to apply these

¹⁶⁶ *Mihaly v. Sri Lanka*, paras. 59-60.

¹⁶⁷ *F-W Oil*, para. 108.

standards in any meaningful way to claims falling short of actual proprietary or contractual rights.¹⁶⁸

Looking first at whether the investor's pre-contract expenditures constituted investments, the tribunal stated that if rights to recover such costs existed, the claim would need to exist under the law of Trinidad and Tobago. There would be no "valid claim under the BIT without a showing that the domestic-law right of action qualifies as an "investment."¹⁶⁹

This approach – which relies on domestic law (including its contract law) to define the scope of rights protected as "investments" under the treaty, appears narrower than that of other tribunals that emphasize the need to protect investors' "expectations" from interference even if they would not have qualified as vested and enforceable rights under applicable domestic law.¹⁷⁰

The tribunal concluded that there were "insurmountable" hurdles to the claimant's case on pre-contract expenditures. Namely, the terms of the bid provided that Trinmar, the state-owned company, would not be responsible for costs or expenses incurred by bidders in connection with the preparation, submission and presentation of bid proposals. In the letter awarding the tender, Trinmar had stated the "award was made subject to the negotiation and execution of a mutually agreeable operating agreement."¹⁷¹ And, after it was awarded the tender, F-W Oil had unsuccessfully requested a liquidated damages clause under which it could be paid a sum of not more than \$10 million if the parties failed to reach a final agreement. Trinmar responded to that request by expressly disclaiming liability for "any costs or expenditures incurred by F-W Oil Interests prior to the execution of a contract on this tender."¹⁷² The tribunal concluded that these facts left

no room for the law to imply a right of repayment, which was expressly requested and expressly refused. As in the normal tendering situation FWO undertook the expenditure at its own risk....In these circumstances we reject the proposition that FWO had a legally enforceable claim for reimbursement under the law of Trinidad and Tobago. By the same token we are unable to agree that FWO's preparatory expenditure constituted an "investment" for the purposes of the BIT or the [ICSID] Convention.¹⁷³

Second, the tribunal assessed whether F-W Oil had an "investment" due to its alleged contractual right to have Trinmar negotiate in good faith to conclude an agreement after F-W Oil had won the tender.¹⁷⁴ It reasoned that it was "far from clear that an intermediate obligation of the nature presupposed, being concerned only with negotiating methods and not substantive rights, could rank as an 'investment' for the purpose of conferring jurisdiction on the present Tribunal."¹⁷⁵ In other words, even if F-W Oil had a contractual right to have Trinmar negotiate in good faith, that did not constitute an "investment" under the treaty.

Finally, the tribunal similarly rejected F-W Oil's arguments that it had an "investment" through the intellectual property (e.g., confidential plans and economic models) it had developed and submitted in connection with its tender offer, and that that investment was later appropriated by the government to use as its second tender. It stated that F-W Oil's pre-contract plans and models did not constitute investments; moreover, the tribunal added, the claimant provided no evidence that it had suffered any

¹⁶⁸ Para. 125.

¹⁶⁹ Para. 142.

¹⁷⁰ On this issue, see also *Micula v. Romania*, ICSID Case No. ARB/05/20, Separate Opinion of Georges Abi-Saab, December 5, 2013, paras. 2-3.

¹⁷¹ Para. 90.

¹⁷² Paras. 90 & 143.

¹⁷³ Paras. 144-145.

¹⁷⁴ *Id.* at para. 175.

¹⁷⁵ *Id.* at para. 183 (emphasis in original).

specific loss as a result of any alleged misappropriation of that intellectual property by the government.¹⁷⁶

D. Damages for Failed Negotiations and Tenders

Once a tribunal finds a government is liable for pre-project conduct, it then moves into an assessment of damages. In *Lemire*, the tribunal awarded Lemire nearly USD 9 million in compensation and costs, plus interest. This tribunal determined that this amount included the funds Lemire's company would have earned if Ukraine's tender procedures had not been characterized by shortcomings and Lemire had been able to secure his licenses and proceed with the plans he had when he invested in the country in 1995.

One of the arbitrators in *Lemire*, however, dissented, taking issue with various aspects of the majority's ruling including its decision to award lost future profits. On the issue of damages, he argued that if any were awarded, they should have been limited to the amount expended during the bid processes, a measure of compensation applied in Ukraine and other domestic jurisdictions. In *PSEG*, as compensation for breach of the failed negotiations, and over respondent's objection that no compensation was due because no ground had been broken for the mine nor construction started on the power plant, the tribunal ordered the government to compensate the investor for costs expended from the submission of its feasibility study through continued negotiations in the effort to develop the project. All expenses were entirely pre-construction, many pre-Implementation Contract, and many were also prior to the Dinastay's approval of the Concession Contract. In all, the tribunal declared that Turkey had to pay PSEG USD 9 million plus interest, and bear 65% of the roughly USD 21 million in arbitration costs.

*Nordzucker AG v. Poland*¹⁷⁷ reflects a different approach. The case shares some features with *PSEG* and *Lemire* in granting the investor pre-contract protections. In particular, the tribunal stated that the government did not treat the claimant fairly and equitably by failing to diligently manage a privatization process and being insufficiently transparent in negotiations with an investor over roughly the last six months of a year-long attempt by the investor to purchase government assets. According to the tribunal, the government should have been clearer with the investor when its views about the sale shifted: it should have better communicated to the investor that the price the investor had offered was too low, and that political opposition to the privatization (particularly at the sale price being contemplated) prevented the government from accepting the investor's proposal.

In contrast to *PSEG* and *Lemire*, however, the *Nordzucker* tribunal appeared to take a stricter approach to awarding compensation. In its decision on damages, *Nordzucker* tribunal rejected the claimant's claims for both future lost profits and for costs expended in unsuccessfully pursuing the deal. On the first issue, claimant failed to establish that it would have been able to close the deal had the government complied with its treaty obligations and been more transparent about its position. The tribunal emphasized that the government had broad rights under the law to reject proposed transactions and did not have to give reasons for its decisions to approve or deny deals. Instead of reviewing the government's decision and analyzing who should have been awarded the contract through an open and adequate process, the tribunal focused on the fact that the government's ability to reject any transaction under the law meant that the claimant had no right to the assets and could not recover for that lost opportunity.

On the second issue, the tribunal stated that the claimant failed to adequately indicate what costs and losses it specifically incurred over the roughly six months that the negotiations were unduly prolonged by the government's negligent and non-transparent conduct. Accordingly, the tribunal did

¹⁷⁶ Id. at para. 185.

¹⁷⁷ *Nordzucker v. Poland*, UNCITRAL, Partial Award, November 23, 2009.

not order the government of Poland to pay the investor any compensation, and did require the investor to reimburse Poland for the government's costs in having to respond to the claimant's claims for "lost opportunity" damages.

Together, these cases illustrate that tribunals do not view themselves as being limited in terms of the damages they can order for failed negotiations and tenders. In addition to awarding compensation for expenses incurred when participating in wrongfully conducted processes, tribunals also appear open to issuing awards to of lost profits for failed negotiations and tenders, though they take different approaches regarding what they will require of claimants in order to successfully recover those damages. Importantly, this opens up a road for damages that at least some authorities indicate goes beyond what is and should be permitted under domestic systems. The Legislative Guide for Privately Financed Infrastructure developed by the United Nations Commission on International Trade Law (UNCITRAL), for instance, describes a different approach. It notes that establishing a mechanism for review of tender procedures and awards constitutes best practice, and different legal systems have developed a variety of mechanisms and processes through which to facilitate that review including judicial or administrative review, or judicial review after opportunities of administrative relief had been exhausted. On the issue of appropriate damages, it states:

Except where a project agreement was the result of unlawful acts, a good solution is that a judgement should not render the project agreement void, but award damages to the injured party. It is usually agreed that such damages should not include loss of profits, but be limited to the cost incurred by the bidder in preparing the bid.¹⁷⁸

UNCITRAL's recommendation highlights that tribunals' decisions on damages in investor-state cases do not necessarily correspond with common or recommended domestic practices for how to compensate potential investors and/or sanction government actors for flawed negotiating and tender procedures. Absent language in the relevant treaty instructing tribunals what types of relief may and may not be awarded, the system of treaty-based investor-state arbitration makes it extremely difficult for states to prevent these types of damages being ordered in a case or to challenge them subsequently.

E. The Role of Treaty Language - Pre- and Post- Establishment Agreements

The majority of treaties only govern states' treatment of *established* investments. Only a minority goes beyond that and expressly covers the *establishment, acquisition and expansion* of investments by foreign investors. Even those, however, tend to only apply the establishment/acquisition/expansion protections to certain treaty obligations, namely the non-discrimination obligations and the restrictions on performance requirements. The FET obligation and provisions on expropriation generally are solely directed at covered "investments", signaling that the treaty parties did not intend them to extend to pre-establishment or expansion phases.¹⁷⁹

Yet the fact that treaties are largely restricted to providing post-establishment coverage and protections, has not proven a barrier to claims relating to pre-project activities and expenditures. This section briefly discusses how the underlying treaty's approach to pre-establishment and post-

¹⁷⁸ UNCITRAL, Legislative Guide on Privately Financed Infrastructure Projects (2001).

