



**Asia-Pacific
Economic Cooperation**

Identifying Core Elements in Investment Agreements in the APEC Region

**APEC Committee on Trade and Investment
APEC Investment Experts' Group**

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Contents

Executive Summary	3
Key Findings	3
Introduction	5
Step one: Selecting APEC IIAs and identifying core elements	5
Step two: Analysing approaches to core elements	6
Step three: Comparing core elements with APEC investment instruments	7
I. Identifying core elements.....	8
A. Scope issues.....	8
1. Investment	8
2. Investor.....	10
3. Coverage of services	12
B. Investment liberalization	12
1. Most-favoured-nation treatment.....	12
2. National treatment	15
3. Transparency	16
4. Performance requirements.....	18
5. Employment of senior personnel.....	20
6. Scheduling exceptions.....	21
C. Investment protection	23
1. Non-discrimination.....	23
2. Fair and equitable treatment, and full protection and security	23
3. Expropriation.....	25
4. Compensation for losses.....	28
5. Transfer of funds	29
6. Investor-State dispute settlement	31
D. Investment promotion.....	33
1. Promotion and facilitation	34
2. Cooperation on investment.....	34
3. Transparency	35
II. APEC Investment Instruments	36
A. Non-Binding Investment Principles	36
B. Menu of Options	37
C. Investment Transparency Standards.....	39
Conclusions	41
References	42
Annex 1 List of covered treaties	43
Annex 2	44
Annex 3	45

Executive Summary

This study responds to an APEC Investment Experts Group request to identify the core elements in investment agreements in the APEC region based on 14 bilateral and 14 plurilateral international investment agreements (IIAs) between and/or involving APEC member economies, including the range of approaches taken in respect of these elements (annexes 1 and 2). The provisions of these treaties are divided into 17 categories and listed in a spreadsheet (annex 3) that consolidates and summarises the approach of APEC economies to IIAs. This allows comparative analysis of treaty texts and assists in understanding convergence and divergence in the approaches taken by APEC economies to drafting IIAs. It also provides a means of considering how different IIAs address three possible objectives: investment liberalization, investment protection, and investment promotion.

This report explains how APEC economies address the legal issues of international investment, the nature and effect of the main provisions (the 'core elements') that appear in IIAs, and how they interact together. It also identifies the purpose of these provisions and where APEC member economies take common and different approaches.

Key Findings

- There is a *considerable degree of conformity* in the core elements and provisions included in IIAs involving APEC economies. This trend is also evident in the global system of IIAs (UNCTAD 2007a and forthcoming a). This high level consistency reflects, *inter alia*, considerable evolution over the last fifty years and in particular in the last ten years, and the influence of agreements such as NAFTA. On a number of core issues, APEC IIAs reflect consensus with respect to the main content and overriding purpose. Provisions such as national and MFN treatment for established investments, fair and equitable treatment, guarantees of prompt, adequate and effective compensation for expropriation and of free transfers, and consent to investor–State and State–State dispute resolution all appear in the vast majority of agreements.
- Certain APEC economies adopt a very consistent approach to their IIAs. For example, Japan has six highly consistent IIAs in this study. The United States has NAFTA and very similar agreements based on revised NAFTA language in the form of its 2004 revised model text. On the other hand, Australia has four different looking IIAs (3 FTAs and an IPPA).
- However, on closer examination, APEC IIAs contain *significant differences in their wording and details*. There is considerable variation in the content and meaning of core elements. There are also some provisions that only appear in a minority of agreements and with considerable variation among agreements. For example, guarantees of national and MFN treatment with respect to the right to establish investment, and prohibitions on performance requirements.
- Some APEC members adopt different approaches to BITs and PTIAs (e.g. in the coverage of pre-establishment issues and admission), whilst other countries are now concluding BITs that pursue the same objectives as their PTIAs.

- APEC IIAs are first and foremost *protective*. That is, the vast majority of commitments are intended to protect investment flows by limiting a host country's regulatory discretion.
- APEC IIAs are moderately *liberalizing*. APEC probably contains proportionally more liberalizing IIAs than exist amongst all countries when considered together. This is driven by the strong liberalizing credentials of some APEC economies including the objectives of the recent BIT model texts of several economies. Nevertheless, the analysis in step 3 concludes that compared to what has been endorsed in APEC investment instruments, considerably more could be done.
- APEC IIAs are indirectly *promotional*. Most agreements do not contain provisions directly promoting international investment flows. Rather, promotion occurs indirectly as a consequence of creating a favourable investment climate through investment protection. Three APEC IIAs include a provision on investment cooperation within the investment agreement and three Japanese EPAs include cooperation obligations elsewhere in the economic partnership agreement. 15 IIAs require parties to promote investment flows, though few go into any detail on how this should be done.
- More recent APEC IIAs contain changes in the wording of substantive provisions such as the fair and equitable treatment (FET) standard and minimum standard of treatment (MST), expropriation, and investor-State dispute settlement. There is evidence that recent APEC IIAs are adopting MST provisions that reflect customary international law, though the same economies generally also have IIAs containing the FET standard. At the moment this remains a localised trend amongst certain countries.
- Finally, the APEC investment instruments encompassing principles and policy recommendations have been substantially followed in terms of the general structure and intent of APEC IIAs. On the other hand, all investment treaties include exceptions and omissions that mean investment liberalization and protection is more limited than the best practices set down in the APEC instruments.
- On closer comparison four further observations can be made. First, the Non-Binding Investment Principles do not encompass several general treatment standards that feature in almost all APEC investment treaties. Second, the Principles address investor behaviour, whereas to date no APEC IIA has imposed obligations on investors. Third, IIAs covering pre-establishment and admission could more actively use the Menu of Options suggestions for reform of prior authorization requirements. APEC members are more likely to bind existing measures than reform prior authorization requirements as part of IIA negotiations. And fourth, APEC's transparency standards are more comprehensive than those included in IIAs.

Introduction

The 28 international investment agreements (IIAs) that form the basis of this study represent a small but diverse sample of the different types of IIAs (annex 1). They illustrate differing objectives and the complexity for policymakers and investors operating in a large treaty network. This study identifies common, core elements of APEC IIAs and the way these provisions assist in the liberalization, protection and promotion of investment. It also considers how the core elements compare with investment principles of existing APEC instruments.

There are two main types of IIAs and both are commonly employed by APEC member economies: bilateral investment treaties (BITs, alternatively known as investment promotion and protection agreements), and preferential trade and investment agreements (PTIAs). PTIAs encompass the investment provisions in bilateral and plurilateral economic integration agreements (EIAs) such as regional trade agreements (RTAs), free trade agreements (FTAs), economic partnership agreements (EPAs) and closer economic partnership (CEP) agreements. Investment provisions are thus increasingly being formulated as part of agreements that encompass a broader range of issues, including trade in goods and services. This has led to increased diversity of international investment law and a new set of issues, particularly concerning the relationship between investment and services chapters in PTIAs. While BITs remain far more numerous than PTIAs, the latter occupy a more important place in the international investment regime than they did a decade ago. Some countries increasingly prefer to address traditional investment protection as well as newer investment liberalization issues in the context of these broader agreements where investment provisions are only part of a larger framework for economic integration (UNCTAD 2006).

Another trend observed in BITs is the distinction between two main models (UNCTAD 2007b). The majority of APEC BITs examined follow the traditional “admission” model and only cover investments at the post establishment stage. Admission is therefore subject to host country domestic laws. A smaller category of BITs, though proportionally more significant in this APEC study because of the membership of three key users of this model, have as their objective the liberalization as well as protection of investments.¹ This “right of establishment” model applies to the pre and post establishment phases and also generally includes provisions on performance requirements and managerial personnel. The methodology of this study is to generally identify convergence and divergence between IIAs without distinguishing between whether the issue in question is in a BIT or PTIA. However, on occasion drawing distinction between BIT and PTIA practice will be necessary.

Step one: Selecting APEC IIAs and identifying core elements

The IIAs in this study include 14 BITs and 14 PTIAs identified as part of step one. All APEC economies are party to at least one IIA in the sample. The most represented are Japan (with 6 IIAs), Singapore (5), Thailand (5), Australia (4), Mexico (4), Canada (3), Chile (3), and the United States (3). These agreements were selected as largely representative of approaches to IIA negotiations taken by member economies, though no more rigorous selection criteria were used in step one of the project to ensure all approaches are represented. Step one also

¹ This model has been used by the United States since the 1980s, Canada after the mid-1990s, and by Japan since earlier this decade.

examined APEC IIAs and categorised treaty provisions on seventeen issues. This classification formed the basis of the analysis in steps 2 and 3 that is the subject of this study.

Step two: Analysing approaches to core elements

APEC IIAs pursue three foreign investment objectives – liberalization, protection and promotion – in varying degrees and in differing combinations. The combinations into which APEC IIAs can be categorised include: investment protection and promotion IIAs, investment liberalization and protection IIAs, and investment liberalization, protection and promotion IIAs. There are no APEC treaties in this study that are solely used for investment cooperation. One APEC IIA, the Framework Agreement on the ASEAN Investment Area, is a close match – at least in structure – to what could be described as an investment liberalization IIA (UNCTAD 2006). A separate issue is how liberalizing this agreement has been in its effect.

The different purposes and objectives of IIAs add to overall complexity of the IIA system. Though not addressed explicitly in what follows, this is an important and recurring theme in the study of investment rulemaking. Complexity for host governments, home governments and investors arises from the growing number of agreements, the co-existence of different types of agreements, and various approaches to drafting provisions and the legal affect of these differences.

Identifying the core elements of IIAs promotes policy coherence and consistency. It also supports the objective of a consistent and predictable regulatory framework for investors and governments. And it provides negotiators with a deeper understanding of how APEC economies have approached the liberalization, protection and promotion of investment.

At the most general level there is consistency in what countries see as the key elements of investment treaties. At a more detailed level, a range of approaches is adopted on virtually all provisions. There is a large degree of consensus amongst APEC members on the core elements of investment protection. National treatment, most-favoured-nation (MFN) treatment, fair and equitable treatment, protection in the event of expropriation, the free transfer of investments, and dispute settlement provisions are included in virtually all APEC IIAs. There is not yet consensus on the question of including investment liberalizing provisions and investment promoting provisions. The increasing number of FTAs and other economic cooperation agreements, and the increasing presence of a right of establishment in the BITs of some APEC members mean an increasing proportion of IIAs address investment liberalization. However, this has not reached the point of APEC-wide, even less multilateral, consensus. Similarly, investment promotion is a direct objective in only about a third of APEC IIAs.

