CHAPTER 9

INVESTMENT TREATY ARBITRATION

9.1 Introduction

The purpose of this chapter is to examine another type of arbitration that impacts on the sector investment treaty arbitration.

Investment treaties are entered into between states. They give investors from one state protection for their investments in the territory of other states. So, for example, an investment treaty between the United Kingdom and Argentina would oblige Argentina to afford investors from the United Kingdom certain minimum standards of treatment. Likewise, the United Kingdom would be obliged to provide the same standards of treatment to Argentine investors in the United Kingdom.¹

Investment treaty arbitration is the process whereby a dispute relating to this protection between an investor and a host state is determined by neutral arbitrators. It would be of little benefit to investors if they were obliged to enforce their rights under investment treaties in the courts of the host state responsible for their mistreatment, since often the action complained of is a change in the local law which the relevant court is obliged to uphold. Instead, investment treaties provide for international arbitration outside the national court system.²

This chapter explores the distinction between commercial arbitration and treaty arbitration, the availability and scope of the latter, and the opportunities that treaty arbitration may provide for investors. To begin with, the concepts which underlie the investment treaty arbitration regime and briefly describe their evolution.

9.2 The Development of Investment Treaties

Initially, powerful states protected the commercial interests of their nationals overseas by so-called 'gunboat diplomacy', ensuring satisfactory treatment through conspicuous military

power. However, in the first half of the 20th century, with the internationalisation of trade and commerce, attempts were made to protect investment through legal principles.

Following World War II, wealthier states started to enter into treaties on friendship, commerce and navigation with states into which their investment capital was exported. These guaranteed certain standards of treatment for investors of one state in the territory of another. Such treaties gradually evolved into more sophisticated instruments for protection of investors and their investments, and in 1959 the first modern bilateral investment treaty (BIT) was entered into between Germany and Pakistan.\(^3\)

In 1965 an international treaty on the protection of foreign investments, the Washington Convention, was opened for signature. It established the International Centre for Settlement of Investment Disputes (ICSID), which is dedicated to the resolution of international investment disputes, under the auspices of the World Bank, and has created its own arbitration rules for this purpose (the ICSID Rules).\(^4\)

The creation of ICSID led to increasing numbers of BITs being entered into, which provided for direct arbitration proceedings between investors and host states. The United Kingdom concluded its first BIT on this model in 1975, agreeing to reciprocal protection of investments with Egypt and investor-state arbitration in the event that such protection was not forthcoming.\(^5\)

The 1990s saw a surge in the popularity of BITs. During this period the number of BITs increased fivefold, as foreign direct investment boomed.\(^6\) The clamour for sophisticated investment protection instruments to accompany huge inflows of investment into developing countries meant that there were over 1,800 BITs at the end of the decade; as of 2010, there were over 2,800 BITs in force.\(^7\)

\(^3\) Ibid.
\(^4\) Id., at 226.
\(^7\) World Investment Report 2011 UNCTAD (July 26 2011).
Accompanying this trend was another phenomenon — multilateral investment treaties (MITs). These operate in essentially the same way as BITs, except that instead of one bilateral relationship between two states, MITs involve a group of states agreeing to provide investment protection to investors from each other's jurisdictions. In the energy sector, the most prominent MIT is the Energy Charter Treaty (ECT). This was established in 1994 and provides for multilateral cooperation on energy transit, trade and investment protection. To date, 51 countries have signed the ECT, and it has been signed collectively by the European Union and the European Atomic Energy Community.\(^8\)

### 9.3 Investment Treaty Arbitration in the Energy Sector

Despite this growth in investment treaties, it was not until 1987 that the first arbitration arising exclusively from an investor-state arbitration clause in a BIT was referred to ICSID.\(^9\) A UK investor sought $8 million in damages from the government of Sri Lanka following the destruction of its shrimp farming enterprise (it prevailed, but was awarded significantly reduced damages).\(^10\)

The number of investment treaty arbitrations has increased steadily since then, and it is believed that by the end of 2010 there had been 390 investment treaty arbitrations, with the overwhelming majority referred to ICSID for determination.\(^11\)

The energy industry has given rise to the highest proportion of ICSID disputes.\(^12\) This is a reflection of the scale of overseas investment in the sector and the economic pressures faced by host states to achieve a 'fair take' from energy projects as oil (and other commodity) prices rise. In particular, the increase in commodity prices since the start of the 21st century has stimulated a

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\(^8\) Supra note 1 at 226.

\(^9\) As opposed to ICSID cases arising from specific consent to arbitration. See paragraph 18 of the award: “The present case is the first instance in which the Centre has been seized by an arbitration request exclusively based on a treaty provision and not in implementation of a freely negotiated arbitration agreement directly concluded between the Parties among whom the dispute has arisen.”

\(^10\) Asian Agricultural Products Ltd v Sri Lanka, (ICSID Case ARB/87/3).


\(^12\) Statistics published by ICSID show that 38% of ICSID arbitrations have arisen from the oil, gas, mining, electric power or other energy sectors. her The ICSID Caseload — Statistics (Issue 2011-2).
spate of unilateral actions by host states from South America to Central and Eastern Europe, which in turn has generated investment treaty claims.\textsuperscript{13}

High-profile investment treaty proceedings in the energy industry in recent years include:

- Chevron's claim against Ecuador arising from Chevron's allegations that it had been deprived of an effective means of asserting claims and enforcing rights in Ecuador under the Ecuador-US BIT;
- Exxon Mobil's claim against Venezuela arising from Exxon Mobil's allegations that its oil assets had been nationalised in Venezuela contrary to the Netherlands-US BIT;
- Saipem's claim against Bangladesh arising from Saipem's allegations that Bangladesh had expropriated its rights contrary to the Italy-Bangladesh BIT in relation to a gas pipeline construction contract after the Bangladeshi courts had overturned a commercial arbitration award;
- claims by certain former shareholders of Yukos against the Russian Federation that Russia had expropriated their investments in Yukos contrary to the ECT; and
- Occidental Petroleum's claim against Ecuador arising from Occidental's allegations of various breaches of the Ecuador-US BIT.\textsuperscript{14}