¹⁷⁹ This conclusion is based on a review of many, though not all, agreements that do provide for pre-establishment protections such as agreements concluded by the United States, Canada, and Japan with third countries. The 2012 US Model BIT, for example, covers any "investor" that "attempts to make, is making, or has made an investment", thereby extending to pre-establishment activities. (Article 1). Its national treatment and MFN obligations then state that they cover "investments" as well as "investors" with respect to the "expansion, management, conduct, operation, and sale or other disposition" of investments. (Articles 3 and 4). Similarly, the article on performance requirements states that it governs measures that apply to the "establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment." (Article 8). In contrast, the articles on FET (Article 5) and expropriation (Article 6) only cover "covered investments". They do not have language extending them to pre-establishment activities or expansion, nor extending them to cover "investors" who are "seeking to make" investments.

establishment protections has impacted tribunals' decisions on liability for failed tenders and negotiations.

The underlying treaty at issue in *Mihaly v. Sri Lanka* (the United States-Sri Lanka BIT) is an example of an agreement that does contain some pre-establishment protections. It requires host states to "permit" investment and associated activities (including the making of contracts and acquisition of property) in accordance with national treatment and MFN treatment, and also prevents either party from "impair[ing] by arbitrary and discriminatory measures" the "acquisition" and "expansion" of investments.¹⁸⁰ Nevertheless, according to the tribunal in the *Mihaly v. Sri Lanka* dispute, there was insufficient evidence that the state parties had intended to define expenditures incurred in preparing for and developing projects as covered "investments" or provide substantive rights and protections relating to those expenditures. The tribunal emphasized that the treaty recognized the parties' prerogatives regarding admission of investment, and that the treaty limited FET protection to investments "in being".¹⁸¹ Thus, the tribunal reasoned, absent the host state's consent to implement a project, it would be premature to allow an investor to seek recovery of project-related costs by claiming they constituted an "investment."¹⁸² The claimant's "unilateral or internal characterization" of its expenditures and expectations was unable to change that conclusion.¹⁸³

The *Mihaly* decision thus seems to place weight on the traditional ability of states to control admission of foreign investment, and evidences reluctance to chip away at states' sovereign authority to control the projects it will permit and implement absent clear indication that that is consistent with the treaty parties' intent.

Lemire and *PSEG* reflect a different approach, though the treaties at issue in those disputes contain language very similar to that in *Mihaly v. Sri Lanka*. More specifically, in *Lemire* and *PSEG*, the tribunals allowed the investors to use a broad asset-based definition of covered "investments" as a hook to cover a basic property right or interest (a framework contract in *PSEG* and a shareholding in a radio company in *Lemire*), and then relied on the FET standard to protect the investors' expectations regarding future development of those assets. Pursuant to this approach, the line between pre- and post-establishment treaties becomes particularly blurred as it would seem to allow an investor to use a variety of assets (e.g., permits, local affiliates, and preliminary agreements) as based upon which to bring claims and seek relief for projects and activities that did not materialize as planned.

Nordzucker v. Poland takes a different approach to identifying whether treaties are limited to post-establishment protections and assessing whether an investment is pre- or post-establishment. As the tribunal noted, the relevant treaty in that dispute barred its state parties from "imped[ing] the management, maintenance, use or enjoyment of investments in its territory ... by means of unjustified or discriminatory measures."¹⁸⁴ The treaty did not bar such conduct when applied to or impeding the *establishment, acquisition, or expansion* of investment.¹⁸⁵ Moreover, with respect to the obligations to admit foreign investment, the treaty provided that each contracting party was required to allow such investment in accordance with its own laws, indicating that each state party retained significant pre-establishment leeway to determine when, whether, and under what conditions to allow foreign investment. The tribunal recognized the policy rationale behind those limits, particularly in the context of tender processes:

¹⁸⁰ Sri Lanka Bilateral Investment Treaty, September 20, 1991, Article II(1) and 2(b).. Treaty between the United States of America and the Government of the Republic of Trinidad and Tobago Concerning the Encouragement and Reciprocal Protection of Investment, September 26, 1994, Art. II(3)(b).

¹⁸¹ *Mihaly v. Sri Lanka*, paras. 60-61.

¹⁸² *Mihaly v. Sri Lanka*, paras. 60-61.

¹⁸³ *Mihaly v. Sri Lanka*, para. 61.

¹⁸⁴ *Nordzucker v. Poland*, para. 177.

¹⁸⁵ *Nordzucker v. Poland*, para. 177.

Taking into account the fact that tenders open for privatization State's assets (shares, business, real estate etc.) attract usually a large number of foreign bidders only one of whom can be successful, the State would be exposed to many international arbitration proceedings commenced by unsuccessful bidders. For this reason the States in principle ... agree to grant the full Treaty protection only with regard to investments actually made and admitted in accordance with the law of the host State and not to intended investments.¹⁸⁶

Yet recognizing those issues, the tribunal reasoned that while not every bidder would be entitled to benefit from all treaty protections, some bidders might be covered under certain standards if they had adequately advanced in their efforts to invest. Based on the treaty and facts before it, the tribunal determined that the tender and subsequent negotiations had proceeded between the claimant and the government to such an extent that, even though Nordzucker had not secured any formal contract rights, it should be deemed to have "investments in the making" that were entitled to be covered by the obligation to "promote" and "admit" investments by foreign investors and the obligation to accord foreign investments fair and equitable treatment.¹⁸⁷

Nordzucker thus takes a relatively permissive approach to allowing claims based on pre-project activities. Indeed, it even appears to go beyond the holdings in *Lemire* and *PSEG* by suggesting that there need not even be a basic asset to serve as the "hook" on which to bring in claims based on expectations for future development and expansion. Rather, and in contrast to *Mihaly*, it is the extent of activity and engagement that counts.

VI. Establishing Linkages as a Condition of Market Access

When identifying contracting parties for major investments such as infrastructure projects, and when defining the ideal features of those projects, governments often seek to identify ways to best ensure those investors and investments provide positive spillovers in the host economies through developing linkages with suppliers and consumers, transferring technology, hiring local workers, investing in research and development and education and training, and making their investment in a particular location.

While developed and developing countries have used various types of conditions and "performance requirements" to accomplish these aims, there is a growing number of investment treaties that prevent use of those policy tools. This section provides a brief overview of these aspects of investment treaties as they are increasingly relevant to the terms of a government can ask for, secure, and subsequently enforce in a deal.

A. Pre-Establishment National Treatment and Most-Favoured Nation Treatment

One main limitation on placing conditions on investments comes from the non-discrimination obligations (i.e., national and most-favoured nation treatment). As noted above, these obligations require host countries to treat covered foreign investors no less favourably than investors from third countries or their own domestic investors. Many treaties only impose these requirements on established investments, meaning that (unless they have committed otherwise in a trade agreement such as the World Trade Organization's General Agreement in Trade in Services (GATS)), states retain the ability to bar, restrict, or impose conditions on foreign investment in infrastructure and other assets, enterprises or activities.

Yet as noted above, some agreements (whose numbers appear to be growing) expand the non-discrimination obligation to the "pre-establishment" and expansion phases. The investment treaty

¹⁸⁶ Nordzucker v. Poland, para. 189.

¹⁸⁷ Id. paras. 202-218.

between Canada and Peru, for instance, provides that host states must accord national treatment and MFN treatment regarding the “establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments” by investors of the other state party.¹⁸⁸

This means that covered foreign investors must be given the same rights and conditions of market access as other foreign investors, or even domestic investors. Through these provisions, states can lose the ability to limit, control, or condition foreign participation in sensitive infrastructure developments, public services, or other investments, even if the aim behind those measures is to try to serve legitimate policy goals such as ensuring regulatory control over the project company or deepening linkages between the foreign investor and the host economy. Requirements to invest through joint ventures or other corporate forms, mandates to have a certain percentage of domestic equity, and obligations to hire or source locally are among those types of requirements or conditions that, if not imposed on foreign and domestic investors alike, can violate non-discrimination obligations.

In contrast to the GATS, where only those sectors that are specifically listed are covered by the treaty’s national treatment obligation (i.e., the “positive list” approach), a number of investment treaties cover all investments in all sectors unless and only to the extent that they are specifically excluded (i.e., the “negative list” approach). This can have the effect of widening the types of economic activities covered by pre-establishment national treatment rules.