Some treaty provisions commonly included in IIAs are nevertheless beyond the scope of this study. For example, umbrella clauses are an important feature of many IIAs, but are less common amongst IIAs of APEC members and were not addressed in step one of this project. State-State dispute settlement mechanisms are commonly included, though infrequently utilised, and were also omitted from step one. And thirdly, exceptions for regional economic integration organisations (REIO), and labour and environment provisions have been dealt with in detail in UNCTAD publications and will not be addressed here (UNCTAD 2004a).

Step three: Comparing core elements with APEC investment instruments

The identified core elements are then compared to the investment objectives set out in three APEC investment instruments – the Non-Binding Investment Principles (NBIP), the Menu of Options, and the Investment Transparency Standards. Observational conclusions are made about the extent to which country' practice in negotiation IIAs meet the objectives laid down in these investment instruments.

I. Identifying core elements

This section examines provisions of APEC IIAs in some detail and illustrates the approaches taken by APEC economies in formulating legal text. It also demonstrates the interrelationship between scope and definitional issues and substantive provisions. Scope issues are addressed first, then substantive provisions are divided into three types: liberalizing, protecting and promoting provisions. Where a provision can, for example, liberalize and protect foreign investment, it has been categorised according to its dominant trait with discussion of its broader effect sometimes being included there and sometimes warranting a separate discussion under a different section.

A. Scope issues

IIA scope – or coverage – issues are relevant to all substantive provisions and so are considered separately. This section only addresses some issues of scope central to step 1 of the study and will not cover other aspects such as scope of application clauses. The coverage of an IIA is a key determinant in how liberalizing or protective the agreement will be, however the effect of scope provisions is dependent on the content of the substantive provisions. IIAs seeking to liberalize investment and according investors greater protection are characterized by a wide coverage. This typically includes: (1) a broad definition of investment, coverage of mode three commercial presence for services, and coverage of portfolio investment, (2) a broad definition of investors with coverage of permanent residents, and (3) limited exceptions to the operation of substantive provisions.

Analysis of APEC IIAs reveals that most include a broad definition of investment, and almost all cover services investment. About half explicitly provide some coverage of portfolio investment with only three IIAs explicitly excluding portfolio investment, and about half extend the IIA provisions to permanent residents. APEC economies draft exceptions in different ways and this is also addressed briefly.

1. Investment

Twenty-one APEC investment agreements adopt a broad asset-based definition of investment with a list of examples setting out different categories of investments. This approach reflects the emphasis of most APEC IIAs on protecting a wide range of investment-related activities (beyond only FDI), and, for many PTIAs and a number of more recent BITs, on liberalization. The most common formulation is illustrated by the China-Germany IPPA:

"investment" means every kind of asset invested directly or indirectly by investors of one Contracting Party in the territory of the other Contracting Party, and in particular, though not exclusively, includes:

- (a) movable and immovable property and other property rights such as mortgages and pledges;*
- (b) shares, debentures, stock and any other kind of interest in companies;*
- (c) claims to money or to any other performance having an economic value associated with an investment;*
- (d) intellectual property rights, in particular copyrights, patents and industrial de-signs, trade-marks, trade-names, technical processes, trade and business secrets, know-how and good-will;*

(e) business concessions conferred by law or under contract permitted by law, including concessions to search for, cultivate, extract or exploit natural resources; any change in the form in which assets are invested does not affect their character as investments.

Another approach to defining investment is to use an *enterprise definition* such as that used in article 1139 of NAFTA. This differs from the broader asset-based definition by limiting investment to those assets associated with an enterprise. Article G.01 of the Canada-Chile FTA also adopts this approach:

"investment means:

- (a) an enterprise;*
- (b) an equity security of an enterprise;*
- (c) 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;*
- (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, but does not include a loan, regardless of original maturity, to a state enterprise;*
- (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;*
- (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);*
- (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and*
- (h) interests arising from the commitment of capital or other resources in the territory of a 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 Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise; [...]"*

Recently, six APEC IIAs (all involving one of the NAFTA economies) have included a definition of investment that also clarifies what is *not* an investment. Several IIAs set out these clarifications through footnotes and several, including the agreement between Canada and Chile, set out limitations in list form:

"[...]

but investment does not mean,

- (i) claims to money that arise solely from
 - (i) 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 the other Party, or*
 - (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d);**
- or*

(j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h); or

(k) with respect to "loans" and "debt securities" referred to in subparagraphs (c) and (d) as it applies to investors of the other Party, and investments of such investors, in financial institution in the Party's territory

(i) a loan or debt security issued by a financial institution that is not treated as regulatory capital by the Party in whose territory the financial institution is located,

(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 subparagraph (i), and (iii) a loan to, or debt security issued by, a Party or a state enterprise thereof."

Yet another recent approach adopted in the Canada-Peru FIPA is to resort to a closed list definition that sets out the exhaustive range of assets that may constitute an investment.

The scope of the agreement, whether using an asset or an enterprise-based definition, can be further narrowed through the investment definition by not extending protection to portfolio investment. Three APEC IIAs explicitly carve out portfolio investment. Article 2 of the Framework Agreement on the ASEAN Investment Area provides that the Agreement "*shall cover all direct investment other than [...] portfolio investment [...]*". The scope of investment activities cannot only be affected by the definition of investment, but also be shaped by the substantive provisions. For example, the Japan-Malaysia national treatment provision carves out portfolio investments.

Another approach reflected in several APEC IIAs, including the Framework Agreement on the ASEAN Investment Area and the Australia-Thailand FTA, is to define investment as an investment made in accordance with the laws of the host country. Investments not made in accordance with the host country's approval requirements and conditions cannot benefit from the agreement's provisions.

2. Investor

All APEC IIAs define the term "investor" as covering both natural and legal persons. Two issues are typically addressed: the types of entities that can be investors, and how to determine the nationality of the investor (an investor must have the nationality of a treaty party to have rights under the treaty).

The typical definition of a national of a party is a natural person recognised by that party's internal law as a national or a citizen. In a number of agreements between APEC members this definition is extended to include permanent residents. For example, Article 27 (3) of the New Zealand-Singapore CEP defines an investor as including

"a) a natural person who resides in the territory of the other Party or elsewhere and who under the law of that other Party:

(i) is a national of that other Party; or

(ii) has the right of permanent residence in that other Party, in the case of a Party which accords substantially the same treatment to its permanent residents as it does to its nationals in respect of measures affecting investments, provided that that Party is not obligated to accord to such permanent residents more

favourable treatment than would be accorded by the other Party to such permanent residents; [...]".

APEC IIAs also typically address the issue of natural persons having the nationality of both treaty parties. Some, such as the United States-Uruguay BIT, consider a person with dual nationality as a national of the country of their dominant and effective nationality. Other formulations used exclude nationals of both parties from coverage of the agreement.

With respect to legal entities, there is considerable divergence on the formulation and preferred approach in APEC IIAs. Three criteria are used by APEC members (often in combination) to define the nationality of companies: the place of incorporation or organisation, the location of the company's headquarters (the place of the seat), and the nationality of those who own or control the entity. A few examples illustrate different approaches adopted. The Japan-Philippines agreement requires entities to be incorporated:

"[...]"

(ii) juridical person of a Party, that seeks to make, is making, or has made investments in the Area of the other Party. A branch of a juridical person of a non-Party, which is located in the Area of a Party, shall not be deemed as an investor of that Party;

(d) a juridical person is:

(i) "owned" by persons if more than fifty (50) percent of the equity interest in it is owned by such persons; or

(ii) "controlled" by persons if such persons have the power to name a majority of its directors or otherwise to legally direct its actions".

The Russian Federation-Thailand BIT requires an investing legal entity to meet three criteria in order to be covered by the BIT:

"[...]"

ii) legal persons, including companies, corporations, business associations and other organisations, which are constituted or otherwise duly organised under the law of that Contracting Party and have their seat, together with real economic activities, in the territory of that same Contracting Party;"

Another aspect addressed by some but not all APEC IIAs is the link of ownership between an asset and the investor that determines whether an asset is foreign investment rather than domestic investment. For example, Article G.01 of the Canada-Chile FTA states that an *"investment of an investor of a Party means an investment owned or controlled directly or indirectly by an investor of such Party"*. This protects investments of a national or company of a contracting party irrespective of how many corporate layers between the investing entity and the investment exist (see UNCTAD 2007b, pp. 16-17).

Overall, APEC IIAs tend to combine the requirement of incorporation with the requirement of also having the head office or the controlling interest in that country.

3. Coverage of services

Since the conclusion of the General Agreement on Trade on Services (GATS) of the WTO, there has been a trend in economic integration agreements to liberalize market access in services sectors including those delivered through mode three (commercial presence). This presents a policy question about liberalization of access for services investments with important implications for the scope and structure of the investment agreement. Half of the APEC IIAs in this study include services market access commitments. Some adopt a structure based on the positive list approach used in the GATS, whilst others use the negative list approach of the NAFTA. Under the GATS approach, the liberalization of market access for services, including through commercial presence, is controlled by a services chapter and protection of investments in services is controlled by the investment chapter. Liberalization only occurs in those sectors listed in the annex. On the other hand, some agreements include mode three in the scope of the investment chapter, but apply the market access provision from the services chapter. The NAFTA creates a general rule of market access in all services sectors subject to exceptions contained in the annex.

B. Investment liberalization

Liberalization is typically associated with the reduction and elimination of barriers to the entry, establishment and operation of investments. This can be brought about in a number of ways. First and most significant are those provisions that provide investors direct entry and a right of establishment. Second, provisions that remove informational barriers, guarantee free transfers, allow the flow of senior personnel, and restrict performance requirements also contribute to liberalization.

IIAs can provide the right to establishment through direct language. This is uncommon in the APEC context, however one example is Article 7(1) of the Framework Agreement on the ASEAN Investment Area:

"[s]ubject to the provisions of this Article, each Member State shall...open immediately all its industries for investments by ASEAN investors."

A more common approach is to give a right of establishment indirectly, through according national and/or MFN treatment. APEC IIAs that address a right of establishment limit this right through the use of either a positive or negative list of sectoral exceptions and non-conforming measures.

1. Most-favoured-nation treatment

MFN treatment (or non-discrimination between source economies) is consistently included in the APEC IIAs reviewed, though two agreements do not incorporate this provision. Out of the 28 reviewed agreements, 14 grant MFN in the pre-establishment phase. At the most general level, there is convergence on key elements of the provision with numerous variations on precise formulation used by APEC economies. Jurisprudence in the last six or seven years has played a significant role in some recent treaty practice on MFN treatment (UNCTAD forthcoming b).