Such claims would suggest that investment treaty arbitration is invariably brought by companies from developed economies against developing economies. However, while there are many that fall into this category that is not always the case. In 2009 Swedish utility Vattenfall commenced proceedings against Germany alleging breach of the ECT in the manner in which environmental restrictions had been placed on Vattenfall's coal-fired power plant. This case, subsequently settled, demonstrates that investment treaty claims may fall outside the usual paradigms. There are likely to be more such cases in future.\textsuperscript{15}

\textbf{9.4 Differences between Investment Treaty Arbitration and Commercial Arbitration}

Investment treaty arbitration differs from commercial arbitration in the following ways:

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\textsuperscript{13} Supra note 1 at 227.
\textsuperscript{14} Ibid.
\textsuperscript{15} Ibid.
• Political dynamic — treaty arbitrations are between states and investors. The decisions of tribunals may have far-reaching consequences for government policy and finances, and may address issues of wide public interest. For example, there may be tensions between the legitimate demands of the people of host nations for development or environmental protection on the one hand and the legal rights of investors for the preservation of their investments on the other. The stakes may often be higher in treaty arbitrations than in conventional commercial disputes, engaging the attention of the media, the business community and non-governmental organisations.¹⁶

• Consent to arbitration party consent is the foundation of the commercial arbitration process. The parties agree to have their dispute determined by an independent tribunal rather than by the courts of any state. This agreement gives the arbitral tribunal the authority to determine the dispute. By contrast, in treaty arbitration the agreement to arbitrate arises from the host state unilaterally consenting to arbitration with any investor which falls within the protections contained within the BIT or MIT, and the investor providing its consent by commencing arbitration proceedings. This has led some commentators to refer to investment treaty arbitration as arbitration 'without privity' (ie, arbitration where there is no direct contractual relationship between host state and investor).¹⁷

• Frequency of jurisdictional disputes states which are recipients of investment treaty claims often seek to raise arguments of jurisdiction. They argue, in particular, that the investor is not entitled to the protection of the applicable BIT or MIT, or contend that the relevant investment does not fall within the scope of the BIT or MIT. Such preliminary issues add to the length and cost of treaty arbitration proceedings.¹⁸

• Importance of international law principles and experts in this subject an understanding of the principles of international investment law is fundamental to treaty arbitration. For this reason, arbitrators and counsel with legal expertise in the field are in great demand. The universe of treaty arbitration specialists is relatively

¹⁶ Supra note 1 at 228.
¹⁷ Ibid.
¹⁸ Ibid.
small, with the discipline crystallising around a small number of international law firms.\(^\text{19}\)

- **Publicity** — unlike commercial arbitration, the existence of investment treaty arbitration proceedings is often made public. Many awards come onto the public record. The exposure of proceedings to public scrutiny may give rise to controversy and criticism, of both the parties and the arbitral process.\(^\text{20}\)

### 9.5 Availability of Investment Treaty Arbitration to Claimants

The first question for an investor considering a treaty claim is whether there exists a treaty that gives appropriate protection. This is likely to depend on two principal issues:

- whether the investor falls within the protections offered by a BIT or MIT; and
- Whether the investment is protected under the BIT or MIT.\(^\text{21}\)

#### 9.5.1 Who is an ‘investor’ under a BIT or MIT?

BITs protect only investments made by investors of one state party to the BIT in the territory of the other state party to the BIT. Many jurisdictional disputes have arisen regarding the definition of 'investor' in BITs.

Different BITs adopt different criteria for determining whether an investor is protected. Often a broad definition is adopted. “Individual investors” might be defined in terms of physical persons deriving their status as [contracting state] nationals from the law in force in the [contracting state].\(^\text{22}\) Corporate investors' might be defined as "corporations, firms and associations incorporated or constituted under the law in force in any part of the [contracting state]."\(^\text{23}\) This incorporation test is common in BITs concluded in recent decades. Other treaties

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\(^\text{19}\) Ibid.
\(^\text{20}\) Ibid.
\(^\text{21}\) Ibid.
\(^\text{22}\) See, for example, the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the State of Bahrain for the Promotion and Protection of Investments (October 1991).
\(^\text{23}\) See, for example, the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India for the Promotion and Protection of Investments (March 1994).
adopt more restrictive language. Thus, a corporate investor might need to have a head office in the territory of the contracting state.

Other treaties require that an investor carry out "effective economic activities" in the territory of the state whose nationality it claims. Some definitions focus on the underlying control of the investor, with wording defining a 'corporate investor' as a company "effectively controlled, directly or indirectly, by nationals of one of the Contracting Parties". Many BITs adopt a combination of tests to determine nationality.

The nature of control or ownership can be significant in the context of defining an 'investor' claimant. Host states often require that project companies be incorporated within their jurisdictions. The nationality of such project companies is from the host state, and they would therefore not be entitled to the protection of the BIT without express provision. For this reason, many treaties contain wording such as that above so that a project company that is incorporated in the state in which the investment is made, but is controlled by overseas investors, would be entitled to the protection of any relevant BIT.

On the other hand, many BITs also contain so-called ‘denial of benefits ‘provisions. These permit a host state to deny the benefits of a treaty to a company that is controlled by investors of a non-party to the treaty. These provisions are aimed at precluding so-called 'letterbox companies', which have no substantial business activities in a contracting state, from taking advantage of treaty provisions.