Importantly, even if a particular investment treaty only imposes rules on a host state that are substantively the same as, but do not go beyond, the state’s commitments under the GATS, investment treaties may, in practice, impose stronger obligations than that treaty. This is because the GATS and other regional or bilateral agreements like it that specifically govern international trade in services generally only allow claims of breach to be resolved through state-to-state mechanisms. Investment treaties, in contrast, allow investors to assert their own rights. They are therefore empowered to directly challenge conditions on bids or proposals that discriminate against foreign investors.

B. Restrictions on Performance Requirements

Another increasingly common set of provisions in investment treaties relates to, and restricts, use of “performance requirements” on investment projects. While countries that are party to the WTO already are bound by some restrictions on their use of performance requirements, a growing number of investment treaties imposes added constraints on governments’ abilities to employ these tools.

More specifically, members of the WTO are bound by the Agreement on Trade-Related Investment Measures (TRIMs Agreement) that limits certain performance requirements relating to trade in goods, such as (1) requirements to use or purchase local goods; (2) trade-balancing requirements; (3) foreign exchange restrictions related to the foreign-exchange inflows attributable to an enterprise; and (4) export controls.

The TRIMs Agreement, however, left many types of performance requirements untouched. These include:

- measures relating to trade in services, not goods;
- requirements to establish a joint venture with domestic participation;
- requirements for a minimum level of domestic equity participation by domestic individuals or entities;
- requirements to locate headquarters in a specific region; local employment requirements;
- export requirements;

¹⁸⁸ Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments, May 29, 2008, Articles 3 and 4.

- technology transfer requirements; and
- research and development requirements.¹⁸⁹

Some investment treaties now go farther than the TRIMs Agreement and prohibit or place limits on governments' abilities to use some of these measures, including requirements in law or contract to procure goods or services locally, to require investment in research and development, or to require technology transfer. Treaties with pre-establishment non-discrimination provisions also restrict governments' abilities to impose conditions such as joint venture or domestic equity requirements through their laws or to require them in contracts.

It may be likely that investors would not want to challenge a government's efforts to contractually impose such conditions when negotiating an agreement or making a bid as doing so would likely put them at a competitive disadvantage as compared to their competitors. But at least some treaties appear to anticipate this. First, some treaties state that host states are not only prohibited from imposing performance requirements on investors from the home state, but are prohibited from imposing them on *any* foreign investor, attempting to ensure that, irrespective of their respective home countries, all foreign investors will be on a level playing field. Second, some treaties bar states not only from imposing performance on foreign investors, but also prevent them from enforcing the requirements. These types of provisions suggest that even if, for example, a state gets an investor's commitment to procure local goods or services in its operations and transfer technology, a state might not be able to take legal action to secure compliance with those obligations, potentially rendering the commitments meaningless.

Issues regarding the scope and effect of restrictions on performance requirements have not yet arisen much in investment-treaty disputes, though that may be changing as those provisions are becoming more and more common in treaties and as investors and their attorneys learn that there is legal recourse against these requirements.¹⁹⁰

Relevant Exceptions

When treaties contain pre-establishment non-discrimination commitments and restrictions on performance requirements, they also often include exceptions to those obligations aiming to protect their ability to regulate certain types of investments or activities, maintain existing policies that would otherwise breach the obligations, give local and regional governments additional flexibilities, and further identified policy aims and government practices, such as government procurement. Thus, even if a treaty covers pre-establishment investments and restricts performance requirements, those rules may not impact a government's ability to design a tender or negotiate a contract in the way it chooses if a relevant exception applies.

VII. The Life of the Deal – Construction and Operation

After the contract has been entered into and performance begins, another host of issues can arise, many of which have likewise triggered arbitration under investment treaties. This section addresses how tribunals have addressed such life-of-the-project challenges, and what their decisions may mean for state parties and their treatment of foreign investors engaged in infrastructure projects. Key issues covered are: (1) liability for legal and regulatory change; (2) liability for permitting decisions and

¹⁸⁹ UNCTAD, *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries* (2003), p. 3.

¹⁹⁰ One case address the scope of restrictions on performance requirements, and the treaty's exceptions to those restrictions, is *Mobil Investments Canada, Inc. v. Canada*, ICSID Case No. ARB(AF)/07/4, Decision on Liability and on Principles of Quantum, May 22, 2012.

other administrative conduct; (3) liability for intra-deal renegotiations (e.g., normal tariff review procedures) and extra-deal renegotiations (e.g., requests for changes in contractual service obligations); and (4) liability for harm caused by conduct of third persons. Throughout the discussion, this section also covers recurring themes such as the role of domestic law in affecting whether a government will be liable under the treaty, the relevance of contractual provisions on the parties' rights and obligations and dispute settlement mechanisms, and the relevance of certain factors such as the "political" nature of government conduct.

A. Legal and Regulatory Change Impacting Performance

One issue that has been at the center of much controversy regarding investment treaties is the question of whether and under what circumstances they will give rise to state liability for shifts in the legal and regulatory environment that impact the profitability of investments.

Traditionally, the rule under international law has been that states would not be liable for changing their laws in ways that impacted the performance of investor-state contracts (or quasi-contracts such as permits or licenses) governed by those laws except in two main circumstances: (1) the change was an abuse of law designed specifically to improperly interfere with the private contracting party's rights, or (2) it impacted an investor's rights under the contract to such an extent that the rights were entirely extinguished, in which case the rights might be deemed to have been expropriated. Yet decisions under investment treaties are evidencing a wider range of circumstances in which states will be liable for legal and regulatory change impacting performance of investor-state contracts in infrastructure and other investments.

1. An Emerging Approach: Protecting "Commitments"

As discussed above, arbitral tribunals have stated that the "fair and equitable treatment" (FET) obligation – protects the legitimate expectations of investors formed at the time of making the investment¹⁹¹ or while it is held,¹⁹² and if the legal framework governing the investment changes in a way that was not anticipated or foreseen by the investor at the time of making the investment, then the investor should be compensated for the cost of complying with those changes.¹⁹³ This means that if a new law is adopted, or an existing law is revoked or interpreted or applied in a new way,¹⁹⁴ those changes can trigger state liability.

Some tribunals have adopted a more lenient approach, stating that investment treaties do not generally act to freeze the law *unless* those changes are contrary to a commitment made by the state.¹⁹⁵ Under this rule, the scope of state liability for legal or regulatory evolution depends on how a tribunal defines a contrary "commitment" to the investor.

On this issue, tribunals have taken a range of approaches. Some have required commitments against regulatory change to be a precise promise by the government in the form of a binding stabilization clause in a contract between the investor and state. In *AES v. Hungary*, for instance, the tribunal rejected the claimant's argument that the government violated the FET obligation changing

¹⁹¹ Técnicas Medioambientales Tecmed, S.A. v. Mexico, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, para. 154.

¹⁹² See Kardassopoulos and Fuchs v. Georgia, ICSID Case Nos. ARB/05/18, ARB/07/15, Award, March 3, 2010, paras. 428-441.

¹⁹³ See, e.g., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAgua Servicios Integrales del Agua S.A. v. Argentina, ICSID Case No. ARB/03/17, Decision on Liability, July 30, 2010, para. 207; Total v. Argentina, ICSID Case No. ARB/04/1, Decision on Liability, Dec. 27, 2010, para. 122.

¹⁹⁴ Occidental Exploration and Production Company v. Ecuador, LCIA Case No. UN 3467, Final Award, July 1, 2004.

¹⁹⁵ See, e.g., AES v. Hungary, ICSID Case No. ARB/07/22, September 23, 2010, para. 9.3.34.

the legal framework regarding pricing for electricity generation. In doing so, it emphasized that there was no stabilization clause in the relevant contract guaranteeing the investor that such change would not be made.¹⁹⁶ Under this view, only a specific commitment by a state to an investor promising the stability of the state's legal framework would give rise to liability for subsequent changes to that framework.¹⁹⁷

But other tribunals have taken a broader view of what can constitute a commitment against regulatory change. In *Electrabel v. Hungary*, for example, the tribunal stated that while “specific assurances made by the host state” were relevant, they were not “always indispensable.”¹⁹⁸ Tribunals have also determined that the “representations” and “assurances” that can support a promise of stability include both written and oral statements by government officials,¹⁹⁹ and can be implicit as well as explicit promises.²⁰⁰ Regarding the maker of the promise, tribunals have likewise taken a flexible approach, and have inferred commitments of stability from statements allegedly made by representatives of state-owned enterprises during contract negotiations with foreign investors.²⁰¹

Although some tribunals have stated that such promises must be legally binding in order to establish an enforceable commitment,²⁰² tribunals have not seemed to strictly apply that rule. In a number of cases, for example, tribunals have adopted a flexible “totality of the circumstances” approach when assessing whether such promises have been made, citing a variety of non-binding statements by public officials in support of their findings that governments have guaranteed regulatory stability.²⁰³ Additionally, tribunals have held that ultra vires contracts or commitments that would be void ab initio under domestic law can nevertheless be protected and enforced under international law.²⁰⁴

Notably, in various decisions tribunals have inferred the existence of commitments against legal change from the simple nature and content of the general legal framework in place at the time the investor made its investment.²⁰⁵

Regarding the types of changes that can trigger liability, cases indicate that those include actual changes in the actual laws or regulations as well as changes in the interpretations of those laws or regulations by reviewing courts or tribunals.²⁰⁶

¹⁹⁶ AES v. Hungary, paras. 9.3.32-9.3.35.