IIAs in the sample almost universally require that a Party give “*treatment no less favourable than that it accords in like circumstances to investors of a third State and to their*

investments". Beyond this, at least six different approaches to wording and construction can be distinguished.

The most concise approach, used in Article 90 of the Japan-Philippines EPA, is to provide that:

"Each Party shall accord to investors of the other Party and to their investments treatment no less favorable than that it accords, in like circumstances, to investors of a non-Party and to their investments with respect to investment activities."

A second approach is to articulate the stages and phases of an investment to which MFN treatment is provided and to address the treatment of investors and investments in separate paragraphs. NAFTA Article 1103 requires that:

"1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

Since NAFTA, this formulation has been adopted in a number of IIAs including those between Canada-Chile, Australia-United States, United States-Uruguay, Canada-Peru, and Iceland-Mexico. Of the NAFTA parties, Mexico has also adopted alternative MFN formulations in its IIAs with Japan and Australia.

A third approach consists of a similar formulation but with a narrower, post-establishment scope. This was adopted in Thailand's agreements with Australia and New Zealand.

A fourth approach, favoured by Japan in its BITs and PTIAs, is not to list the stages of investment for which MFN treatment will be accorded. See for example the Japan-Republic of Korea IPPA and the Japan-Malaysia EPA.

A fifth approach involves incorporating MFN treatment with other general standards of treatment. For example, Article 3 of the Malaysia-Viet Nam IPPA combines MFN with fair and equitable treatment and compensation for losses:

"(1) Investment made by investors of either Contracting Party in the territory of the other Contracting Party shall receive treatment which is fair and equitable, and not less favourable than that accorded to investments made by investors of any third State.

(2) Investors of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, or

owing to a state of national emergency, revolt, insurrection or riot in the territory of the other Contracting Party shall be accorded by the latter Contracting Party treatment as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to investors of any third State.”

A sixth variation, used in the Hong Kong China-Thailand IPPA (Article 3, Treatment of Investments), is to combine fair and equitable treatment and MFN treatment in a paragraph addressing investments, with a separate paragraph applying the two standards for investors, but limiting it to the post-establishment phase.

Finally, MFN treatment is not included in the Australia-Singapore FTA. Rather than guaranteeing the same treatment accorded to third parties, the Parties agreed to a 'best endeavours' approach requiring that a Party "give positive consideration to a request by the other Party for the incorporation herein" of treatment no less favourable than that provided to a third party or resulting from unilateral liberalization (Article 15).

The most important development in the use of MFN treatment provisions derives from jurisprudence interpreting the effect of MFN provisions over the last few years (see UNCTAD 2007b, p. 39). The *Maffezini* award's finding that the more favourable dispute settlement provisions of another BIT could be invoked led to considerable discussion about the scope of MFN provisions and whether MFN treatment must be accorded for procedural provisions as well as substantive provisions.² Three further major cases have since also dealt with the applicability of the MFN standard to dispute settlement before ICSID. While *Siemens*³ concurs with the *Maffezini* finding, the *Salini*⁴ and *Plama*⁵ cases have found that MFN treatment will only extend to dispute settlement provisions where there is a clear and unambiguous intention. Some IIAs accord MFN to investments and "activities associated with investments". Depending on the meaning of this term in a particular treaty, it may give sufficient scope to import a better dispute settlement mechanism.

In response to this uncertainty, some recent IIAs have been careful in explicitly drafting the intended scope of MFN treatment. Amongst APEC IIAs examined, only the recent Canada-Peru agreement addresses the issue directly:

“ANNEX B.4 Most-Favoured-Nation Treatment

For greater clarity, treatment “with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments” referred to in paragraphs 1 and 2 of Article 4 does not encompass dispute resolution mechanisms, such as those in Section C, that are provided for in international treaties or trade agreements.”

² *Maffezini v. Kingdom of Spain*, ICSID Case No. Apr/97/7, Decision on jurisdiction of 25 January 2000 and Award of Tribunal of 13 November 2000.

³ *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August 2004.

⁴ *Salini Construttori S.p.A. and Italstrade S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 23 July 2001.

⁵ *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, 8 February 2005.

The footnote to the MFN provision (Article 59) in the Japan-Mexico EPA ensures investors have the same access to domestic courts *and* international tribunals as third parties and domestic investors:

“Note 3: Each Party shall in its Area accord to investors of the other Party treatment no less favourable than the treatment which it accords, in like circumstances, to its own investors or investors of a non-Party with respect to access to the courts of justice and administrative tribunals and agencies in all degrees of jurisdiction, both in pursuit and in defense of such investor’s rights.”

In summary, addressing the scope of MFN provisions and carefully framing treaty language which reflects Parties’ intent is now a core element of IIA negotiations. The MFN principle provides foreign investment the most liberal treatment and the best protection offered by the host country to foreign investors. MFN therefore may promote coherence between different agreements and convergence in the treatment accorded investors. However, this may also neutralise efforts of contracting parties to distinguish one agreement from another.

2. National treatment

According to foreign investors and their investments the same treatment as nationals is a key indicator of liberal investment policy. Analysis of the standard can be divided into treatment during the pre-establishment phase and treatment once investments are established in the host country. The national treatment standard is common amongst APEC IIAs with 14 PTIAs and 4 recent APEC BITs (i.e. those between Japan-Republic of Korea, Japan-Viet Nam, United States-Uruguay, and Canada-Peru) covering pre and post establishment phases subject to exceptions. Eight APEC BITs only deal with post-establishment national treatment, and two contain no reference to this standard.

The degree to which the national treatment standard liberalizes investment flows is affected by several factors. Scope issues (definitions and exceptions) will determine whether an investment activity is captured by the treaty and the national treatment provision. And the extent of liberalization is also dependent on whether investors are unencumbered in their establishment of an investment. This is not strictly a question of *national* treatment, since there can be no direct comparison with how domestic investors are treated at the border. Rather, it is a question of treating foreign investors and their investments as if they are domestic entities.

An example for granting national treatment with respect to establishment, subject to annexed exceptions, is Article 2.1 of the Japan-Republic of Korea IPPA states:

*“Each Contracting Party shall in its territory accord to investors of the other Contracting Party and to their investments treatment no less favourable than the treatment it accords in like circumstances to its own investors and their investments (hereinafter referred to as "national treatment") with respect to the **establishment**, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investments (hereinafter referred to as "investment and business activities").”* (emphasis added)

Article 4 of the same agreement allows Parties to maintain non-conforming measures:

"1. Notwithstanding the provisions of Article 2, [...] each Contracting Party may adopt or maintain any measure not conforming with the obligations imposed by Article 2 [...] in the sectors or with respect to the matters specified in Annex I to this Agreement. [...]"

This general approach to national treatment is common amongst APEC members, with variations on the precise wording used. For example, the Canada-Chile FTA deals with MFN and national treatment separately. Its national treatment provision states that:

*"[...] Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the **establishment**, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."* (emphasis added)

Another approach taken, for example, in the Japan-Malaysia agreement applies national treatment to establishment, but does not extend this treatment to the "establishment, acquisition and expansion of *portfolio investments*" (emphasis added).

Eight of the APEC IIAs reviewed only cover investments after they are established in the host country. For example, article 4 of the Australia-Mexico IPPA talks of treatment accorded to "*investments made in its territory*":

"Each Contracting Party shall, subject to its laws, regulations and policies, grant to investments made in its territory by Investors of the other Contracting Party and to activities associated with investments, in like circumstances, treatment no less favourable than that which it accords to investments of its own Investors."

Post establishment national treatment is typically characterized as protecting investments against discrimination rather than liberalizing, however it can have a liberalizing effect, particularly where a treaty contains few exceptions, a negative list and offers full transparency to investors.

Finally, several APEC IIAs have taken a hybrid approach to national treatment. The Australia-Thailand and New Zealand-Thailand FTAs accord pre-establishment national treatment in a positive list and separate provision sets out post establishment national treatment for 'covered investments'.

It can be concluded from this practice that right of establishment provisions are key investment liberalizing provisions. APEC IIAs show consistency in the approach to drafting national treatment provisions, although they vary in terms of extending it to the pre-establishment phase or limiting it to the post-establishment phase of an investment.

3. Transparency

Transparency provisions aim to remove informational barriers to entry by allowing participants in the investment process to access information in order to make informed decisions and meet obligations. This availability of information can liberalize, promote and protect investment and so is relevant to several sections of this study. The inclusion of transparency provisions in IIAs imposes obligations and rights on all three participants in the

investment relationship – the home country, the host country and the foreign investor.

Nine APEC IIAs contain transparency requirements amongst investment provisions and at least 11 of the PTIAs include transparency provisions in separate chapters. Some convergence is evident in the way APEC members address transparency issues. The content of transparency obligations varies depending on the items of information to be made public (e.g. policies, laws, regulations, administrative decisions, as well as corporate business information). There are also different modalities employed to implement transparency, which may involve, for example, the exchange of information or the publication of relevant government measures. Other issues relate to the time limits for meeting transparency requirements and exceptions to transparency obligations (UNCTAD 2004b, vol. 1, chapter 10).

One type of transparency provision requires the prompt publication or availability of laws and regulations “*respecting any matter covered by this Agreement*” or “*that pertain to or affect covered investments*”. For example, the Japan-Viet Nam IPPA states:

"Article 7

1. Each Contracting Party shall promptly publish, or otherwise make publicly available, its laws, regulations, administrative procedures and administrative rulings and judicial decisions of general application as well as international agreements which pertain to or affect investment activities. [...]"

Since the regulatory framework of both the host and home countries affects foreign investment, transparency obligations formulated in these terms should cover laws and regulations of both countries. Although this reading appears logical, there is a tendency to interpret these types of provisions as only covering host countries. This approach also represents a broader obligation because in addition to “laws and regulations on investment”, it requires the public availability of “administrative rulings and judicial decisions of general application” and a Party’s international obligations that might “pertain to or affect” business activity.

On the other hand, some provisions, such as Article 6 of the Australia-Mexico IPPA, present a narrower requirement and are drafted to more clearly target host countries:

"Each Contracting Party shall, with a view to promoting the understanding of its laws and regulations on investment that pertain to or affect investments in its territory by Investors of the other Contracting Party, take reasonable measures as may be available to make such laws and regulations public."

A second type of clause used by several APEC economies requires the parties to act transparently in their dealings with investors:

"[...] 2. Each Contracting Party shall, upon request by the other Contracting Party, promptly respond to specific questions and provide that other Contracting Party with information on matters set out in paragraph 1 of this Article. [...]" (Article 7, Japan-Republic of Korea IPPA)

The greatest transparency can be seen in IIAs that include a requirement to, where possible, publish in advance proposed laws, regulations etc., provide interested parties with a reasonable opportunity to comment on proposed measures, and notify the other party of any proposed or actual measures that might affect operation of the agreement or the other party's interests (Australia-United States FTA, articles 20.2 and 20.3).