The ECT adopts a broad definition of ‘investor’:

(a) with respect to a Contracting Party:

(i) a natural person having the citizenship or nationality of or who is permanently residing in that Contracting Party in accordance with its applicable law;

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25 Supra note 1 at 229.
26 Ibid.
(ii) a company or other organization organized in accordance with the law applicable to that Contracting Party.\textsuperscript{27}

In the claims brought by former shareholders in Yukos against the Russian Federation alleging expropriation of their shareholdings, the Russian Federation argued that the claimants did not fall within definition (ii) above because they were not truly nationals of another contracting party to the ECT, but were ultimately Russian nationals.\textsuperscript{28} The tribunal disagreed, observing that the ECT requires only that a claimant be organised in accordance with the law applicable in the contracting state through which it claims the jurisdiction of the ECT, "regardless of the nationality of shareholders, the origin of investment capital or nationality of the directors or management". The claimants satisfied this test.\textsuperscript{29}

Accompanying the ECT's definition of 'investor' is 'denial of benefits' wording entitling the host state to exercise its right to “deny the advantage of [the investment protection provisions of the ECT] to a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Areas of the Contracting Party in which it is organized” (Article 17). Arbitral tribunals in ECT cases have consistently taken the view that host states must actively exercise their rights to deny advantages under the ECT under this provision. Those rights cannot merely be denied automatically.\textsuperscript{30} The exercise of the right to deny benefits to an investor has no retrospective effect, meaning that a respondent state could not deny the benefits of the ECT to an investor as a defence to an arbitration claim.\textsuperscript{31}

\subsection*{9.5.2 What is an ‘investment’ under a BIT or MIT?}

It is a misconception that investment treaties commonly protect only a narrow category of investments and transactions. 'Investment' is often defined broadly. Frequently, the definition will

\begin{footnotesize}
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\item\textsuperscript{27} Article 1(7). The concept of ‘control’ or ‘ownership’ of assets is addressed by the definition of ‘investment’ (see below).
\item\textsuperscript{28} \textit{Huley Enterprises Limited v The Russian Federation} (PCA Case AA 226); \textit{Yukos Universal Limited v The Russian Federation} (PCA Case AA 227); \textit{Veteran Petroleum Trust v The Russian Federation} (PCA Case AA 228).
\item\textsuperscript{29} Supra note 1 at 230.
\item\textsuperscript{30} See, \textit{Pima Consortium Ltd v Bulgaria}, Award on Jurisdiction (ICSID Case ARB/03/24); \textit{Yukos Universal Ltd v Russian Federation}.
\item\textsuperscript{31} See, \textit{Plasm Consortium Ltd v Bulgaria}, Award on Jurisdiction.
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take the form of an asset-based formulation, referring to "every kind of asset" and then setting out a non-exhaustive list of categories, such as:

- movable and immovable property and any other property rights;
- shares in and stocks and debentures of a company;
- claims to money or to any performance under a contract having financial value;
- IP rights, goodwill, technical processes and know-how and similar rights; and
- business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.\(^{32}\)

This list makes it clear that the definition includes both the more obvious categories of investment asset (eg, ownership of physical property) and contractual rights (eg, those for the exploration and development of oil and gas reserves). Some treaties define ‘investments’ more restrictively by:

- requiring that the investment be made in accordance with the laws and regulations of the host state, which effectively imposes an obligation on an investor to comply with domestic legislation rather than seeking to benefit from a more favourable regime for overseas investors;
- requiring that the investment be made in the territory of the host state. This may raise issues where the investment is intangible (eg, a contractual right) and is not obviously made within the host state;
- requiring that the investment have the characteristics of an investment. The US Model BIT requires that an investment be one that "an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk";
- defining 'investment' exhaustively such that the investment must fall within the finite categories specified in the definition; or
- excluding certain 'investments', such as those made other than for business purposes (in order to prevent assets such as holiday homes from attracting protection).

\(^{32}\) See, for example, Agreement between the Government of the Republic of Ghana and the Government of the Republic of Guinea for the Promotion and Protection of Investments.
Tribunals have distinguished between investments which receive protection under BITs and ordinary commercial transactions which do not. In doing so they have adopted tests similar to those used to determine whether an investment exists for the purposes of the Washington Convention. For example, in Romak SA v Republic of Uzbekistan a tribunal found that "rights... embodied in and [that] arise out of a sales contract, a one-off commercial transaction pursuant to which [the claimant] undertook to deliver wheat against a price to be paid by the Uzbek parties" did not constitute an investment for the purposes of the applicable BIT.

One issue which has been considered is the extent to which the costs of making an abortive investment can qualify for BIT protection. In Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka expenditure incurred before an investment in the development of a power station in Sri Lanka was held not to be an investment. The power station development never proceeded and the tribunal stated that it could find no evidence in investment treaty practice that "pre-investment and development expenditures... could automatically be admitted as 'investment' in the absence of the consent of the host State to the implementation of the project".

Although the definition of 'investment' may extend to contracts entered into directly between two private parties, rather than between an investor and the host state, any such transaction which does not have the necessary characteristics of an investment (see below) will not be afforded protection.

The ECT sets out a non-exhaustive list of investment categories that again recalls wording found in many BITs, and refers to "every kind of asset owned or controlled directly or indirectly by an Investor", including tangible and intangible property, shares, claims to money, intellectual property and returns (Article 1(6)).

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33 See, for example, the decision of an ad hoc committee (a body convened to review an award) in Mitchell v Democratic Republic of Congo (ICSID Case ARB/99/7 (decision on annulment)).
34 Supra note 1 at 231.
35 Ibid.
36 See, for example, Alps Finance and Trade AG v The Slovak Republic (UNCITRAL award).
37 Supra note 1 at 231.
However, as the ECT is concerned only with the energy industry, protected investments are those associated with economic activity in the energy sector relating to certain energy materials and products. The definition of 'economic activity in the energy sector' comprises any economic activity concerning the exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade marketing or sale of "energy materials and products" (Article 1(5)). This latter phrase encompasses materials and products in the nuclear, coal, natural gas, petroleum and electrical industries.\(^\text{38}\)