¹⁹⁷ EDF v. Romania, ICSID Case No. ARB/05/13, Award, October 8, 2009, para. 217.

¹⁹⁸ Electrabel v. Hungary, ICSID Case, No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, November 30, 2012, para. 7.78. The tribunal thus seems to have rejected the claimant's contention that its “expectation that its contractual rights [would] not be affected by governmental measures without compensation [was] legitimate in and of itself, without further affirmative governmental representations or assurances.” *Id.* para. 7.76.

¹⁹⁹ See, e.g., Técnicas Medioambientales Tecmed v. Mexico, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003, paras. 158-74; Metalclad v. Mexico, Reasons for Judgment of the Honorable Mr. Justice Tysse, paras. 28-29 (S.C. B.C. May 2, 2001).

²⁰⁰ Parkerings v. Lithuania, ICSID Case No. ARB/05/8, Award, September 11, 2007, para. 331. The tribunal further stated that “[s]ave for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment.” *Id.* para. 332.

²⁰¹ Occidental Petroleum Corp. v. Ecuador, ICSID Case No. ARB/06/11, Award, October 5, 2012, paras. 467-547.

²⁰² CMS Gas Transmission Company v. Argentina, ICSID Case No. ARB/01/8, Award, May 12, 2005, para. 124.

²⁰³ See, e.g., *id.* paras. 134-35.

²⁰⁴ See Occidental v. Ecuador, ICSID Case No. ARB/06/11, Award, October 5, 2012.

²⁰⁵ See, e.g., Frontier v. Czech Republic, Award, Nov. 12, 2010, para. 285; Enron v. Argentina, ICSID Case No. ARB/01/3, Award, May 22, 2007.

²⁰⁶ Occidental v. Ecuador (2004), para 191

In some disputes, tribunals have rested liability for legal change on a breach of the umbrella clause.²⁰⁷ Yet tribunals also commonly base their findings of liability for regulatory change on a breach of the FET requirement,²⁰⁸ viewing modifications to the general legal framework as upsetting investors' "legitimate expectations" in breach of the guarantees of stability and predictability enshrined in that standard. This suggests that the FET obligation has evolved in the eyes of at least some arbitrators to constitute a *de facto* umbrella clause capable of giving rise to liability for interference with contractual (and other) commitments.

Overall, these arbitrations suggest that if there is a legally binding investor-state contract for an infrastructure or other project, the terms of that contract can serve as a "commitment" with which subsequent legal and regulatory change cannot interfere without violating an investment treaty. But they also suggest more: namely, that, according to some tribunals, conduct and circumstances external to the four corners of a legally enforceable contract can also constitute the "commitments" restricting, or requiring compensation for, such change.

Through this approach, investment treaties provide investors/investments more rights than the government had formally committed to give or than the investors were able to formally secure through, for example, negotiating contractual provisions like express stabilization clauses to insulate them against the cost of complying with certain regulatory changes. These decisions also indicate that investors can benefit from rights that are more expansive than permitted under relevant domestic law. It appears, for instance, that tribunals would enforce stabilization clauses even if those clauses would otherwise be inconsistent with and invalid under a country's domestic legal framework.

3. Legal Change and other Government Action in the Absence of "Commitments"

Even if there has been no "commitment" against legal or regulatory change, decisions indicate that shifts in law or policy may nevertheless give rise to liability impacting a foreign investor's investment in various circumstances.

Factors that have influenced whether a tribunal will determine that such changes constitute a treaty breach under the FET obligation have related to both matters of substance and procedure, including:

- whether the investor should have legitimately expected (even in the absence of any explicit or implicit promise by the state) that the changes would not occur;²⁰⁹
- whether the purpose of the change is legitimate;²¹⁰
- whether the changes appear an arbitrary, irrational, unreasonable, or inappropriately tailored way of meeting their objective;²¹¹
- whether the government acted in good faith;²¹²

²⁰⁷ LG&E v. Argentina; EDFI v. Argentina.

²⁰⁸ LG&E v. Argentina, paras. 123, 175; EDFI v. Argentina, paras. 221-40.

²⁰⁹ See, e.g., Micula v. Romania, paras. 528-529; LG&E v. Argentina, para. 125; Saluka v. Czech Republic, Partial Award, March 17, 2006, paras. 63, 164; Frontier Services v. Czech Republic, Award, paras. 284-285 ("The investor may rely on the legal framework as well as on representations and undertakings made by the host state including those in legislation, treaties, decrees, licenses, and contracts. Consequently, an arbitrary reversal of such undertakings will constitute a violation of fair and equitable treatment. While the host state is entitled to determine its legal and economic order, the investor also has a legitimate expectation in the systems' ability to facilitate rational planning and decision making.").

²¹⁰ See, e.g., Tecmed v. Mexico, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, paras. 162-64.; Saluka v. Czech Republic, Partial Award, March 17, 2006, paras. 309 and 460; AES v. Hungary, Award, para. 10.3.7;

²¹¹ SD Myers v. Canada, Partial Award, November 13, 2000, paras. 195, 322; Saluka v. Czech Republic, paras. 309 and 460; Micula v. Romania, para. 525.

- the nature of the host state's legal system and the phases or changes it is or can be expected to go through;²¹³
- the transparency through which the changes were adopted and/or implemented;²¹⁴
- whether there is intra-state consistency in policy and action (e.g., whether the national and sub-national entities, different federal ministries, or different branches of government are sending the same signals regarding the change);²¹⁵ and
- the ability of the affected investor to know of, comment on, challenge, or participate in the formulation and adoption of the changes.²¹⁶

Apart from those FET claims, a change in laws, regulations, or interpretations thereof may be subject to treaty-based challenges on the ground that it violates other treaty obligations such as the non-discrimination obligations, the requirement to pay compensation for expropriation, restrictions on performance requirements, or the umbrella clause.

B. Permitting Decisions and Other Administrative Conduct

The same principles governing liability for legal and regulatory change noted above have also been relevant in tribunals' awards addressing challenges to administrative decision-making such as permit approvals, rejections and modifications and other areas of adjudicatory administrative conduct. In addition, because tribunals generally hold that investors need not exhaust local remedies before pursuing treaty claims, this means that investors can use investment treaties to challenge (or threaten to challenge) a vast set of actions or omissions by lower-level officials even if those investors were able or required to challenge that conduct through administrative and/or judicial processes.²¹⁷

On certain issues, one might envision tribunals drawing distinctions between different types of conduct, recognizing, for instance, that the motives and processes appropriate for an administrative decision maker will differ from the motives and processes appropriate for rule makers such as legislators or drafters of regulations, and that those differences are legitimate and should be taken into account when assessing whether the relevant government actor's conduct breaches international law. "Politically" motivated conduct may, for example, be entirely appropriate for a legislator but less so for an administrative judge. Likewise, the due process required in administrative proceedings may necessarily and legitimately be entirely different than that required in judicial hearings.²¹⁸

(Contd.) _____

²¹² *Biwater v. Tanzania*, para. 602; *Waste Management v. Mexico II*, ICSID Case No. ARB(AF)/00/3, Final Award, April 30, 2004; *Saluka v. Czech Republic*, Partial Award, March 17, 2006, para. 303; *Frontier v. Czech Republic*, Award, para. 297; *Teco v. Guatemala*, para. 456.

²¹³ See *Parkerings v. Lithuania*, paras. 341-345.

²¹⁴ *AES v. Hungary*; *Saluka v. Czech Republic*, Partial Award, March 17, 2006, paras. 164, 307, 356; and *Waste Management v. Mexico II*, Final Award, para 98.

²¹⁵ See, e.g., *Micula v. Romania*, para. 534; *Metalclad v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award, August 30, 2000, para. 333; *MTD Equity Sdn. Bhd. V. Chile*, ICSID Case No. ARB/01/7, Award, May 21, 2004, paras. 113, 163; *Saluka v. Czech Republic*, para. 307.

²¹⁶ See *AES v. Hungary*, para. 9.3.70; ; *Tecmed v. Mexico*, paras. 172-73.

²¹⁷ *Helnan v. Egypt*, ICSID Case No. ARB/05/19, Decision of the ad hoc Committee on Annulment, June 14, 2010.