To summarise, transparency provisions are usually framed in general terms and can impose obligations on all parties. They play an important role in fostering the strengthening of institutions and providing regulatory openness that has a liberalizing effect.

4. Performance requirements

Performance requirement provisions in IIAs restrict the imposition and enforcement by a host government of certain obligations on foreign investments or investors that are meant to shape the economic consequences of an investment. For example, to ensure that the investment contributes to employment in the host country or to the country's export earnings, an investment may be required to hire local staff or export a certain percentage of output. These requirements can be imposed as a condition for establishment of the investment, or could be used as a condition for receipt of some other benefit. These sorts of requirements can also distort trade and work against liberalization.

Fifteen APEC IIAs do not limit performance requirements. Many APEC economies use performance requirements of some description as part of their economic policy. However, regardless of whether IIAs include performance requirements provisions, such measures may be contrary to the national treatment provision and the WTO TRIMs Agreement. Where the IIA uses schedules, a host country must reserve in an annex the right to impose a performance related measure that violates the national treatment provision.

Of the remaining 13 APEC IIAs that restrict the use of performance requirements, most are PTIAs of five economies: the United States, Japan, Canada, the Republic of Korea, and Chile. Recent BITs with provisions on performance requirements include those between the United States and Uruguay, Canada and Peru, Japan and the Republic of Korea, and Japan and Viet Nam. Two main types of provision can be discerned amongst those IIAs that seek to limit the use of performance requirements: a TRIMs-consistent approach only covering trade in goods and the NAFTA approach which broadens the coverage of prohibitions by also restricting the use of performance measures other than TRIMs and extending it in services sectors.

The first approach is to simply include a prohibition that confirms adherence to the WTO TRIMs agreement. One way of doing this is to incorporate the TRIMs Agreement into the IIA text. This approach was used in the Japan-Malaysia EPA:

“Article 79 Prohibition of Performance Requirements

1. For the purposes of this Chapter, the Annex to the Agreement on Trade-Related Investment Measures in Annex IA to the WTO Agreement, as may be amended, is incorporated into and forms part of this Agreement, mutatis mutandis.

2. The Countries shall enter into further consultations, at the earliest possible time. The aim of such consultations is to review issues pertaining to prohibition of performance requirements within five years from the date of entry into force of this Agreement.

3. The aim of consultations referred to in paragraph 2 of this Article may include the review of reservations relating to prohibition of performance requirements.”

In this treaty, parties agreed to a further review of the performance requirements provision, suggesting they might include more detailed obligations at some future point. This formulation also means the incorporated TRIMs obligations are enforceable through any dispute resolution mechanism in the EPA.

The second formulation used in APEC IIAs includes prohibitions on performance requirements beyond those addressed by the TRIMs Agreement. 11 APEC IIAs include a list of prohibited performance requirements along the lines of that used in NAFTA Article 1106. The list restricts export requirements, domestic content requirements, requirements to use domestic suppliers, technology transfer requirements, or requirements that relate the volume or value of imports or the quantum of domestic sales to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment.

The provisions in APEC IIAs also set out in some detail measures that could be considered performance requirements but that are permissible. This recognises the role performance requirements play in policy making in some host countries. For example, Article 10.7 of the Chile-Republic of Korea FTA sets out that:

“[...]

4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, in compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory. In the event of any inconsistency between this paragraph and the TRIMS Agreement, the latter shall prevail to the extent of the inconsistency. [...]

6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in [this provision] shall be construed to prevent a Party from adopting or maintaining measures, including environmental measures:
(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
(b) necessary to protect human, animal or plant life or health; or
(c) necessary for the conservation of living or non-living exhaustible natural resources.”

Another feature that appears in seven APEC IIAs (including NAFTA) is an obligation to refrain from imposing the banned performance requirements not only on each other's investments and investors, but also on investments and investors of any third country. The

purpose of this non-discrimination is to provide a less restricted and more level playing field for investors.

In summary, the intermittent use of restrictions on performance requirements suggests it is not yet a core element amongst APEC economies. This is consistent with the situation in the broader IIA community. However, this provision has become more common in recent years, using the WTO TRIMs Agreement as its basis. The main difference in drafting amongst APEC economies that include performance requirements provisions is that some take a TRIMs consistent approach and some a 'TRIMs plus' approach. Restricting performance requirements can be liberalizing where it offers additional certainty for investors regarding their autonomy over investment decisions. It also prevents distortions. On the other hand, APEC economies recognise the role performance requirements can play in economic policymaking and these provisions seek to strike a balance between competing objectives.

5. Employment of senior personnel

This provision, included in 10 APEC IIAs, ensures investments can employ key managerial or professional staff of other nationalities, unregulated by the host country. This offers investors additional flexibility where host countries sometimes require foreign investments to employ their own nationals to increase employment and facilitate the transfer of skills. Part of the competitive advantage of a foreign investment may be the managerial and technical knowledge of its foreign employees. This provision is more commonly associated with BITs, though in APEC treaty practice seven of the agreements with a senior personnel provision are PTIAs. Some economic integration agreements, for example the Australia-Thailand FTA, include a chapter on the movement of natural persons applying to the trade in services and the investment chapters, and therefore contain no reference to this issue amongst investment provisions.

There is a settled view on the legal text for this provision amongst those APEC IIAs that include it:

“Neither Party may require that an enterprise of that Party that is an investment of an investor of the other Party appoint to senior management positions individuals of any particular nationality.”

This right interacts with other core elements in a liberalizing way, in particular in combination with the right of establishment provisions (pre-establishment national treatment) and scope provisions (definition of investor). Notwithstanding, host countries can preserve existing nationality restrictions on senior personnel in IIAs that include schedules by reserving against these measures. Another limitation is that the operation of the right to employ senior personnel of any nationality is dependent on them being able to lawfully enter the host country. Only one APEC IIA, the Canada-Peru FIPA (Article 6), links the senior personnel provision with the issue of entry and sojourn of these personnel:

“[...]
3. Subject to its laws, regulations and policies relating to the entry of aliens, each Party shall grant temporary entry to nationals of the other Party, employed by an investor of the other Party, who seek to render services to an investment of that investor in the territory of the Party, in a capacity that is managerial or executive or requires specialized knowledge.”

Another agreement, the Australia-Mexico IPPA, doesn't include a senior personnel provision, but contains an obligation on a party "*within the framework of its laws*" to "*give a sympathetic consideration to applications for the permits necessary for the engagement of key managerial and technical personnel in connection with investments in its territory of the Investor's choice from abroad*".

A similar approach, though more general in the language it uses and without reference to senior personnel, is taken in article 8 of the Japan-Viet Nam IPPA. This requires "*sympathetic consideration to applications for the entry, sojourn and residence of a natural person having the nationality of the other Contracting Party who wish to enter the territory of the former Contracting Party and remain therein for the purpose of investment activities*".

Another category comprising four of these 10 APEC agreements also includes a clause that preserves the right of a Party to require that a majority of the board of directors of an investment hold a particular nationality or have residency status in the territory of the Party. This can only be imposed provided it does not materially impair the ability of the investor to exercise control over its investment. This too is subject to exceptions listed in the schedules.

It can be concluded that in the APEC context this provision is more commonly associated with PTIAs, though in the broader IIA system it is more typically found in BITs. Regulating the hiring of senior personnel is not yet an established core element of APEC IIAs, but is linked to other provisions regulating the movement of natural persons.

6. Scheduling exceptions

Exceptions to certain substantive IIA provisions set out in a schedule to an annex are a common means of further determining the scope of APEC PTIAs and are mentioned a number of times throughout this study. Though traditionally not used in BITs, more recent agreements covering pre-establishment and admission, such as the Canada-Peru FIPA and United States-Uruguay BIT, also use annexes to limit coverage. Whilst schedules are not a liberalizing feature of IIAs per se, there are a number of mechanisms within these provisions that produce a *more* liberalizing outcome and warrant brief mention.

APEC IIAs follow one of three main approaches to scheduling. First, 10 agreements do not use schedules and provide only post-establishment national treatment. Second, 16 adopt a negative list approach and set out those measures and sectors that are carved out from the scope of the treaty. Using a negative list usually implies a "standstill" commitment where the parties are not allowed to introduce new non-conforming measures beyond those included in the negative list. These are typically set out in one annex, with a second annex for sectors where future flexibility is preserved. Some APEC IIAs, beginning with the NAFTA, go further than this and also include a so-called "ratchet" mechanism. This means any regulatory changes bringing about further liberalization are automatically incorporated into the country's treaty commitments (UNCTAD 2006b). The negative list approach is commonly referred to as the NAFTA-inspired approach.

A third approach used in two PTIAs – Thailand's agreements with New Zealand and Australia – is to include GATS-style positive lists where treatment provisions apply only to

those measures and sectors set out in the schedule.⁶ The Australia-Thailand FTA is unique amongst APEC IIAs for combining a positive and negative list approach; pre-establishment national treatment is provided on a positive list basis, and post-establishment national treatment is offered on the basis of a negative list. It is recognised that negative lists provide greater transparency for foreign investors of areas of differential treatment.

Another liberalizing innovation was included in the Chile-Republic of Korea BIT but does not appear in other APEC IIAs. Article 10.10 locks in future liberalization:

"Through future negotiations, to be scheduled every two years by the Commission after the date of entry into force of this Agreement, the Parties will engage in further liberalisation with a view to reaching the reduction or elimination of the remaining restrictions scheduled in conformity with paragraphs 1 and 2 of Article 10.9 on a mutually advantageous basis and securing an overall balance of rights and obligations."

Another option aimed at preserving flexibility is to include a review of commitments clause or a modification of commitments provision. This could have a less liberalizing effect. For example, the Lebanon-Malaysia agreement has maintained full flexibility for policy makers through the Article 11 Amendment, which retains the ability to amend the treaty by mutual consent, although rights arising under the treaty prior to an amendment are preserved. A slightly different approach was taken in the Australia-Singapore FTA where Article 7 allows for the modification or addition of reservations provided three months written notification is given and the "*overall balance of commitments undertaken by each Party*" is maintained.