The text of the ECT is accompanied by a number of understandings agreed by the contracting states with regard to interpretation of the ECT. One understanding clarifies that direct or indirect control by an investor, for the purposes of the definition of 'investment', means "control in fact, determined following consideration of the investor's financial interest in the investment, and its ability to exercise substantial influence over the investment and its management" (Understanding 3). Another understanding specifies illustrative "economic activities in the energy sector", which include exploration and extraction operations, construction and operation of power generation facilities (including wind and renewable sources), removal and disposal of waste (including radioactive waste), decommissioning of facilities and research, consulting, planning, management and design activities (Understanding 2).\(^\text{39}\)

9.5.3 Can an Investor Participate in ICSID Arbitration?

ICSID remains the preferred choice for investment treaty arbitration claimants because of the involvement of the World Bank and the restricted grounds on which a losing party may resist enforcement of an ICSID award, leading to greater chances of successful enforcement. Claimants considering proceedings must establish that they are able to take advantage of the Washington Convention.\(^\text{40}\)

Nearly 150 states have signed and ratified the Washington Convention.\(^\text{41}\) States which have not signed the convention include Brazil, Mexico, South Africa, Poland and India. Equally

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\(^\text{38}\) Id., at 232.
\(^\text{39}\) Ibid.
\(^\text{40}\) Ibid.
\(^\text{41}\) ICSID, List of Contracting States and other Signatories of the Convention.
significant are a small number of countries which have signed the convention, but have not ratified it, such as Canada and Russia, meaning that claims under the Washington Convention cannot be brought against those states and investors from those states cannot bring ICSID arbitration against other states.

In addition, a number of states have notified ICSID of exemptions from the convention under Article 25(4). Thus:

- China has consented to ICSID arbitration only in respect of "disputes over compensation resulting from expropriation and nationalisation";
- Saudi Arabia “reserves the right of not submitting all questions pertaining to oil and pertaining to acts of sovereignty” to ICSID arbitration; and
- Turkey has notified ICSID that "disputes, related to the property and real rights upon the real estates are totally under the jurisdiction of the Turkish courts” and not subject to ICSID arbitration.\(^\text{42}\)

Even if an investor identifies a BIT or MIT under which it might be able to pursue an ICSID claim, in order to participate in ICSID arbitration it must satisfy the test set out in Article 25 of the Washington Convention. Pursuant to Article 25, the principal requirements for ICSID arbitration are that:

- the parties consent to ICSID arbitration in writing; and
- there exists a legal dispute arising directly from an investment between two ICSID contracting states (ie, states that have ratified the Washington Convention).\(^\text{43}\)

There are different ways in which parties may consent to ICSID arbitration. A contracting state and an investor may agree to ICSID arbitration in an investment contract, such as a production sharing agreement. Alternatively, a contracting state may consent to ICSID arbitration in its domestic investment legislation. More commonly, a BIT or MIT will contain the contracting state's unilateral consent to arbitrate disputes arising thereunder at ICSID. As described above, the investor then provides its consent by commencing arbitration proceedings.\(^\text{44}\)

\(^{42}\) \textit{Supra} note 1 at 232.

\(^{43}\) \textit{Ibid.}

\(^{44}\) \textit{Supra} note 1 at 233.
The nature of an 'investment' and whether an 'investor' is a national of another ICSID contracting state has given rise to controversy. These tests frequently generate jurisdiction objections by respondent states and there is overlap here with the jurisdictional arguments under investment treaties that have been referred to above.

The Washington Convention does not define an 'investment'. Tribunals considering the issue have tended to use as a starting point the decision in Salini Costruttori SpA v Kingdom of Morocco, which involved claims arising from a Moroccan construction project. The tribunal held that an investment must involve:

- contributions by the investor;
- a certain duration of performance of the contract;
- a participation in the risks of the transaction; and
- a contribution to the development of the host state.  

However, in recent years tribunals have moved away from adopting an exclusive set of criteria. In Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania, a case involving sanitation facilities in Tanzania, the tribunal favoured “a flexible and pragmatic approach”.

In Phoenix Action v The Czech Republic the tribunal reconsidered the approach of the Salini case and noted that an investment made either in bad faith or illegally cannot fall within the scope of ICSID. In Saba Fakes v Republic of Turkey, a case involving alleged expropriation of telecommunications assets, the tribunal considered the approaches adopted by tribunals and noted that some tribunals had added, to the four Salini criteria, the “requirement of a regularity of profit and return”. However, the tribunal concluded that “the criteria of (i) a contribution, (ii) a certain duration, and (iii) an element of risk, are both necessary and sufficient to define an investment within the framework of the Washington Convention”.

An investor seeking to bring a treaty claim to ICSID will need to satisfy the definition of 'investment' both in the applicable treaty and in Article 25 of the Washington Convention. The tests are separate, although satisfaction of the treaty test may well, in practice, satisfy the ICSID test. In Malaysian Historical Salvors, SDN, BHD v Malaysia, a claim arising from operations to

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45 Ibid.
salvage a historical wreck, an ICSID annulment committee rejected a restrictive interpretation of 'investment' under the Washington Convention in circumstances where the BIT pursuant to which the claim was commenced defined 'investment' broadly. The committee concluded that the definition of 'investment' under the Washington Convention had to be interpreted by reference to the definition of 'investment' in the BIT.  

ICSID arbitration is available only to nationals of a contracting state other than the contracting state in which the investment is made. However, parties to a dispute can agree that a national of a contracting state in which an investment is made shall be considered a national of another contracting state by virtue of foreign control (Article 25(2) (b)). This is intended to apply where a host state requires that a project company be incorporated within its jurisdiction. If the project company is controlled by nationals of a different contracting state, the parties can agree that it will be entitled to participate in ICSID arbitration, notwithstanding its nationality.

The approaches of tribunals to the ICSID nationality requirement have varied. In TSA Spectrum de Argentina SA v Argentine Republic (ICSID Case ARB/05/5), which involved the privatisation of the Argentinian radio spectrum, the claimant argued that it should be treated as Dutch because its immediate parent company was Dutch. The tribunal concluded that even though the claimant's immediate parent company was Dutch, the ultimate owner was an Argentine national; consequently, jurisdiction was denied. However, in Tokios Tokeles v Ukraine the tribunal took a different approach. Even though nationals of Ukraine owned 99% of the claimant's shares and made up two-thirds of its management, the tribunal considered the claimant to be Lithuanian because it was incorporated there.