²¹⁸ See, e.g., *Apotex Holdings, Inc. and Apotex, Inc. v. United States*, ICSID Case No. ARB(AF)/12/1, Rejoinder on Merits and Reply on Objections to Jurisdiction of Respondent United States of America, September 27, 2003, pp. 146-174 (addressing the meaning and content of "due process" in administrative decision-making as opposed to other contexts).

To date, however, tribunals do not seem to have engaged in such nuanced analysis of the various roles and functions of different layers and branches of governments, and, more significantly, the relevance of those variations for the approach they should take in scrutinizing challenged conduct.²¹⁹

C. Renegotiations

International contracts – particularly those running over long time horizons – are often renegotiated. Some of these renegotiations are “intra-deal renegotiations”, meaning that the contract itself provides that certain parts of the agreement may or will be renegotiated at specified times or in certain circumstances.²²⁰ The renegotiation takes place in accordance with the original contract.²²¹ An example is a clause requiring a periodic review of tariffs charged for water or electricity, or a clause providing for an extraordinary review of those tariffs in the event of particular events or circumstances. These provisions aim to inject flexibility into the deal in order to enable it to survive over time and under changing circumstances.²²²

Other renegotiations are “extra-deal renegotiations”:

These negotiations take place “extra-deal,” for they occur outside the framework of the existing agreement. Forced renegotiation of mineral concession contracts of the 1960s and 1970s, negotiations to reschedule loans following the Third World debt crisis of the early 1980s, and the restructuring of infrastructure and financial agreements in the wake of the Asian financial crisis of the late 1990s all fit within the category of extra-deal renegotiations. In each case, one of the participants was seeking relief from a legally binding obligation without any basis for renegotiation in the agreement itself.²²³

Each type of renegotiation has figured as an issue in investment disputes, with tribunals’ decisions having noteworthy implications for states’ conduct in connection with both intra-deal and extra-deal talks.

1. Intra-Deal Renegotiations

Several cases indicate that, irrespective of what the contract or relevant domestic law provides, treaties may impose an additional layer of obligations and potential liability on governments relating to their conduct in pursuing or responding to requests for intra-deal renegotiations.

In *PSEG v. Turkey*, as noted above, the tribunal signaled that investors are “entitled to expect that [their] negotiations [will] be handled competently and professionally,” and that there will be a breach of the FET obligation if those expectations are not met.²²⁴ In *Saluka v. Czech Republic*, the tribunal stated that the treaty’s FET provision required the state to “take[] seriously a proposal that has sufficient potential to solve the [relevant] problem and deal with it in an objective, transparent, unbiased and even-handed way.”²²⁵ Citing those two decisions, the tribunal in *Frontier Services v. Czech Republic* declared that the requirement of good faith was central to the FET standard and that a

²¹⁹ *Vivendi II* illustrates this pattern, as the conduct of different types of government actors with very different roles and responsibilities was lumped into and evaluated as a uniform “campaign”.

²²⁰ Jeswald Salacuse, *Renegotiating International Business Transactions: The Continuing Struggle of Life Against Form*, 35 *Int’l Law* 1507, 1508-1509 (2001).

²²¹ *Id.*

²²² For more on intra-deal renegotiations, see Salacuse, *supra* n. 221, at 1513-1518.

²²³ *Id.* at 1509.

²²⁴ *PSEG v. Turkey*, para. 246.

²²⁵ *Saluka v. Czech Republic*, para. 364.

failure to negotiate in good faith would thus violate the treaty obligation.²²⁶ It added that liability could still attach even if the state were not acting in bad faith.²²⁷

In *Teco v. Guatemala*, the tribunal stated that a lack of administrative due process in an inter-deal tariff review processes would violate the FET obligation.²²⁸ An administrative body's failure to provide reasons supporting its decisions, or to abide by its own procedural rules were factors that the tribunal viewed as establishing a lack of administrative due process and, consequently, a treaty breach.²²⁹ The tribunal added that the fact that those alleged failings had already been challenged before Guatemalan courts, that those courts had upheld the legitimacy of the government's conduct under Guatemalan law, and that there was no indication or allegation of a denial of justice or corruption in those judicial proceedings, did not prevent the tribunal from taking jurisdiction over the dispute and deciding whether the government's conduct violated international law under the treaty.²³⁰ According to the tribunal, it was not bound by the Constitutional Court's findings that the government's actions were consistent with Guatemala's legal framework governing tariffs.²³¹ It reasoned that the outcome in the project company's suit against the regulator under domestic law could not determine the outcome of the minority shareholder's suit against Guatemala under the treaty as the different cases involved different parties and different legal standards.²³²

Ultimately, the tribunal determined that Guatemala violated the investment treaty when it decided to rely on one expert report regarding appropriate tariff calculations rather than another expert report, and did not provide adequate reasons for its choice. The tribunal stated that although the government regulator was not bound by the report it had opted not to adopt, it nevertheless had the "duty to seriously consider [the report's conclusions] and to provide reasons in case it would decide to disregard them."²³³ That procedural obligation to give reasons, the tribunal concluded, was both implicit in Guatemala's domestic regulations and an element of administrative due process required under the MST.²³⁴

Some cases indicate that treaty-based obligations to renegotiate are obligations regarding results binding on the government (as opposed to obligations as to process or efforts). In *Impregilo v. Argentina*,²³⁵ the tribunal determined that the government breached the FET obligation by not renegotiating the water and sanitation services concession in order to restore the economic equilibrium of the contract in response to the economic crisis in the country and the decision by the government to de-peg the peso from the dollar and establish a floating exchange rate. The tribunal reasoned:

325. The Arbitral Tribunal considers that, once the value of the peso was determined by market conditions, the balance provided for in Article 12.1.1 [setting forth the principles on which tariffs would be calculated]²³⁶ no longer existed and that, according to Article 12.1.1, it was then

²²⁶ Frontier Services v. Czech Republic, paras. 297-300.

²²⁷ Frontier Services v. Czech Republic, para. 300.

²²⁸ Teco v. Guatemala, para. 457.

²²⁹ Id.

²³⁰ Teco v. Guatemala, paras. 471-484.

²³¹ Id. para. 517. See also id., paras. 512-589.

²³² Teco v. Guatemala, para. 517.

²³³ Id. para. 588.

²³⁴ Id. paras. 583-589.

²³⁵ Impregilo S.p.A. v. Argentina, ICSID Case No. ARB/07/17, Award, June 21, 2011.

²³⁶ Article 12.1.1 provided " '[t]he calculation of applicable tariffs pursuant to Article 28 II of Law 11,820 shall be based on the general principle that tariffs shall cover all operating expenses, maintenance expenses and service amortization and provide a reasonable return on Concessionaire's investment subject to efficient management and operation by the Concessionaire and strict compliance with the applicable service quality and expansion goals'." Impregilo v. Argentina, para. 324.

incumbent on the Province, in order to treat AGBA in a fair and equitable manner, to find appropriate solutions to restore the envisaged balance. In other words, since the new exchange rate caused by the abolition of the fixed legal rate had highly detrimental effects on AGBA, the Province should have offered AGBA a reasonable adjustment of its obligations under the Concession Contract.

326. Indeed, it appears that the Emergency Law also envisaged a renegotiation of public utilities agreements to adapt them to the new exchange system. This would have been a basis for finding a new equilibrium between the Parties to the Concession Agreement and for ensuring that Impregilo, as shareholder in AGBA, was granted fair and equitable treatment.

...

330. Since the disturbance of the equilibrium between rights and obligations in the concession was essentially due to measures taken by the Argentine legislator [in establishing the floating exchange rate and regulating water and sewerage services], it must have been incumbent on Argentina to act to effectively restore an equilibrium on a new or modified basis. Although Argentina has attributed the failure of the negotiations to what it regarded as AGBA's unreasonable demands, it does not appear that Argentina took any measures to create for AGBA a reasonable basis for pursuing its tasks as concessionaire which had been negatively affected by the emergency legislation, including the New Regulatory Framework.

331. In these circumstances, the Arbitral Tribunal considers that Argentina, by failing to restore a reasonable equilibrium in the concession, aggravated its situation to such extent as to constitute a breach of its duty under the BIT to afford a fair and equitable treatment to Impregilo's investment.²³⁷

The tribunal's decision thus seems to read the FET obligation as imposing a duty on the government to not only offer or engage in a renegotiation effort, but to secure an outcome fair to the investor "restor[ing] a reasonable equilibrium in the concession." Yet where, as in *Impregilo*, the claimant in the treaty dispute is a minority shareholder in the domestic concessionaire, and that the concessionaire is not a party to the treaty-based dispute before the tribunal, it likely becomes particularly difficult to identify whether the failure to restore equilibrium was due to the conduct of the government, the concessionaire, or both parties.