The interaction between scheduled exceptions and the substantive provisions will determine the degree of liberalization and protection offered. On the whole, those APEC IIAs that cover admission and use scheduled exceptions appear to favour the negative list approach that provides for more straightforward liberalization. These agreements often employ standstill and ratchet mechanisms. Together these work to prevent parties turning away from their commitments and becoming more protectionist. However, this does not lead to a conclusion that APEC IIAs are generally liberalizing.

Several points can be made in summing up the liberalizing effect of these agreements. First, the coverage of admission issues in half of these agreements and a corresponding general trend in those IIAs to favour negative lists demonstrates from an architectural standpoint a moderate level of commitment to the liberalization objective. However, second, there are very few examples of APEC IIAs being used as a vehicle for liberalizing investment policies and laws. One partial exception is the Australia-United States FTA where Australia made legislative amendments to implement FTA commitments reducing barriers to United States investors.⁷ As is discussed in part III below, APEC investment instruments, in particular the Options for Investment Liberalization and Business Facilitation to Strengthen the APEC Economies (or 'Menu of Options'), encourage an approach to liberalization that is not taken up in the treaty practice of APEC economies.

⁶ The recent Japan-Thailand EPA, not part of the current APEC sample, has also followed the positive list approach for both services and investment.

⁷ See the Australia-United States FTA, Annex 1, <http://www.dfat.gov.au/trade/negotiations/us_fta/final-text/index.html>

C. Investment protection

The protection of foreign investment remains the most significant objective of APEC IIAs. Protection provisions are commonly found in BITs, though the accepted practice is to also include these provisions in PTIAs where the principal objective is closer economic integration.

1. *Non-discrimination*

Non-discrimination provisions guarantee investments national and MFN treatment. These provisions have been discussed in the previous section on liberalization. As discussed above, the same guarantees also protect investments once they have crossed the border and indeed apply only in the post-establishment phase in a substantial number of the APEC agreements reviewed (i.e. 12 agreements in the case of MFN, and 8 agreements in the case of national treatment). National treatment ensures foreign and domestic investors are subject to the same competitive conditions in the host country market, and MFN treatment offers protection against discrimination with respect to investments from other countries.

2. *Fair and equitable treatment, and full protection and security*

"Fair and equitable treatment" provides a basic standard, detached from the host country's domestic law, against which the behaviour of the host country in relation to foreign investments can be assessed. It is a key standard of investment protection included in all but three of the APEC IIAs. However, "fair and equitable treatment" remained largely undefined until relatively recently. Over the last few years, claimants have increasingly relied on this provision and consequently the standard has received considerable attention.

Opinion is divided as to whether the obligation to grant "*fair and equitable treatment*" is always synonymous with the minimum standard of treatment of foreign investment required under customary international law, or whether it means something different – albeit with some overlap. Some commentators have argued that the plain meaning of this term in particular treaties sets a higher standard than that required under customary international law. This has been recognised in recent jurisprudence (*Saluka v. the Czech Republic*), however a number of Tribunals have also found no distinction on the facts between the standard of treatment required under customary international law and the fair and equitable treatment treaty standard.

There is considerable divergence in approaches to drafting the standard in APEC IIAs. Some treaties make no link between the phrase "fair and equitable treatment" and treatment under international law, and some do. A survey of the APEC IIAs reveals five approaches to dealing with "fair and equitable treatment" provisions. Further categories not discussed here include where the fair and equitable treatment standard is combined with other legal principles such as obligations to provide full protection and security and non-discrimination.⁸

⁸ Note that the UNCTAD 2007 BIT survey identifies seven distinct categories used amongst all BITs (UNCTAD 2007b).

First, 14 APEC IIAs grant covered investments fair and equitable treatment without making any reference to international law.⁹ For example, the BIT between India and Indonesia:

"ARTICLE 3 Promotion and Protection of Investment

[...]

2. Investments and returns of investors of each Contracting Party shall at all times be accorded fair and equitable treatment in the territory of the other Contracting Party."

The absence of a reference to customary international law leads some commentators to favour according provisions worded in this way an interpretation that results in a case-by-case assessment of whether the actions infringe an equity-based test.

A variation on this approach is found in the Lebanon-Malaysia IPPA. Here there is a reference only to "equitable" treatment in a promotion and protection provision (Article 2), then the MFN provision (Article 3) states that investments "shall receive treatment which is fair and equitable, and not less favourable than that accorded to investments made by investors of any third State."

A third approach appears in agreements such as the NAFTA and Japan's agreements with Mexico and the Philippines. This approach seeks to address the relationship between fair and equitable treatment and international law. NAFTA Article 1105 requires parties to accord investments of investors "treatment in accordance with international law, including fair and equitable treatment [...]". In the NAFTA context, the Parties have issued an interpretation clarifying that this does not require treatment beyond what is required under the customary international law minimum standard of treatment of aliens. This clarification is reflected in the language of the Chile-Peru ALC and was included as a footnote in the abovementioned IIAs involving Japan:

"Note: This Article 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 the other 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 fourth approach has been adopted in the recent practice of several APEC economies. The United States, Mexico and Canada have sought to overcome confusion or uncertainty over the intended content of the standard through revised model text wording. This takes as its starting point the series of NAFTA Chapter 11 claims. Five APEC IIAs¹⁰ have incorporated this revised language clarifying the meaning of "fair and equitable treatment" and limiting its meaning to the minimum standard of treatment.

⁹ They are the following IIAs: Hong Kong China-Thailand, Japan-Republic of Korea, Japan-Malaysia, Japan-Singapore, Japan-Viet Nam, Australia-Thailand, Peru-Singapore, Australia-Mexico, Chile-Peru, Russian Federation-Thailand, Malaysia-Viet Nam, Lebanon-Malaysia, India-Indonesia, and Germany-Philippines.

¹⁰ These are Australia-United States, United States-Uruguay, Canada-Peru, Chile-Republic of Korea, and Iceland-Mexico.

The fifth approach is to omit any reference to fair and equitable treatment or the minimum standard of treatment. This was the decision reached in the New Zealand-Singapore CEP, the New Zealand-Thailand CEP, and the Australia-Singapore FTA.

Whilst the vast majority of all IIAs still include a treaty standard of fair and equitable treatment with no link or reference to any international law standard, an increasing number of countries are now reviewing their approach to formulating the fair and equitable standard. It can be expected that this will continue to be a key area of debate amongst APEC economies.

3. Expropriation

Historically, protection against expropriation has been the most important issue in international investment law. There is a high level of convergence amongst APEC IIAs on the formulation of this provision. IIAs recognise the right of the host country to expropriate, but impose conditions that must be satisfied. What follows summarises the two main issues that arise, namely the scope of the expropriation provision, and the conditions for a lawful expropriation. A more detailed coverage of the issue is found in other UNCTAD publications (for example, UNCTAD 2006a and 2007b).

The scope of the expropriation provision refers to host country actions that may be deemed expropriatory. The most obvious and well understood is an act of direct expropriation or nationalisation that transfers the ownership or possession of the investment to the country. This results in complete destruction of the value of the investment. However, other host country measures can devalue an investment whilst being intended to pursue legitimate regulatory objectives. These measures may indirectly expropriate an investment. The scope of some IIA expropriation provisions seeks to address the situations where investors would or would not receive compensation as a result of countries exercising their right to regulate in the public interest (i.e. whether the government regulatory action is legitimate or not).

The agreement between the Russian Federation and Thailand illustrates a formulation used to describe those acts of expropriation set out in 27 of the 28 APEC IIAs (with minor variations in wording):¹¹

“Article 4 Expropriation

1. Investments of investors of one Contracting Party made in the territory of the other Contracting Party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation (hereinafter referred to as expropriation) except [...]”

Most APEC IIAs contain no clear language to define the scope of the expropriation provision. The issue of indirect expropriation is addressed in virtually all APEC IIAs but in different ways. One way is the approach of the Chile-Republic of Korea FTA that specifically refers to acts that expropriate directly *or indirectly*:

"1. Neither Party may, directly or indirectly, nationalize or expropriate an investment of an investor of the other Party in its territory [...]" (Article 10.13)

¹¹ In the sample for this study, only the New Zealand-Singapore CEP does not contain protection against expropriation.

Other APEC IIAs, including Article 4 of the Germany-Philippines BIT, prevent taking measures *equivalent* to or *tantamount* to expropriation:

"(2) Investments by investors of either Contracting State shall not be expropriated, nationalized or subjected to any other direct or indirect measure the effects of which would be tantamount to expropriation or nationalization [...]"

A number of economies have expressed concern at the potentially wide reading that might be given to these formulations and the potential for every measure substantially impairing the value of an investment to be challenged as an indirect expropriation. However, in the wake of numerous investment disputes, some APEC economies have started including in IIAs more detailed clarifications to specifically address the situations where indirect expropriations might occur. For example, the Australia-United States FTA includes an annex on expropriation:

"Annex 11-B - Expropriation

1. The Parties confirm their shared understanding that Article 11.7.1 is intended to reflect customary international law concerning the obligation of States with respect to expropriation.

2. An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.

3. Article 11.7.1 addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.

4. The second situation addressed by Article 11.7.1 is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;

(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and

(iii) the character of the government action.

(b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations."¹²

¹² Other APEC IIAs with the same or a similar annex are the United States-Uruguay BIT and the Canada-Peru FIPA.

The second expropriation issue concerns the conditions imposed on a host country if it is to lawfully expropriate an investment. In all APEC IIAs, an expropriation by the contracting party is lawful, as illustrated in Article 10.10 of the Chile-Republic of Korea FTA, where the expropriation is:

- “[...]”
- a) *for a public purpose;*
 - b) *on a non-discriminatory basis;*
 - c) *in accordance with due process of law and Article 10.5(1); and*
 - d) *on payment of compensation in accordance with paragraphs 2 through 6.”*

Some APEC IIAs require only that payment of compensation is “*prompt, adequate and effective*”, and in one case – the agreement between India and Indonesia – compensation must be “*fair and equitable*”. However, most APEC IIAs adopt the approach taken in the Chile-Republic of Korea FTA and spell out in further detail the requirements for compensation, albeit using various formulations and with only some addressing the question of which currency compensation payments are made in:

- “[...]”
2. *Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.*
 3. *Compensation shall be paid without delay and be fully realizable.*
 4. *If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.*
 5. *If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than that if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.*
 6. *On payment, compensation shall be freely transferable as provided in Article 10.11.*
 7. *This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, or to the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with the TRIPS Agreement.”*

In conclusion, the issue of expropriation is a core element of protective IIAs. Recent IIAs contain more carefully drafted provisions that are intended to minimise disputes over whether regulatory actions have expropriated an investment and require payment of compensation. As shown above, some APEC economies are now including more detailed treaty text clarifying the scope of the expropriation provision and in particular what may amount to an indirect expropriation. This is likely to continue to be an area of importance amongst APEC economies. Two other options for reducing the potential for expropriation claims demonstrate how substantive provisions such as expropriation can interact with scope provisions. First, one could narrow the definition of ‘investment’ to limit the type of assets to which the expropriation obligations apply. And a second option is to remove regulatory actions in certain policy areas from the scope of an IIA, either in a broad sense through the use of general exceptions, or in a narrower fashion, through drafting an exception to the expropriation provision.