Other cases have adopted similarly differing approaches, which have tended to turn on the precise facts in dispute. As a result, it is difficult to formulate clear principles on which investors can rely as to when an investor will be considered to satisfy the nationality test.

As the requirements of Article 25 of the Washington Convention are restrictive, in 1978 ICSID introduced the Additional Facility Rules. These authorise the ICSID Secretariat to

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46 Supra note 1 at 234.
47 Ibid.
48 Ibid.
administer certain proceedings which do not fall within Article 25. Such proceedings include arbitration proceedings for the settlement of investment disputes between parties, one of which is not a contracting state or a national of a contracting state, and arbitration proceedings that do not arise directly out of an investment, "provided that the underlying transaction is not an ordinary commercial transaction" (Article 4(3) of the Additional Facility Rules). The Additional Facility Rules enable parties which do not satisfy the requirements of the Washington Convention to resolve their disputes using rules tailored to investment disputes. However, such arbitrations do not lead to awards which can be enforced under the Washington Convention, but instead must be enforced under the New York Convention (ie, they are treated as commercial arbitration awards).

9.6 Which Law Governs the Substance of the Dispute?

Investment treaties often make express provision for the substantive law which is to govern any dispute between an investor and a host state. Frequently this is expressed to be the treaty itself and the applicable rules and principles of international law. Reference may also be made to the laws of the host state. The ECT provides that any arbitral tribunal appointed thereunder shall "decide the issues in dispute in accordance with this Treaty and applicable rules and principles of international law" (Article 26(6)).

The Vienna Convention on the Law of Treaties provides that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose" (Article 31(1)), and by reference to "any relevant rules of international law applicable in the relations between the parties" (Article 31(3)).

In the absence of express choice of governing law, if ICSID arbitration is chosen, guidance is given by Article 42(1), which provides that "the Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable".

The modern approach to BITs and MITs is to interpret them in accordance with principles of international law, as informed by the law of the host state. This ensures that international

\[^{49}\text{Ibid.}\]
minimum standards apply to treaty interpretation and prevent host states from relying exclusively on their own laws in order to prejudice investors.50

9.7 What Claims may be Available to an Investor?

Many investment treaties offer substantially the same protections. Treaties are usually short and contain around 10 key provisions.

For example, the 1995 UK-Kazakhstan BIT comprises the following articles:

- definitions;
  - promotion and protection of investment, including the obligation to accord fair and equitable treatment to investors;
  - national treatment and most favoured nation (MFN) provisions;
  - compensation for losses (e.g., upon the occurrence of war, riots or emergency);
  - regulation of expropriation;51
  - repatriation of investment and returns;
  - exceptions;
  - settlement of disputes between an investor and a host state;
  - disputes between the state parties;
  - subrogation;
  - application of other rules;
  - territorial extension;
  - entry into force; and
  - duration and termination (providing that the BIT shall remain in force for 10 years and continuously thereafter, unless notice is given to terminate).

Investment treaty claims have produced a substantial body of case law. Significant awards are briefly discussed below. However, the wording of treaties and the extent of the protections

50 “A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty” (Vienna Convention on the Law of Treaties, Article 27).
51 That is, not without suitable compensation (see further below).
offered do differ. Decisions of tribunals are influential, but not binding on subsequent tribunals, and a variety of approaches is a feature of investment treaty case law.

9.7.1 Fair and Equitable Treatment

Providing fair and equitable treatment to investors is one of the fundamental obligations found in investment treaties and is a cornerstone of investment protection. However, there have been difficulties defining precisely what this is in particular circumstances. For this reason, investors often include claims for breaches of the duty of fair and equitable treatment in disputes under investment treaties in addition to claims brought under other provisions. The outcome of arbitration claims on the basis of breaches of the duty of fair and equitable treatment can sometimes be unpredictable.\(^{52}\)

Claims for breach of the obligation to provide fair and equitable treatment often arise where investors allege that the courts of a host state have treated them unjustly. This may involve a court failing to consider adequately claims brought by investors or by dispensing justice in a discriminatory way. In Mondev International Ltd v United States of America, a claim brought by Canadian investors under the North American Free Trade Agreement, the tribunal stated that “the test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome ... In the end the question is whether... a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment”.\(^{53}\)

Unfair administrative decisions by authorities in host states have also been advanced as the basis for investment claims. These may arise where the legitimate expectations of investors have not been met or the host state has acted inconsistently. In Saluka Investments BV v The Czech Republic (United Nations Commission on International Trade Law (UNCITRAL) arbitration) the tribunal held that the protection of legitimate expectations was the "dominant element" of fair and equitable treatment. However, the tribunal observed that "no investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order

\(^{52}\) Supra note 1 at 236.  
\(^{53}\) Ibid.
to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well".\textsuperscript{54}

Host states are entitled to make changes to the business environment within which an investor operates. However, if investors have received specific representations, legislative or regulatory changes should not be made contrary to these representations.

In Plama Consortium Limited v Bulgaria, an investor claimed breach of the fair and equitable treatment obligation in Article 10(1) of the ECT on the grounds that it had a legitimate expectation that it would not be liable for environmental damage occurring prior to its acquisition of a Bulgarian oil refinery. The tribunal disagreed, noting that "the ECT does not protect investors against any and all changes in the host country's laws. Under the fair and equitable treatment standard the investor is only protected if (at least) reasonable and justifiable expectations were created in that regard".\textsuperscript{55}

In Petrobart v Krygyzstan (Stockholm Chamber of Commerce (SCC) Award) the tribunal concluded that Krygyzstan had failed to accord Petrobart fair and equitable treatment under the ECT by transferring assets from a state-owned company which owed Petrobart money to another company, and by intervening in court proceedings to the detriment of Petrobart.