Moreover, in this case, a duty to successfully renegotiate the contract would likely have been particularly challenging due to the fact that the government – even prior to the country's financial crisis and currency devaluation – had been facing various requests by the concessionaire to renegotiate the deal by reducing its investment commitments and service obligations, and therefore might have faced counterproposals it was unwilling to accept. Indeed, as the tribunal noted in support of its finding of liability, the government appeared "reluctant to renegotiate the Concession Contract" and was concerned about making "adjustments in favor of the [concessionaire] ... as this would have negative effects for the customers whose economic interests required protection."²³⁸ In such circumstances, one can perceive, as Argentina contended, that the failure of renegotiations may have been due at least in part to the concessionaire's demands being unreasonable.²³⁹ Nevertheless, under the tribunal's interpretation of the treaty's rule, it appears that the government is subject to demands, standards and attendant potential liabilities that do not similarly apply to concessionaires, much less the minority shareholders in those companies.

The familiar caveat to any conclusion regarding these decisions again applies: Briefs and awards demonstrate that not all states, arbitrators, or reviewing judges agree that the FET obligation incorporates these requirements of good faith, transparency, or administrative due process whether in

²³⁷ *Impregilo v. Argentina*, paras. 325-331.

²³⁸ *Impregilo v. Argentina*, para. 329.

²³⁹ *Id.* para. 330.

intra-deal reviews or renegotiations, or other circumstances.²⁴⁰ The cases highlighted here are not used to show what the law is, but what the decision might be, lest any state be unsure what potential liability arises as a result of investment treaties.

2. Extra-Deal Renegotiations

Extra-deal renegotiations involve intense challenges and pressures, not least because they are usually unwanted by one party:

Unlike negotiations for the original transaction, which are generally fueled by both sides' hopes for future benefits, extra-deal negotiations begin with both parties' shattered expectations. One side has failed to achieve the benefits expected from the transaction, and the other is being asked to give up something for which it bargained hard and which it hoped to enjoy for a long time. Whereas both parties to the negotiation of a proposed new venture participate willingly, if not eagerly, one party always participates reluctantly, if not downright unwillingly, in an extra-deal renegotiation. Beyond mere disappointed expectations, extra-deal renegotiations, by their very nature, can create bad feeling and mistrust. One side believes it is being asked to give up something to which it has a legal and moral right. It views the other side as having gone back on its word, as having acted in bad faith by reneging on the deal. Indeed, the reluctant party may even feel that it is being coerced into participating in extra-deal renegotiations since a refusal to do so would result in losing the investment it has already made in the transaction.²⁴¹

These characteristics of extra-deal renegotiations are evident in and important for considering treaty-based investor-state arbitration. This is primarily because if the investor is the unwilling party that feels unfairly forced to renegotiate, it can seek treaty-based relief by threatening or pursuing investor-state arbitration. By pursuing this avenue, the investor can try to convince its state counterparty not to pursue extra-legal renegotiation; and, if the state insists, the investor can seek compensation for any costs it is asked to incur, thereby undoing if not mitigating the consequences of the renegotiation. Alternatively, if the investor seeks renegotiation, the government has no recourse under the investment treaty. Investment treaties give investors, not states, protections and the ability to initiate investor-state disputes.

This asymmetry can put states at a significant disadvantage vis-à-vis their contracting parties, creating scenarios in which they may be brought back to the negotiating table against their will in order to save a deal, while their own ability to force investors to renegotiate aspects of the agreement is weakened. This is especially important given that studies have shown investors – not states – are commonly the drivers for extra-legal renegotiations. Indeed, one review of 1,000 concession contracts in the telecommunications, transportation, water and sanitation services, and electricity sectors that were awarded in Latin America and the Caribbean between the mid-1980s and 2000 found that extra-legal renegotiations were “extremely common”²⁴² and in 61 percent of those renegotiations, the renegotiations were requested by the concessionaire or operator. Only in 26 percent did the government initiate the renegotiation. The remaining cases consisted of those in which both the concessionaire and the government sought renegotiation.²⁴³

That study shows that firm-led renegotiations are particularly common in cases where the contract was awarded through competitive bidding as opposed to direct negotiations. This, researchers explain,

²⁴⁰ See, e.g., *Apotex Holdings, Inc. and Apotex Inc. v. United States*, ICSID Case No. ARB(AF)/12/1, Rejoinder on Merits and Reply on Objections to Jurisdiction of Respondent United States of America, pp. 147-164.

²⁴¹ Salacuse, *supra* n. 221 at 1518.

²⁴² Guasch, p. 81. According to the study, 30 percent of these concessions were renegotiated. Among the concession contracts for water and sanitation services, that number was 74 percent, and for transportation contracts, 55 percent. The study did not count as renegotiations standard, scheduled tariff adjustments or periodic tariff reviews. *Id.* at 80.

²⁴³ Guasch, pp. 84-85

appears to reflect the fact that investors are able to secure contracts by underbidding (e.g., on tariffs) or overbidding (e.g., on payments to the government and investment contributions), with the intent or effect of subsequently opportunistically renegotiating the deal. In contrast, when securing the contract through direct negotiations, investors are more likely to “secure all the benefits or rents at the start, making renegotiation unnecessary from the operator’s perspective.”²⁴⁴

Investors are also more likely to seek renegotiation when the contract is structured in a way that the risk of changes in circumstances and adverse events are born by them (e.g., through a price-cap system of regulating tariffs) rather than the government (e.g., through a rate-of-return method),²⁴⁵ which may be due to such factors as capture or corruption, or lack of regulatory strength and capacity to resist opportunistic renegotiation requests.²⁴⁶

Once renegotiation is sought, investors have strong power to get states back to the negotiating table:

[T]he operator has significant leverage, because the government is often unable to reject renegotiation and is usually unwilling to claim failure—and let the operator abandon the concession—for fear of political backlash and additional transaction costs. In such cases the operator, through renegotiations, can undermine all the benefits of the bidding- or auction- led competitive process.²⁴⁷

Thus, although discussions about foreign investment in infrastructure and other capital intensive projects frequently mention the phenomenon of the “obsolescing bargain” in which an investor with significant fixed assets in the host country becomes hostage to government power and discretion,²⁴⁸ the dominance of this narrative obscures a different reality – one in which the government is held hostage to opportunistic renegotiations.

Against that background, it is especially crucial to review how tribunals have treated extra-legal renegotiations; and the cases suggest governments have significant cause for concern that these decisions may greatly tilt the balance of power in favor of investors even where investors already enjoy important leverage. In particular, investment treaties seem to erect an important shield around investors protecting them from government attempts to renegotiate agreements, while placing pressure on governments to come back to the table when requested by the investor.

i. Government-led Renegotiations

Various investment disputes have arisen precisely out of a scenario in which the change was requested by the government, putting the investor in the position of the reluctant renegotiator. In, response, investors have used investment arbitration (or the threat of arbitration) to challenge government efforts to “pressure” them to renegotiate deals.

Investors have succeeded on these claims, with at least some tribunals finding that governments violate the investment treaties when trying to get their contracting party to renegotiate their deal.²⁴⁹ The motives and methods used to secure renegotiations have also been relevant to tribunals’ views on liability, as investors – with varying degrees of success – have argued that governments’ “political” motives and/or exercises of sovereign powers are key factors supporting treaty breach.

²⁴⁴ Guasch, p. 92.

²⁴⁵ Guasch, p. 91.

²⁴⁶ Guasch, pp. 91-94.

²⁴⁷ Guasch, p. 33.

²⁴⁸ Guasch, pp. 84-86.

²⁴⁹ In addition to the cases discussed in this section, see also *Siemens AG v. Argentina*, ICSID Case No. ARB/02/8, Award, February 6, 2007, para. 308.

One case highlighting these issues is *Vivendi v. Argentina II*, in which the tribunal concluded that government officials in an Argentine province breached the investment treaty by improperly pressuring the concessionaire to renegotiate the agreement.

In that case, even before the concession was awarded, there was notable opposition to the privatization of the water services at the heart of the dispute; and after transfer to the concessionaire, that opposition escalated, fueled by a number of factors, including a change in government, the concessionaire's doubling of tariffs charged, lack of certainty among residents and governments about the conditions of the concession and terms of the contract, and major problems in delivery of water, including incidents of red turbidity over the course of one to two months, and black turbidity that lasted over the course of two weeks, neither of which users had previously experienced.²⁵⁰ Media attention on the concession and its operation intensified; an independent ombudsman advised water users of their legal rights and remedies regarding issues with payment and service quality; individual legislators made comments critical of the concession and, like the ombudsman, also gave citizens information regarding their rights with respect to the concessionaire; the legislature appointed a special committee to investigate the legitimacy of the concession contract; and the Court of Accounts issued a report questioning the agreement's consistency with the law. There was, therefore, notable pressure on the government to address these concerns; prompting its requests for renegotiations of the tariff, but also contemplating that the investor would be able to reduce its investment commitments and obligations to extend service.