4. Compensation for losses

This element looks to provide investors with some level of protection in situations where their property is damaged as a result of war or civil strife. Protection owed under this provision is generally formulated as a relative standard thereby leaving the host country with the choice of whether to compensate, but requiring that any action is taken on a non-discriminatory basis. This relative standard in cases of war and civil disturbance therefore provides additional protection to the absolute treaty standard of full protection and security.

There is a considerable degree of convergence on the use and content of this element. Firstly, there is little variation in the range of situations for which compensation is available in APEC IIAs when compared to those situations envisaged amongst the wider system of IIAs. Secondly, there is some variation in the extent of protection provided.

Eighteen APEC IIAs provide investors with national treatment and MFN treatment for compensation of losses. Most of these provide protection from a combination of some or all of the following types of manmade violence: “*war or other armed conflict*”, “*civil strife*”, “*revolution*”, “*a state of national emergency*”, “*revolt*”, “*insurrection*”, or a “*riot or other similar situation*”. Only one APEC IIA, the Canada-Peru FIPA, also includes natural disasters:

“Article 12 Compensation for Losses

*1. Each Party shall accord to investors of the other Party, and to covered investments, non-discriminatory treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict, civil strife or a **natural disaster**.”* (emphasis added)

The agreement between Chile and the Republic of Korea also provides investors with the better of national or MFN treatment, but narrows the scope for compensation by adding the requirement that loss caused by violent and dangerous human situations “*was not caused in combat action or was not required by the necessity of the situation*”. Other agreements do not contain this express limitation.

Six APEC IIAs only grant MFN treatment for compensation for losses. The FTA between New Zealand and Thailand illustrates this concept:

“Article 9.12 Compensation for Losses

*When a Party adopts any measures relating to losses in respect of covered investments in its territory by persons of any other country owing to war or other armed conflict, revolution, a state of national emergency, civil disturbance or other similar events, the **treatment** accorded to investors of the other Party as regards restitution, indemnification, compensation or other settlement **shall be no less favourable than that which the first Party accords to persons of any non-Party.**” (emphasis added)*

There is also a high degree of standardisation in the means of compensating for losses with almost all APEC IIAs using the phrase “*restitution, indemnification, compensation or other settlement*”.

Finally, three agreements include additional protection to the investor beyond the relative standards of national and MFN treatment.¹³ These IIAs provide that, in certain situations, host countries owe an absolute obligation to compensate foreign investors. This obligation arises where the host country plays an active role in the damage caused in war or a civil disturbance, as distinct from damages caused without direct action by the host country. Thus where the forces or authorities of the host country requisition an investment, or cause destruction of an investment “*not required by the necessity of the situation*”, there is an absolute obligation to compensate.

To sum up, two IIA provisions interact to protect investors from war and civil disturbances: the relative obligation for host countries to compensate on a non-discriminatory basis for losses arising from war and civil disturbance, combined with an absolute standard in three APEC IIAs to compensate for losses, and the more widely adopted absolute treaty standard of full protection and security.

5. Transfer of funds

The ability to transfer an investment and any returns from an investment is critical to its protection. This standard also promotes unrestricted capital flows and is therefore broadly liberalizing. At the same time, transfer of funds provisions can give rise to concerns on the part of developing economies. The adverse consequences of capital flight and sudden large inflows can be severe, at least in the short run. Nevertheless, there is unanimous agreement amongst APEC IIAs to include as a core element of investment protection a right to transfer funds relating to an investment.

Looking at the practice of APEC economies more closely, a typical approach is to require that all transfers relating to an investment must be freely permitted, but then include an illustrative, non-exclusive listing of transfers that must be permitted. The currency and exchange rate of transfers is also specified. This is illustrated in the Australia-Singapore FTA:

¹³ Hong Kong China-Thailand, Australia-United States, and United States-Uruguay.

“Article 11 Transfers

1. Each Party shall permit, on a non-discriminatory basis, all funds of an investor of the other Party related to an investment in its territory to be transferred freely and

without undue delay. Such funds include the following:

(a) the initial capital plus any additional capital used to maintain or expand the investment;

(b) returns;

(c) proceeds from the sale or partial sale or liquidation of the investment;

(d) loan payments in connection with the investment;

(e) unspent earnings and other remuneration of personnel engaged from abroad in connection with that investment; and

(f) compensation paid pursuant to Article 10 (Compensation for Losses).

2. Each Party shall permit such transfers to be made in the currency of the other Party or any freely useable currency at the prevailing rate of exchange on the date of transfer. [...]”

Some APEC IIAs only protect certain transfers and therefore include a closed list. The agreement between Malaysia and Viet Nam is an illustration of this approach. Note that this formulation also includes MFN treatment of transfers:

“Article 6 Repatriation of Investment

(1) Each Contracting Party shall, subject to its laws, regulations and administrative practices allow without unreasonable delay the transfer in any freely useable currency:

(a) the net profits, dividends, royalties, technical assistance and technical fees, interest and other current income, accruing from any investment of the investors of the other Contracting Party;

(b) the proceeds from the total or partial liquidation of any investment made by investors of the other Contracting Party;

(c) funds in repayment of loans related to an investment; and

(d) the earnings of citizens and permanent residents of the other Contracting Party who are employed and allowed to work in connection with an investment in the territory of the other Contracting Party.

(2) The exchange rates applicable to such transfer in paragraph (1) of this Article shall be the rate of exchange prevailing at the time of remittance.

(3) The Contracting Parties undertake to accord to the transfers referred to in paragraph (1) of this Article a treatment as favourable as that accorded to transfers originating from investments made by investors of a third State.”

Eighteen APEC IIAs include some limitation on the right to transfer funds. Most of these allow for the host country to restrict transfers during times of balance of payments difficulties consistent with the IMF Articles of Agreement. An example is the Japan-Mexico EPA:

“Article 72 Temporary Safeguard Measures

1. A Party may adopt or maintain measures not conforming with its obligations under Article 58 relating to crossborder capital transactions and Article 63:
(a) in the event of serious balance-of-payments and external financial difficulties or imminent threat thereof; or
(b) in cases where, in exceptional circumstances, movements of capital cause or threaten to cause serious difficulties for macroeconomic management, in particular, monetary and exchange rate policies.”

Even those agreements that allow for unfettered transfers commonly include some provisos. The following formulation is almost universally used:

“3. Notwithstanding paragraphs 1 and 2 above, a Contracting Party may delay or prevent a transfer through the equitable, non-discriminatory and good faith application of its laws relating to:
(a) bankruptcy, insolvency or the protection of the rights of creditors;
(b) issuing, trading or dealing in securities;
(c) criminal or penal offenses; or
(d) ensuring compliance with orders or judgements in adjudicatory proceedings.”

Another way of differentiating country practice is on the basis of whether the agreement protects transfers coming into the host country as well as the more commonly protected outflows. A reference to the transfer of funds “*related to an investment*” (e.g. the Australia-Singapore example set out above) should be broad enough to include bringing capital in. Protection of ‘transfers in’ often corresponds to those agreements that provide for the admission of investments. Thus, the transfer of funds provision can operate with establishment provisions to facilitate a more liberal investment regime. There is a corresponding investment protection issue because it also covers existing investments that wish to transfer further capital for the operation of the investment.

6. Investor-State dispute settlement

Dispute settlement provisions are included in IIAs by APEC members and serve to protect foreign investment. A mechanism for investors to take up claims directly against the host country is included in all but one of the reviewed IIAs (the Australia-United-States FTA). Access to international arbitration is only available on the consent of the host government in the Japan-Philippines EPA, though this provision is the subject of further negotiation.¹⁴ Investor-State dispute settlement increases the level of certainty regarding the host country’s business environment and depoliticises disputes by ensuring they are decided on legal grounds. Investor-State mechanisms therefore interact with substantive IIA provisions to

¹⁴ “Article 107 Further Negotiation: 1. The Parties shall enter into negotiations after the date of entry into force of this Agreement to establish a mechanism for the settlement of an investment dispute between a Party and an investor of the other Party.

2. In the absence of the mechanism for the settlement of an investment dispute between a Party and an investor of the other Party, the resort to international conciliation or arbitration tribunal is subject to mutual consent of the parties to the dispute. This means that the disputing Party may, at its option or discretion, grant or deny its consent in respect of each particular investment dispute and that, in the absence of the express written consent of the disputing Party, an international conciliation or arbitration tribunal shall have no jurisdiction over the investment dispute involved.”

liberalize foreign investment flows. Other studies provide detailed analysis of all the features of investor-State dispute settlement (UNCTAD 2004b (volume 1, chapter 12), 2005, 2006a, and 2007b). In particular, there are recent developments and significant innovations in the investor-State arbitration provisions of several APEC economies. These recent trends are important elements of treaty negotiations involving these APEC economies. What follows is a summary of key features of investor-State arbitration with an emphasis on these recent developments.

Practice on investor-State dispute settlement provisions varies significantly. Some APEC economies follow the NAFTA model and deal with the issue in a set of lengthy and detailed provisions that offer guidance to the disputing parties on procedural issues and aim to strengthen the rules-based nature of these mechanisms. Other agreements, particularly most BITs, only mention the main features and include general guidance on procedures. They place greater reliance on existing arbitration rules, often those offered by ICSID or UNCITRAL. As mentioned, more recent practice amongst a number of APEC members, led by the NAFTA experience of Canada and the United States, have reformed their investor-State dispute settlement procedures to provide greater transparency in arbitral proceedings, allow more involvement of interested third parties and facilitate the consolidation of claims.

A key feature of investor-State provisions is the scope of claims that can be taken to international arbitration. This varies from any dispute between an investor and host country, to disputes involving a provision of the treaty or an obligation of contracting parties. A number of APEC IIAs offer more limited access to arbitration and require that an investor “*has incurred loss or damage by reason of, or arising out of, an alleged breach of any right*” (Article 15, Japan-Republic of Korea BIT). The scope of these provisions is also a question of legal standing. Some IIAs allow a foreign subsidiary, locally incorporated, to access the provisions as a foreign investor.