\textbf{9.7.2 Most favoured Nation/National Treatment}

A fair and equitable treatment provision places an absolute obligation on the host state. It must treat its investors fairly and equitably. Investment treaties also often provide for relative standards of treatment for investors.

An MFN provision ensures that an investor is treated no less favourably than other overseas investors. National treatment provisions ensure that investors are treated no less favourably than nationals of the host state. An MFN provision enables investors to take advantage of favourable provisions in other investment treaties entered into by the host state. In MTD Equity Sdn 131rd v

\textsuperscript{54} \textit{Ibid.}
\textsuperscript{55} \textit{Supra} note 1 at 237.
Republic of Chile, Malaysian investors seeking to establish a planned community in Chile incurred significant expenditure on the project. Following the subsequent refusal of permits, the investors relied on provisions in the Chile-Croatia and Chile-Denmark BITs that were more extensive than those found in the Chile-Malaysia BIT.

Debate has been provoked with regard to the extent to which investors can use MFN provisions to 'import' procedural rights from other investment treaties into treaties on which they rely. In Maffezini v The Kingdom of Spain, there was a complicated dispute resolution clause in the Argentina-Spain BIT. An Argentine investor failed to comply with the requirement that disputes be submitted to Spanish courts before arbitration. Instead, the investor relied on the simpler procedure in the Chile-Spain BIT. The tribunal held that he was entitled to do so. This decision has been criticised and tribunals have adopted differing approaches to whether procedural rights, as distinct from substantive rights, in other BITs can be invoked under MFN provisions.

9.7.3 Regulation of Expropriation

There is a perception that investment treaties forbid expropriation. In fact, they typically recognise that expropriation may occur, but provide for the level of compensation to which the investor is then entitled. Expropriation will often be permissible if it is justified and non-discriminatory, and if prompt, adequate and effective compensation is paid to the investor.

Expropriation is a broad concept which may take different forms. ‘Direct expropriation’ might involve the seizure of an asset by the host state. 'Indirect expropriation' might involve measures by a state depriving the investor of the economic benefit of its investment. Another example of indirect expropriation might be amendments to the fiscal terms governing a transaction. In recent years there has been a trend towards so-called ‘creeping expropriation’, where states gradually introduce measures that have the effect of depriving the investor of the benefit of its investment over time.

In Generation Ukraine Inc v Ukraine, the tribunal stated that “creeping expropriation is a form of indirect expropriation with a distinctive temporal quality in the sense that it encapsulates the situation whereby a series of acts attributable to the State over a period of time culminate in the expropriatory taking of such property”. In Walter Bair AG v The Kingdom of Thailand
UNCITRAL arbitration) the tribunal stated that “a strong interference with contractual rights needs to be shown”. No creeping expropriation was found to have occurred in a claim brought by a shareholder in a tollroad, noting that the host states “alleged misdeeds... were inaction rather than affirmative action”.

Article 13 of the ECT prohibits expropriation save where it is in the public interest, non-discriminatory, carried out under due process of law and accompanied by the payment of “prompt, adequate and effective compensation” calculated on the basis of “fair market value”.

In Ioannis Kardassopoulos v Georgia, the Greek claimant argued that Georgia had expropriated his investment in pipeline facilities by a series of governmental decrees. The tribunal concluded that this represented a “classic case” of direct expropriation and rejected Georgia's contentions that it had acted in the public interest by transferring pipeline rights to companies better able to develop necessary infrastructure, and that its acts had been non-discriminatory.

In Nykomb Synergetics v The Republic of Latvia (SCC Award) a tribunal considered a claim arising from the tariff to be paid for electrical power in Latvia to an investor. The investor claimed that the refusal by the state to pay the full tariff constituted creeping expropriation such that the enterprise was no longer economically viable. The tribunal concluded that so-called ‘regulatory takings’ may amount to expropriation. It stated that “the decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail”. However, in the circumstances it concluded that there was no taking of possession over the investor's assets or interference with the investor's rights or control over the investment.

9.7.4 Protection of Investments

Investment treaties usually require host states to offer full security and protection to investors. This is usually treated as a separate and distinct standard to fair and equitable treatment. Although the precise formulations differ, tribunals have found that host states are obliged to exercise due diligence and to be vigilant with regard to the physical protection of investments.

Tribunals have taken different approaches as to whether a protective obligation extends to legal protection as opposed to physical safeguarding. In Azurix Corporation v The Argentine
Republic, the tribunal noted that full protection and security “is not only a matter of physical security; the stability afforded by a secure investment environment is as important from an investor's point of view”. It found that Argentina had failed to protect adequately Azurix's investment in water and sewerage assets.

9.7.5 Free Transfer of Funds

The ability to transfer returns made from their investments to bank accounts outside the host state is important to investors. Most investment treaties address this. In some treaties, this protection is qualified by the application of the laws of the host state for the purposes of protecting creditors' rights (eg, on insolvency of an investor), enforcement and satisfaction of judgments and the collection of taxes. For example, the ECT states that the obligation to guarantee the freedom of transfer of funds is subject to the host state's right to "protect the rights of creditors, or ensure compliance with laws on the issuing, trading and dealing in securities and the satisfaction of judgments in civil, administrative and criminal adjudicatory proceedings" (Article 14).

9.7.6 Umbrella Clauses

In many investment treaties the host state agrees to observe any obligation that it has entered into with regard to investments in its territory. Provisions to this effect are known as 'umbrella' (or 'observance of undertaking') clauses. Such clauses can radically broaden the scope of what can be claimed under an investment treaty. If a host state has entered into a contract with an investor and then breaches that agreement, an umbrella clause may have the effect of elevating a contractual claim into a BIT claim.