Reviewing these events, the tribunal concluded that the government had "mounted an illegitimate 'campaign' against the concession, the Concession Agreement, and the 'foreign' concessionaire from the moment it took office, aimed either at reversing the privatization or forcing the concessionaire to renegotiate (and lower) [the concessionaire's] tariff's."²⁵¹ The tribunal further declared that the government's "so-called regulatory activity constituted ongoing, unfair and inequitable behavior because it was no more than politically driven arm-twisting aimed at compelling Claimants to agree to new terms to the Concession Agreement which were acceptable to the new government."²⁵² Such conduct, the tribunal determined, violated the FET standard under the treaty.

The tribunal's finding of liability thus seemed to largely hinge on its view that the government's actions were motivated by "political" concerns and through public and governmental means. The tribunal highlighted the role of the individual legislators, legislature, ombudsman, concession regulator, and the governor of the province as forming part of this political "campaign" against the concessionaire and criticized the government's apparent role in harming, rather than improving, the relationship between the concessionaire and the public.

This approach raises a number of issues for governments. For one, through such a totality of the circumstances approach where liability is based on the perception of a "campaign" implemented by a variety of different actors who are accountable to different individuals and groups within and outside the government, the tribunal applied a standard that can be breached even if each individual act making up that "campaign" could not or would not give rise to liability under domestic or international law.²⁵³ This standard may be particularly difficult for states to comply with as many of the actions alleged to be wrongful here – e.g., comments to the press, communications to the public, government

²⁵⁰ The tribunal downplayed these events by noting that although they were "unquestionably unpleasant" they lasted "only" about two weeks (for the black turbidity), "only" impacted a "relatively small part of the population (5-10%) (for the red turbidity), and posed no known health risks. *Vivendi v. Argentina*, para. 7.6.2. It seems questionable that users of the water were as comforted by those factors.

²⁵¹ *Vivendi II v. Argentina*, para. 7.4.19; see also *id.* at para. 7.4.31 & n. 355.

²⁵² *Id.* para. 7.4.38.

²⁵³ *Id.* para. 7.5.29 (referring to the measures "taken cumulatively"); *id.* paras. 7.4.38-7.4.39 (referring to the regulator's conduct "against a background of" other individuals' and entities' criticisms of and questions regarding the concession);

responses to public outcries, and legislative establishment of investigative committees – are common if not encouraged in democratic governments. Indeed, such actions as are often even given enhanced free speech protections and immunities from discovery and/or liability in order to avoid chilling them.

Moreover, the tribunal’s approach focusing on the “political” motives for the government’s efforts to renegotiate the contract fails to take into account that governments likely will by their very nature – and should be – responsive to and driven by political motives as those are ultimately driven by the needs and demands of constituents they represent, particularly when the contract relates to provision of essential public services. Just as a project company may seek renegotiation in order to satisfy shareholders, lenders or other key stakeholders to whom they owe duties, governments may seek renegotiation in order to respond to and advance the needs of the citizens to whom they are also accountable.

Other tribunals have similarly focused on the nature or mode of government conduct used to bring a private party back to the negotiating table.²⁵⁴ In *PSEG v. Turkey*, when the claimant had sought government approval to convert its public law contract to a private law one giving it the right to arbitrate disputes, the government indicated that it would only agree to support the claimant’s application if the claimant agreed to renegotiate certain aspects of the underlying contract. The tribunal considered the government’s attempt to impose that condition an improper exercise of sovereign authority and relied on it when finding that the government had violated the treaty.²⁵⁵

AES v. Hungary is similarly critical of government efforts to use sovereign powers to encourage or “force” renegotiations:

[I]t cannot be considered a reasonable measure [consistent with the for a state to use its governmental powers [including its power to implement laws or issue decrees] to force a private party to change or give up its contractual rights. If the state has the conviction that its contractual obligations to its investors should no longer be observed (even if it is a commercial contract, which is the case), the state would have to end such contracts and assume the contractual consequences of such early termination.²⁵⁶

With respect to the motives, the *AES v. Hungary* tribunal said – in contrast to *Vivendi II* – that “political” reasons for taking action could weigh against, rather than in favor of liability. That case had arisen out of Hungary’s actions to address alleged excessive profits obtained by electricity generators under the country’s pricing regime. The tribunal noted that the level of the companies’ returns had become “a public issue and something of a political lightning rod in the face of upcoming elections”;²⁵⁷ but rather than evidencing the irrationality of the government’s conduct, the political attention on the matter indicated it was a public policy topic of widespread concern that the government could legitimately address through exercise of its lawmaking powers. If exercise (or potential exercise) of government authority had the effect of encouraging the investor to renegotiate the underlying contract then, under the *AES* tribunal’s reasoning, that fact would not be sufficient to render the government’s conduct a breach of the investment treaty.

In another departure from the *Vivendi II* approach, in *Electrabel v. Hungary*, the tribunal rejected the claimant’s assertion that Hungary’s actions seeking, inter alia, renegotiations of power purchase agreements, were improperly driven by “political” motives and thus violated the FET obligation.²⁵⁸ The tribunal stated:

²⁵⁴ See, e.g., *AES v. Hungary*, para. 10.3.12; *RDC v. Guatemala*, paras. 230-235.

²⁵⁵ *PSEG v. Turkey*, para. 247.

²⁵⁶ *AES v. Hungary*, para. 10.3.12.

²⁵⁷ *AES v. Hungary*, 10.3.22.

²⁵⁸ On these arguments by the claimant, see, e.g., *Electrabel v. Hungary*, paras. 7.6 and 8.8.

There is no doubt that by late 2005 and early 2006 there was political and public controversy in Hungary over the perceived high level of profits made by Hungarian Generators, including Dunamenti. However, politics is what democratic governments necessarily address; and it is not, ipso facto, evidence of irrational or arbitrary conduct for a government to take into account political or even populist controversies in a democracy subject to the rule of law.²⁵⁹

ii. Firm-led Renegotiation

Other cases have looked at government conduct in response to investor requests for extra-deal renegotiations, and have signaled that even when the government had no legal duty under the relevant contract to enter into or conclude those renegotiations, investment treaties may impose certain requirements regarding how to respond to those renegotiation requests. In *Biwater v. Tanzania*, for instance, the tribunal recognized that the government had no legal obligation under the contract to enter into the broad renegotiations sought by the water services concessionaire, but that it nevertheless decided to accommodate the concessionaire and engage in those discussions. Rather than rejecting the claimant's claim that the government was liable for its conduct in those renegotiations on the ground that the government had no duty to engage in them in the first place, the tribunal proceeded to scrutinize the government's approach to procedural and substantive aspects of those talks. It ultimately concluded that the government performed the renegotiation in good faith, was not unreasonable in its decision to require the renegotiations be conducted within a limited timeframe,²⁶⁰ and was also not unreasonable in its decision to reject the concessionaire's proposal or to require the concessionaire to accept certain of the government's own terms.²⁶¹

This decision, similar to *PSEG v. Turkey*, suggests that investors dissatisfied with the process or outcome of investor-initiated extra-deal renegotiations may be able to use investment treaties to challenge the procedures adopted and stances taken by governments in those talks, potentially providing them leverage over their government counterparty to the contract.

D. Harm Caused by Conduct of Third Persons

In a number of cases, the tribunals have examined whether, when, and to what extent a government has an obligation to protect an investor against physical, legal, and economic harm²⁶² directly caused by third persons and citizens of the host country including, but not limited to, customers of the

²⁵⁹ *Electrabel v. Hungary*, para. 8.23.

²⁶⁰ *Biwater v. Tanzania*, paras. 652-654.

²⁶¹ *Biwater v. Tanzania*, paras. 673-675.