Another key element is the prerequisites for accessing arbitration. First, consultations between parties to the dispute are almost always required, though there is divergence amongst APEC IIAs on whether consultations must take place for three, five or six months. Second, consent to arbitration is often provided through the inclusion of a “*compulsory jurisdiction*” provision. Here again there is considerable divergence in how the legal text is drafted. Thirdly, almost all APEC IIAs do not require exhaustion of local remedies prior to submitting a dispute to international arbitration. This reflects the fact that most APEC members consider arbitration an alternative means of resolving a dispute rather than a subsidiary mechanism.

The recent significant innovations by APEC members to investor-State dispute settlement procedures underscore the interaction of dispute settlement mechanisms with substantive provisions. Substantive IIA provisions depend on effective and enforceable dispute resolution mechanisms. Reforms have been introduced to promote greater procedural predictability and control of the parties over arbitration. First, parties to some treaties are now required to be involved in the arbitration process to interpret aspects of their treaties. For example, Article 41 of the Canada-Peru FIPA requires the parties, sitting as the ‘*Commission*’ that oversees the operation of the treaty, to interpret the annexes:

“1. Where a disputing Party asserts as a defence that the measure alleged to be a breach is within the scope of a reservation or exception set out in Annex I, Annex II or Annex III, on request of the disputing Party, the Tribunal shall request the interpretation of the Commission on the issue. The Commission, within 60 days

of delivery of the request, shall submit in writing its interpretation to the Tribunal.”

Second, there have been efforts by some APEC economies to promote judicial economy, for example by seeking to avoid frivolous claims and by allowing for the consolidation of claims. In Article 28 (Conduct of the Arbitration) paragraph 6 of the United States-Uruguay BIT, it states that in deciding as a preliminary question any objection by the respondent that a claim submitted cannot be the subject of an award:

“[...] the tribunal shall consider whether either the claimant’s claim or the respondent’s objection was frivolous, and shall provide the disputing parties a reasonable opportunity to comment.”

And in the same treaty a process for the consolidation of claims is provided for under Article 33 *“(w)here two or more claims have been submitted separately to arbitration [...] and the claims have a question of law or fact in common and arise out of the same events or circumstances”*.

There have also been attempts to create greater transparency and to ensure greater consistency among arbitral awards. An example of this is the ongoing discussion about subjecting arbitrations to appeal, though nothing concrete has been proposed.

D. Investment promotion

Some IIAs have the objective of improving direct investment flows through the inclusion of investment promotion provisions. Most commonly, this will be an objective of less developed economies seeking to entice capital inflows. Indeed the BITs of some economies are called Investment Promotion and Protection Agreements (IPPAs). However most IIAs, including many IPPAs, only promote foreign investment indirectly through their contribution to the creation of a favourable investment climate.

The same can be said of APEC IIAs. 12 IIAs completed by APEC economies include language on investment promotion with several further PTIAs involving Japan including references to investment promotion in a separate chapter.¹⁵ These agreements include language that encourages the promotion and facilitation of investment in general terms, and a small subset of three IIAs include provisions with greater detail on investment cooperation between the parties. A third class of investment-promoting IIAs include those with transparency provisions (also discussed in the Section on Investment Liberalization, above). The removal of informal barriers to investment is important to the promotion of capital flows.

IIAs with investment promotion objectives are often concluded by a developing economy with an industrialized economy. Investment promotion therefore offers some quid pro quo for the less developed party in return for the protections it offers as host country to investors and their investments from the industrialized economy. The promotion objective is also central to some IIAs between developing economies, in particular where investment provisions are part of a push towards closer regional integration. The ASEAN Framework Agreement on Investment is one such example.

¹⁵ One of the twelve, the Russian Federation-Thailand BIT, only refers to investment promotion in the preamble and doesn’t include an investment promotion provision.

1. Promotion and facilitation

The first class of IIAs containing a reference to investment promotion offer a somewhat vague and general commitment to “encourage” or “promote” investment, or “create favourable conditions” for investors. These are usually formulated in a similar way to Article 2 (Promotion and Protection of Investments) of the Malaysia-Viet Nam IPPA:

“(1) Each Contracting Party shall encourage and create favourable conditions for investors of the other Contracting Party to invest in its territory and subject to its rights to exercise powers conferred by its laws, regulations and administrative practices, shall admit such investments. [...]”

Article 3 (Promotion and Protection of Investment) of the India-Indonesia IPPA requires that Parties “*encourage and create favourable conditions for investors*” and the Australia-Mexico IPPA asks that Parties “*to the extent possible, promote investments in its territory by Investors of the other Contracting Party*”.

2. Cooperation on investment

Several IIAs go further than a best endeavours approach and impose more specific obligations on parties.¹⁶ For example, an IIA may require parties to exchange information on investment opportunities in their respective economies. This may be contained in a stand-alone provision or incorporated in a transparency provision. The Japan-Malaysia EPA includes a separate provision on cooperation. Article 92 states:

“1. Both Countries shall co-operate in promoting and facilitating investments between the Countries through ways such as:

(a) discussing effective ways on investment promotion activities and capacity building;

(b) facilitating the provision and exchange of investment information including information on their laws, regulations and policies to increase awareness on investment opportunities; and

(c) encouraging and supporting investment promotion activities of each Country or their business sectors.

2. The implementation of this Article shall be subject to the availability of funds and the applicable laws and regulations of each Country.”

The New Zealand-Thailand CEP includes a similar but more broadly phrased requirement in Article 9.4 for Parties to “*strengthen and develop cooperation efforts in investment*” through “*research and development*”, “*information exchange*”, “*capacity building*” and so forth. However, this agreement also identifies key sectors where cooperation should be developed, namely in “*biotechnology, software, electronic manufacturing and agro-processing*”.

The distinction between those provisions that purport to promote and facilitate and those that provide for cooperation is sometimes illusory. In practice, the wording of some cooperation

¹⁶ These three are: Japan-Malaysia EPA, New Zealand-Thailand CEP, and the Framework Agreement on the ASEAN Investment Area.

provisions does not provide for substantively more than an obligation to “encourage and promote” investments.

One APEC IIA stands out as going much further to promote investment flows. Article 6 of the Framework Agreement on the ASEAN Investment Area includes programmes and action plans for the promotion of investment:

“1. Member States shall, for the implementation of the obligations under this Agreement, undertake the joint development and implementation of the following programmes:

- a. co-operation and facilitation programme as specified in Schedule I;*
- b. promotion and awareness programme as specified in Schedule II; ...*

2. Member States shall submit Action Plans for the implementation of the programmes in paragraph 1 to the AIA Council established under Article 16 of this Agreement.

3. The Action Plans shall be reviewed every 2 years to ensure that the objectives of this Agreement are achieved.”

As this approach demonstrates, it remains an open question whether some economies’ IIAs could include more detailed provisions on transparency and exchange of investment-related information, fostering linkages between foreign investors and domestic companies, capacity-building and technical assistance, granting of investment insurance, encouragement of transfer of technology, easing informal investment obstacles, joint investment promotion activities, access to capital, and the setting up of an institutional mechanism to coordinate investment promotion activities. One option would be to give structure to this through IIA text (UNCTAD forthcoming c)

3. Transparency

Transparency in relation to FDI policy is an important theme common to different sections of this study. It has particular relevance to investment. The overriding aim of transparency is to enhance the predictability and stability of the investment relationship and to provide a check against circumvention and evasion of obligations by resort to covert or indirect means. Thus, transparency can serve to promote investment through the dissemination of information on support measures available from home countries, investment conditions and opportunities in host countries and through the creation of a climate of good governance. Transparency is also important for assessing the treatment and protection of investment and is also necessary for the monitoring of disciplines, restrictions, reserved areas, and exceptions that are provided for in IIAs. Equally, the extension of transparency obligations to corporate disclosure can help protect the interests of host countries and home countries, as well as other stakeholders (UNCTAD 2004b, volume 1, chapter 10).

II. APEC Investment Instruments

This section discusses the extent to which the principles and practices in APEC investment instruments are reflected in the approach to treaty making taken by member economies. Considered together, the APEC investment instruments set out principles and practices that are consistently reflected in the IIAs concluded by APEC members. Looking at each of the three instruments individually reveals divergence in several areas.

A. Non-Binding Investment Principles

The Non-Binding Investment Principles ('NBIP') were adopted in Bogor in 1994 as a means of facilitating investment flows within the region. The instrument sets out 12 investment principles that are broadly similar to the core elements of IIAs identified in this study. The principles relate to: transparency, non-discrimination between source economies, national treatment, investment incentives, performance requirements, expropriation and compensation, repatriation and convertibility of funds, settlement of disputes, the entry and sojourn of personnel, the avoidance of double taxation, investor behaviour, and the removal of barriers to capital exports.

A number of areas of difference or gaps between these principles and investment treaty practice can be identified. First, the NBIP transparency provision requires member economies to make publicly available "all laws, regulations, administrative guidelines and policies *pertaining to investment in their economies*" (emphasis added). This limits the obligation of transparency by imposing the requirement exclusively on the host country. This often occurs within BITs, largely because there is a perception that some host country measures negatively affect the establishment and operation of foreign affiliates. For example, Article 6 (Transparency of Laws) of the Australia-Mexico IPPA provides that:

"Each Contracting Party shall, with a view to promoting the understanding of its laws and regulations on investment that pertain to or affect investments in its territory by Investors of the other Contracting Party, take reasonable measures as may be available to make such laws and regulations public."

However, a number of other APEC IIAs do not limit the transparency obligation to host countries. For example, Article 19 of the Canada-Peru FIPA provides:

"1. Each Party shall, to the extent possible, ensure that its laws, regulations, procedures, and administrative rulings of general application respecting any matter covered by this Agreement are promptly published or otherwise made available in such a manner as to enable interested persons and the other Party to become acquainted with them. [...]"

Second, the principles recommend member economies accord foreign investors national treatment at the establishment phase, but subject to domestic laws. Whilst this provides flexibility for member economies to impose restrictions on the entry of foreign investment, it nevertheless sets down the principle that treatment no less favourable than that accorded to domestic investors be provided during the establishment of an investment. As was seen in Section II, above, ten APEC BITs in this study do not offer national treatment at the pre-establishment phase, though several recent BITs have adopted the NBIP approach.

A third difference is that APEC investment treaty practice commonly grants investors additional protection in line with the so-called general treatment standards of fair and equitable treatment, full protection and security, and compensation for losses arising from war or civil disturbances. These standards are not incorporated in the NBIP. IIA treaty practice by most APEC economies therefore commonly extends the objective of investment protection beyond what has been envisaged by APEC investment instruments.