Investors frequently argue that umbrella clauses elevate all breaches of contract by a state into breaches of BITs; states argue that they do not. The approach of tribunals to this has not been consistent. In SGS Societe Generale de Surveillance SA v Islamic Republic of Pakistan, a tribunal refused to elevate a breach of contract into a breach of the relevant BIT because to do so would have consequences "so far-reaching in scope, and so automatic and unqualified and sweeping in their operation [and] so burdensome in their potential impact upon a Contracting Party". The
tribunal held that "clear and convincing evidence" would have to be adduced to indicate that that
was the intention of the parties to the BIT.56

Conversely, in SGS Societe Generale de Surveillance SA v Republic of the Philippines, the
tribunal took a different view: it considered the wording of the BIT to be sufficiently clear that
a failure by the Philippines to observe a contractual commitment amounted to a breach of the
treaty.57

Subsequent tribunals have variously followed the approach taken in each of these cases. However, some commentators and practitioners consider that interpreting the clear meaning of
umbrella clauses in the manner of SGS v Philippines case is the more appropriate course. SGS v
Pakistan has been criticised as being overly restrictive. In Sempra Energy International v The
Argentine Republic, the tribunal "distinguished breaches of contract from treaty breaches on the
basis of whether the breach has arisen from the conduct of an ordinary contract party, or rather
involves a kind of conduct that only a sovereign state function or power could effect". The tribunal
noted that this distinction may not always be apparent. Article 10(1) of the ECT contains an
obligation on each contracting party to “observe any obligations it has entered into with an
Investor”. In Mohammad Ammar Al-Bahloul (Austria) v Tajikistan (SCC Arbitration) a tribunal
found that this obligation had been breached by Tajikistan failing to issue hydrocarbon exploration licences to the claimant investor in breach of contractual obligations to that effect.

9.8 How is an Arbitration Commenced and Conducted under an Investment Treaty?

Investment treaties typically set out the procedures to be applied in the event of a dispute.
Common practice is for the treaty to require mandatory negotiations between investor and host
state before the commencement of any proceedings. This cooling-off period is frequently three to
six months from notification of a claim.58

56 The relevant wording in the Switzerland-Pakistan Treaty was: “Either Contracting Party shall constantly
Guarantee the observance of the commitments it has entered into with respect to the investments of the
investors of the other Contracting Party.”

57 The relevant wording in the Switzerland-Philippines Treaty was: “Each Contracting Party shall observe
any obligation it has assumed with regard to specific investments in its territory by investors of the other
Contracting Party.”

58 The ECT prescribes a three-month cooling-off period (Article 26(2)).
Some older BITs require an investor to exhaust local remedies before commencing arbitration proceedings. This approach derives from a time when arbitration was perceived as a dispute resolution mechanism subsidiary to litigation. More commonly, investment treaties offer an investor the choice of litigation in local courts or international arbitration. In such circumstances, if the decision is taken to proceed in the local courts, the right to apply to arbitration may be extinguished. This mechanism is known as a 'fork in the road' provision.

The ECT offers investors the choice of dispute resolution in the courts or administrative tribunals of the host state, by any previously agreed dispute resolution procedure or by international arbitration (Article 26(2)). Certain states have required that where a dispute is submitted to local courts or other agreed procedure, the host state is deemed not to have consented to arbitration (Article 26(3)) (Annex ID).

Recent investment treaties provide investors with a choice of arbitration forum. Investors are often given the option of arbitration under ICSID or the ICSID Additional Facility Rules (where one of the treaty states is not party to the Washington Convention). Arbitration under the Rules of the Court of Arbitration of the International Chamber of Commerce (ICC) or the SCC Rules of Arbitration is often offered. Investment treaties commonly also enable an investor to commence ad hoc arbitration proceedings under the UNCITRAL Arbitration Rules. The majority of treaty arbitrations take place under either ICSID or the ICSID Additional Facility Rules, with UNCITRAL arbitration proving the next most popular choice.\(^{59}\)

Claimants selecting arbitration under the ECT have a choice of ICSID, ICSID Additional Facility Rules, SCC or ad hoc UNCITRAL Rules arbitration (Article 26). Faced with a choice between ICSID arbitration and arbitration in accordance with other institutional or ad hoc rules, the factors that the investor should consider are as follows:

- 'Delocalisation' of proceedings — unlike other forms of arbitration, ICSID arbitration is regulated exclusively by the Washington Convention. It is not dependent on national legal systems and there is no scope for the supervision or interference of national courts in the conduct of the arbitral proceedings.

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\(^{59}\) IIA Issues Note 1, March 2011, “Latest Developments in Investor-State Dispute Settlement”.
• Enforcement of awards — enforcement is not by means of the New York Convention. The Washington Convention regulates enforcement of ICSID awards, requiring contracting states to treat them as if they were judgments of a court of such state. ICSID awards are often considered to be more enforceable than awards where enforcement is sought under the New York Convention. This may be because of ICSID's association with the World Bank and the reluctance of states to be seen to defy an ICSID award. There are also fewer grounds to resist enforcement. Nevertheless, the Washington Convention does not prevent a state from invoking sovereign immunity to prevent the execution of any ICSID award (Article 54(3)) over its assets.  

• Scope for jurisdiction disputes — as explained above, ICSID arbitration frequently gives rise to disputes as to whether the ICSID arbitral tribunal has jurisdiction. The requirement of ICSID that there exist "a legal dispute arising from an investment between two ICSID Contracting States" gives scope for differing interpretations. Host states invariably object to the jurisdiction of ICSID, resulting in increased costs and length of ICSID proceedings. Such jurisdiction disputes can be avoided if non-ICSID arbitration is adopted.

• Confidentiality — confidentiality is often associated with arbitration proceedings as a distinguishing factor from court litigation (although commercial arbitration is often less confidential than parties may assume). However, the existence and progress of an ICSID arbitration are matters of public record, published on ICSID's website. There is also provision under the ICSID Rules for non-parties to file written submissions in respect of the issues in dispute (Arbitration Rule 37). The ICSID Rules impose no obligation on the parties to keep awards confidential and a large number of ICSID awards are available online. By contrast, non-ICSID arbitrations are more likely to remain confidential, although non-ICSID awards are frequently published or made available online. The likelihood of publicity of proceedings may be attractive to an investor, as a means of increasing the pressure on a host state; on the other hand, such publicity may prove distracting or disruptive, particularly if it results in criticism of the investor by the media.