²⁶² See, e.g., *Viviendi II v. Argentina*, paras. 7.4.15 - 7.4.16 (stating that unless parties to the treaty expressly limited the obligation to provide full protection and security to "physical security" the tribunal would not read such a limit into the text); *Azurix v. Argentina*, ICSID Case No. ARB/01/12, Award, para. 408; *Frontier Services v. Czech Republic*, Award, para. 263. See also, *PSEG v. Turkey*, para. 258 (noting that the full protection and security standard "has developed in the context of the physical safety of persons and installations, and only exceptionally will it be related to [a] broader ambit"); *AES v. Hungary*, para. 13.3.2 (stating that while generally concerned with protecting covered investors (or enabling those investors to protect themselves) from physical harm by third persons, the standard can, "in appropriate circumstances, extend beyond a protection of physical security"). But see, e.g., *Saluka v. Czech Republic*, Partial Award, para. 483. These cases illustrate that tribunals differ regarding the type of protection offered by the "full protection and security" provisions. Some of those differences may derive from the fact that the wording of the provision differs from treaty to treaty; some also may derive from the fact that states had different understandings of the language. But see *Frontier Services v. Czech Republic*, Award, para. 260 (stating without explanation that the differences in wording did not appear to have "substantive significance").

investor²⁶³ and other branches and entities of government²⁶⁴. This duty is treated as part of the FET obligation and/or the obligation to provide foreign investors “(full) protection and security.”²⁶⁵

Relevant to private investment of infrastructure and related public services, investors have argued that treaties impose on governments certain duties to protect investors and investments from harm through ensuring that investors have access to legal mechanisms to safeguard and assert their rights in disputes with other private or governmental individuals or entities, including consumers or regulators of concessionaires,²⁶⁶ protecting investors against legal and economic changes that impair their business,²⁶⁷ and protecting investors from disruptions in business operations and physical harm to property through actions of worker, environmental, protestors, squatters, or others.²⁶⁸

A number of cases have dealt with the particular issue of the government’s role in easing or exacerbating tensions between the concessionaire and the public, including its customers and workers. In *Vivendi v. Argentina II*, the tribunal took issue with the public statements made by and actions of individual legislators, the legislature, the ombudsman, the Court of Accounts, executive officials, and the regulating entity – conduct that the tribunal viewed as “devastating ... the economic viability”²⁶⁹ of the concession by “undermin[ing]” the concessionaire and the legitimacy of the concession contract,²⁷⁰ thereby explicitly or implicitly discouraging customers’ payment of their water bills and putting the concessionaire in a financial position where it was effectively compelled to renegotiate:

Under the fair and equitable standard, there is no doubt about a government’s obligation not to disparage and undercut a concession (a “do no harm” standard) that has properly been granted, albeit by a predecessor government based on falsities and motivated by a desire to rescind or force a renegotiation.²⁷¹

²⁶³ See, e.g., *Vivendi II v. Argentina*, paras. 7.4.15 – 7.4.16, 7.4.38-7.4.39.

²⁶⁴ *Biwater v. Tanzania*, Award, para. 730.

²⁶⁵ The obligation to protect against harm by third persons has been described by as some as “an obligation [not] of result, [but] an obligation of good faith efforts to protect the foreign-owned property ... without special regard for the resources available to do so. This has been referred to as a standard of ‘due diligence’ on the part of the host country.... It places a clear premium on political stability, and the obligation of host countries to ensure that any instability does not have negative effects on foreign investors, even above the ability to protect domestic investors.” UNCTAD Series on International Investment Policies for Development, *Investor-State Disputes Arising from Investment Treaties: A Review* (2005), pp. 40-41 (discussing cases).

²⁶⁶ See, e.g., *Biwater v. Tanzania*, Award, para. 483 (noting that claims under the full protection and security standard can be brought against government actors); and *Frontier Petroleum Services v. Czech Republic*, Award, Nov. 12, 2010, paras. 272-73 (stating that for a judicial system to provide “full protection and security” that means the state must “make a functioning system of courts and legal remedies available to the investor” and that courts can satisfy that test if they have “acted in good faith and have reached decisions that are reasonably tenable” id. at para. 273)(emphasis in original)); see also *Lauder v. Czech Republic*, Final Award, September 3, 2014, para. 314 (“The investment treaty created no duty of due diligence on the part of the Czech Republic to intervene in the dispute between the two companies over the nature of their legal relationships. The Respondent’s only duty under the Treaty was to keep its judicial system available for the Claimant and any entities he controls to bring their claims.”).

²⁶⁷ *Azurix v. Argentina*, ICSID Case No. ARB/01/12, Award, July 14, 2006, para. 408.

²⁶⁸ See, e.g., *Toto Costruzioni Generali v. Lebanon*, ICSID Case No. ARB/07/12, Award, June 7, 2012 (rejecting the investor’s claim that the state was liable for failing to remove Syrian troops and former landowners and residents from an area on which the investor was to construct a highway); *Noble Ventures v. Romania*, ICSID Case No. ARB/01/111, Award, October 12, 2005, paragraphs 164-166 (rejecting the claimant’s argument that the state breached the standard by failing to protect against protests by workers); *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, paras. 175-177.

²⁶⁹ *Vivendi v. Argentina II*, paras. 7.4.38 – 7.4.39.

²⁷⁰ *Vivendi v. Argentina II*, para. 7.5.29.

²⁷¹ *Vivendi v. Argentina II*, paras. 7.4.39 – 7.4.39.

In another water services investment, the tribunal similarly held that the respondent state violated the investment treaty by making public statements that undermined the legitimacy of the concessionaire in the eyes of the public:

622. The Arbitral Tribunal notes that at an early stage of the Project, the Republic did actively manage the expectations of the public with regard to the speed of improvements of the network. In his State of the Nation address to Parliament on 12 February 2004, the President of Tanzania stated as follows:

“The decision to privatize water and sewerage services in Dar es Salaam City was not an easy one to take. But we had to take a decision having analyzed the reality of our situation, and carefully weighing the pros and cons. Finally we took a decision and concessionary (sic) the infrastructure to City Water from 1 August 2003. Surprisingly, even when the concession has not run for six months some people are becoming impatient wanting all problems to disappear immediately. That is not realistic. We have lived with these problems, and countenanced them for many years. How can one expect City Water to resolve all of them in six months?”.

...

624. In May 2005, the Republic’s attitude dramatically changed. Far from seeking to manage the public’s expectations, the Minister acted in such a way as to undermine the public’s confidence in City Water, especially during the press conference of 13 May 2005 where the Minister referred to City Water’s poor performance and informed the public that the Lease Contract had been terminated and that DAWASCO was taking over.

...

627. The position in May, therefore, was that despite its poor record, and despite all the public criticisms, City Water still had a right to the proper and unhindered performance of the contractual termination process. In the Arbitral Tribunal’s view, the Republic’s public statements at this time constituted an unwarranted interference in this. They inflamed the situation, and polarised public opinion still further, thereby ensuring that from May 2005 onwards, the process by which the Lease Contract was terminated and City Water was removed did not – and could not – follow a normal contractual course.

628. The Arbitral Tribunal concludes that in acting in such a way in May 2005, the Republic did not comply with the fair and equitable treatment principle.²⁷²

Ultimately, in *Biwater v. Tanzania*, the tribunal determined that the government’s breach of the treaty did not cause the investor any monetary damages; nevertheless it and *Vivendi II* counsel caution by governments when communicating to the public regarding what to expect from and what their rights are with respect to their public services providers. These decisions prompt concern that governments will be unduly reluctant to take positions on concessionaires or share information with the public. These decisions may contradict domestic laws providing privileges or immunities to such conduct in order to ensure that fear of liability does not hinder public speech.

VIII. Other Issues

This paper focuses on addressing what investment treaties mean for investments in infrastructure and related public services by addressing when investment treaties cover those investments, how they impact the pre-project phases, and how they are relevant for ongoing operations. Yet other issues are also important that must be kept in mind and that merit deeper examination. These include questions relating to how investment treaties impact contract termination,²⁷³ what government individuals and entities can trigger state liability; and what implications treaty-based investor-state arbitration has for a

²⁷² *Biwater v. Argentina*, Award, paras. 622-628.

²⁷³ Investment tribunals have also weighed in on states’ rights and duties in connection with terminating concessions or other investor-state contracts relating to infrastructure and other long-lived projects. See, e.g., *Biwater v. Tanzania*, ICSID Case No. ARB/05/22; *Occidental v. Ecuador*, ICSID Case No. ARB/06/11.

range of crucial topics such as strength of incentives for parties to litigate or resolve disputes, the extent of state liability, the amount of litigation costs, the nature of contracting parties' rights, obligations, claims and defenses, and the procedural and evidentiary issues that may impact the success of parties' cases.

IX. Conclusion

Countries globally have entered into thousands of investment treaties protecting foreign "investments" and "investors", broadly defined. Like political risk insurance, these treaties are tools investors can use to secure compensation for damages caused by the host state's conduct. Such protections can be particularly important in the eyes of investors whose investments require large sunk costs and significant commitments of time in the host country, face risks associated with high degrees of uncertainty regarding future legal and economic conditions affecting the investment, and involve activities of heightened public and political interest.

These features are all common features of investments in infrastructure projects (and are also frequently characteristic of investments in the extractive industries). Thus, investors in infrastructure projects are likely to be interested in benefitting from the added buffer against host-state conduct that investment treaties can provide and, in fact, have used those treaties in order to challenge allegedly wrongful government conduct in a growing body of disputes.

For governments, however, the treaties can bring unanticipated challenges, risks and costs. Crucially, investment treaties are capable of modifying the legal framework that would otherwise govern an investment project, enabling the investor to invoke a set of rights and recover damages that would have been unavailable under the contract or domestic law applicable to the project. In some circumstances, this outcome can help ensure investors are not abused through egregious government conduct that might nevertheless be valid under the law of the host jurisdiction. Yet it also threatens to upset the balances between public rights and private interests, and mechanisms of governance and accountability that many jurisdictions have carefully struck.

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