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60 Awards rendered pursuant to the ICSID Additional Facility Rules must be enforced pursuant to the New York Convention.
Availability of provisional measures — the arbitral rules most commonly used in investment arbitration (ICSID, ICSID Additional Facility, ICC, SCC and UNCITRAL) each provide that provisional measures can be sought pending determination of the dispute. However, whereas recourse may be made to a national court in non-ICSID arbitration prior to the formation of the arbitral tribunal,\textsuperscript{61} the ICSID Rules empower only the tribunal to recommend provisional measures unless the parties have agreed that they may apply elsewhere. Given the time which it may take in order to appoint a tribunal and the potential urgency of provisional measures, this may be a significant factor in directing an investor away from ICSID to an alternative form of arbitration. Further, while in some states provisional measures during non-ICSID arbitration may be enforced through the courts, provisional measures in ICSID proceedings are merely 'recommendations' requiring the goodwill of the party against which the measures are granted (although the prevailing trend is to consider such recommendations to constitute binding obligations).

Annulment/challenge of awards — the Washington Convention provides for annulment of awards where:

(a) the Tribunal was not properly constituted;
(b) the Tribunal has manifestly exceeded its powers;
(c) there was corruption on the part of a member of the Tribunal;
(d) there has been a serious departure from a fundamental rule of procedure; or
(e) the award has failed to state the reasons on which it is based. (Article 52)

Annulment applications are considered by a panel of three arbitrators unconnected with the original award. Such applications must be brought within 120 days of the award or, in the case of corruption, within 120 days of discovery of the corruption and in any event within three years of the date of the award (Article 52(2)). By contrast, challenges to non-ICSID awards are considered by the courts and governed by the laws of the seat of the arbitration. There is a general perception that the ICSID annulment mechanism is unpredictable, wills an increasing number of awards being fully or partially annulled. The approach of courts in arbitration-friendly jurisdictions such as Singapore, France and Sweden is viewed as more consistent.

\textsuperscript{61} Including pursuant to the ICSID Additional Facility Rules (Article 46(4)).
9.9 Current trends in Investment Treaty Arbitration

Before the late 1990s there were relatively few investment treaty arbitrations (fewer than 150 known claims). Since then, as cross-border investment flows have increased and more investment treaties have been entered into, the number of arbitrations has increased enormously, reaching an annual high in 2003, when over 40 reported cases were commenced. There has been some decline since then and 2010 saw the lowest number of known arbitrations commenced since 2001. By 2010, 83 countries had received claims, with Argentina, Mexico, Czech Republic and Ecuador facing the most.

The boom in investment treaty arbitration in the 21st century has focused attention on its practice, drawing comment and criticism. In August 2010 a group of academics issued a public statement expressing a “shared concern for the harm done to the public welfare by the international investment regime as currently structured, especially it’s hampering of the ability of governments to act for their people in response to the concerns of human development and environmental sustainability”. They advocated the withdrawal from or renegotiation of investment treaties.

Criticisms of treaty arbitration tend to focus on:

- the perceived favour shown by tribunals to investors;
- the emphasis on protecting commercial concerns over the public interest; and
- the failure by tribunals to respect defences advanced by states that actions taken were required by necessity or otherwise justified by the public interest.

In this climate, Ecuador and Bolivia have withdrawn from ICSID and Venezuela has indicated that it favours taking a similar route. Australia has also announced that it no longer proposes to include investor/state arbitration provisions in its investment treaties, citing concerns

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62 Argentina has faced many claims arising from the emergency measures implemented with regard to its 1999 to 2002 financial crisis. It is not uncommon for one act of a host state, or series of acts, to generate a multitude of treaty claims. Single projects can also result in multiple claims. The failed Dabhol power project in India led to a slew of claims by both the major shareholders (GE and Bechtel) and the commercial lenders (all of which subsequently settled).

63 IIA Issues Note 1, March 2011, “Latest Developments in Investor-State Dispute Settlement”.

64 See Public Statement on the International Investment Regime (August 31 2010).

regarding the conferral of greater legal rights on overseas investors in preference to domestic businesses and constraints on Australia's ability to enact social and environmental legislation.66

Substantive criticisms aside, the costs and length of treaty arbitrations have also raised concerns. Legal costs routinely run into the many millions of US dollars — for example, the parties to a notorious ECT claim in 2011, which did not even proceed to a substantive hearing but failed on jurisdictional grounds, together claimed $60 million in costs.67 There is also a perception that the duration of treaty cases have increased significantly in recent years, not least because of the proliferation of jurisdiction objections. It has been calculated that the average length of a treaty case is between three and four years.68

9.10 Conclusion

It is the nature of the energy industry that investors are often reliant on the protection and cooperation of host states. In the oil and gas industries, resources are often found in politically unstable jurisdictions with relatively undeveloped legal systems. Power sector investors which have invested heavily in immovable and long-term infrastructure find themselves vulnerable to aggressive host states seeking to redefine investment bargains. Investors reliant on subsidies and favourable taxation regimes to justify their investments may be obvious targets for host states struggling with financial downturns. Finally, as commodity prices increase there may be political pressure on governments to try to recover more from a project than a foreign investor had previously bargained for.

A familiarity with investment treaties and the protections which they offer can be invaluable for investors negotiating with host states. Investment treaty arbitration is often at best undesirable and frequently unthinkable in practical terms for investors, which work hard to retain the favour of host governments. Divisive arbitration proceedings are rarely anything other than measures of last resort. However, the prospect, and perhaps the threat, of arbitration can serve to

67 Libananco Holdings Co Limited v Republic of Turkey (ICSID Case ARB/06/8).
68 Investor-State Disputes: Prevention and Alternatives to Arbitration (UNCTAD 2010).
focus minds. Investment treaty arbitration is an important part of the international investor's armoury.