Fourth, the NBIP sets out that APEC members aspire to “*minimise the use of performance requirements [...]*”. More than half the APEC IIAs in this study do not seek to curtail the use of performance requirements, though all APEC economies are now subject to the WTO TRIMs Agreement. There is therefore a substantial gap between this principle and treaty practice amongst member economies.

Fifth, member economies are encouraged to allow the free and prompt repatriation and convertibility of funds related to foreign investments. This objective is embraced by APEC IIAs with most guaranteeing free transfers without restricting the type of investment-related transactions. Two APEC IIAs articulate a more limited approach with a closed list of transactions that are guaranteed under the IIA and with the qualification that transactions are subject to the Parties' domestic laws and regulations.

Sixth, the NBIP spells out that member economies will permit the temporary entry of key foreign technical and managerial personnel engaged in activities connected with foreign investment. It is important here to distinguish between provisions permitting temporary entry for natural persons and provisions looking to regulate the nationality of senior management or board members. Of the 10 APEC IIAs addressing investment personnel issues, all but three focus on nationality restrictions on management. As mentioned in Section II.B.5, only one APEC IIA links temporary entry with the regulation of senior personnel nationality, and several economic integration agreements deal with temporary entry in separate chapters. There is therefore considerable scope for further addressing these issues in APEC IIAs.

Finally, the NBIP places emphasis on the role investor behaviour and investor obligations play in facilitating investment flows and acknowledge that foreign investment is facilitated when foreign investors abide by the host economy's laws and regulations. The issue of reciprocal obligations is not addressed in APEC IIAs. IIAs to date have focussed almost exclusively on creating obligations for host countries and corresponding rights for investors. The question of how to balance the rights and interests of foreign investors and those of host countries is at the core of current debate about the future development of international investment rules (UNCTAD 2007a).

B. Menu of Options

The Options for Investment Liberalization and Business Facilitation to Strengthen the APEC Economies (or ‘Menu of Options’) offers a comprehensive list of policies for liberalization and business facilitation. An important distinction between this investment instrument and APEC IIAs is that the Menu of Options is cast more broadly than just encouraging foreign direct investment. Its objective is to improve all investment in economies. Items are therefore presented as regulatory reform options at the domestic level. A direct assessment of performance by APEC economies against some of these reform options is not possible from examining treaty practice. However, in many instances domestic reform items in the Menu of Options have equivalent international law commitments reflected in IIA treaty practice.

These can be broadly indicative of State practice. For example, the approach taken by APEC economies to defining investment in IIAs may give some indication as to how economies have addressed the Menu of Options recommendation to "(b)roaden definitions of investment [...] in existing legislation".

Most topics in the Menu of Options (items 1-9) are reflected in core elements of APEC IIAs, but a number of policy areas (items 10-15) are not included in APEC IIAs. These include items relating to intellectual property, the avoidance of double taxation, competition policy, and elements of the sections on business facilitation, technology transfer, and venture capital. It is increasingly common for these issues to be covered in other chapters of economic integration agreements.

Items 1.01-1.03 are addressed by APEC IIAs. All IIAs in the study adopt a broad definition of investment covering the classes of transactions included in item 1.01. On the other hand, not all IIAs offer investors a standstill on restrictions (item 1.03). As pointed out above, 12 of the 14 BITs surveyed do not use schedules of commitments to identify restrictions on investors. Commitments on current treatment are however a common feature of APEC economic integration agreements.

Perhaps the most notable gap between the Menu of Options and APEC IIAs is in the area of prior authorization requirements (items 1.04-1.07 and items 1.08-1.09). The Menu of Options recommends eliminating or phasing out prior authorization requirements as a critical step towards investment liberalization, but there is little evidence of APEC economies using IIAs to liberalize existing establishment requirements. First, only two BITs address prior authorization. One partial exception where an APEC IIA has relaxed establishment requirements is the Australia-United States FTA and Australia's decision to raise its screening thresholds in certain sectors for United States investors.

Another recent study (Fink and Molineuvo 2007) found that high-income APEC economies including Singapore, the Republic of Korea and Japan have achieved greater openness in their services sectors (including investment in services through commercial presence) through EIAs than lower income economies. This suggests an opportunity for greater ambition in addressing items 1.04 - 1.07 of the Menu of Options.

Item 2, which deals with the transparency of investment regimes, is addressed in Section III.C below.

Item 3 concerns policy options to introduce further non-discrimination of foreign investment. Items 3.01-3.08 recommend progressively improving the level of MFN and national treatment offered to foreign investors. This study shows general consensus in favour of including treaty provisions committing APEC economies to non-discriminatory treatment. As with item 1, general practice amongst APEC members is to bind existing exceptions to non-discrimination rather than use IIAs to drive further domestic reforms. Identifying the sectoral coverage of these non-discrimination commitments and exceptions to such treatment requires analysis of domestic measures scheduled in treaty annexes. This could be the subject of further study.

APEC IIAs fully meet the objectives of item 4 in relation to expropriation and compensation. Indeed the practice of APEC economies is to address the issue in greater detail by also seeking to protect foreign investors against indirect expropriation.

All APEC IIAs also meet the level of treatment set out in item 5. APEC treaty practice offers investors and their investment non-discriminatory protection from strife and similar events. Some offer both MFN and national treatment, others offer MFN treatment, and several offer absolute protection in the event of war or other civil disturbances.

Item 6 relates to the transfer of capital related to investments and commends member economies to remove or reduce restriction on free transfers. All APEC IIAs reflect a commitment to this objective. 10 agreements fully meet the objectives of this item and allow unfettered transfers. Most other IIAs include only limited exceptions (an exception to free transfers in the case of balance of payment crises), consistent with item 6.03.

Items 7.01-7.03 deal with restrictions on performance requirements. As has been observed previously, this is an area of investment regulation that is not addressed as comprehensively amongst APEC IIAs and requires further attention in future IIA negotiations. Still, some economies have consistently exceeded what this item recommends and included restrictions on performance requirements for investment in services as well as in goods sectors.

Items 8.01 and 8.02 address the temporary entry and stay of personnel for investment purposes. This is equivalent to the objectives set out in the NBIP, and as mentioned above, is an issue addressed in the investment provisions of only three of the APEC IIAs with several EIAs dealing with temporary entry in separate chapters. However, the inclusion of 8.03 and 8.04 in the Menu of Options links temporary entry of personnel with liberalization of the regulation of nationality of senior management. As articulated previously, these two issues are not usually addressed together in APEC IIAs.

Item 9 supports the use of effective dispute settlement mechanisms and endorses membership of international arbitration bodies. These regulatory options are well supported by APEC treaty practice.

C. Investment Transparency Standards

Transparency principles were set out in the Statement to Implement APEC Transparency Standards (“Leaders’ Statement”) delivered at Los Cabos in October 2002. In October 2003, the IEG developed a set of transparency standards on investment for incorporation into the Leaders’ Statement. These standards flowed from APEC Leaders’ 2002 principles on transparency and built on the Menu of Options.

APEC investment transparency standards cover the publication, awareness and availability of investment laws and measures. This level of transparency obligation is what most commonly appears in APEC IIAs. The APEC transparency standards require that members ensure “*that appropriate domestic procedures are in place to enable prompt review and correction of final administrative actions [...]*” relating to investment matters. This expansion of the concept of transparency to include elements of due process is infrequently included in APEC IIAs. However it does appear in the transparency chapter of some economic integration agreements:

"Each Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:
(a) a reasonable opportunity to support or defend their respective positions;
and

(b) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority."

The APEC transparency standards also seek to maintain consistency in the use of screening guidelines, procedures for registration and government licensing, prior authorization requirements and investment promotion programmes (paragraphs 5-8). These issues are not covered in IIAs.

Finally, paragraph 9 of the standards highlights the link between transparency and investment disputes and encourages the inclusion of transparency provisions in investor-State dispute settlement mechanisms. There has been considerable attention given to transparency in dispute settlement proceedings in the IIAs of several APEC members, notably Canada and the United States. For example, Article 29 of the United States-Uruguay BIT requires the respondent to transmit certain documents to the home country and to make them available to the public. These documents include the notice of arbitration, the memorials, the transcripts of hearings and the arbitral awards. In addition to keeping the public informed, some APEC IIAs now also allow *amicus curiae* briefs to be submitted by parties not involved directly in the dispute. Indeed this development goes beyond what is included in the transparency standards.

Conclusions

The core elements of IIAs described in this study interact to determine the obligations of the treaty parties and how the treaties will liberalize, protect and promote investment. Three types of interaction can be identified. First, the interaction of definitions with the substantive provisions. Second, the interactions of exceptions (general exceptions and scheduled exceptions) with the substantive provisions. And third, the interaction of the substantive provisions with the dispute resolution provisions.

There has been a recent trend in a small but growing number of APEC IIAs to include significant revisions to the wording of various substantive treaty obligations. Prominent amongst these are more detailed treaty language on the meaning of fair and equitable treatment and the concept of indirect expropriation. There have also been revisions to procedural provisions with some recent IIAs including significant innovations to the investor-State dispute resolution procedures. The main purpose of these innovations is to increase transparency, to promote judicial economy, and to foster sound and consistent results. At the same time, all these changes increase the complexity of the IIA dispute settlement system.

There is general agreement on which are the core elements and provisions of IIAs involving APEC economies. This conformity is also evident in the global system of IIAs (UNCTAD 2007b and forthcoming a). On a number of core issues, APEC IIAs reflect consensus with respect to the main content and overriding purpose. Provisions such as national and MFN treatment for established investments, fair and equitable treatment, guarantees of prompt, adequate and effective compensation for expropriation and of free transfers, and consent to investor-State and State-State dispute resolution all appear in the vast majority of agreements.

On closer examination, APEC IIAs are quite different in their wording and meaning. There are also some provisions that only appear in a minority of agreements and with considerable variation among agreements. For example, guarantees of national and MFN treatment with respect to the right to establish investment, and prohibitions on performance requirements. These differences are partly attributable to an inadequate understanding of the aims and objectives underpinning the recent evolution of treaty language for certain key substantive obligations. This requires further targeted capacity building amongst APEC economies.

The implications of this convergence and divergence in treaty practice are drawn together in Section III of the study. Four key conclusions for APEC economies can be drawn from a comparison of APEC IIA treaty practice with those principles and policy recommendations set out in APEC investment instruments. First, the biggest gap between APEC principles and APEC practice is in the limited use of IIAs to drive domestic investment policy reform in the ways endorsed by the Menu of Options items, namely through reducing prior authorization requirements (item 1) and reducing exceptions to non-discriminatory treatment of foreign investors (item 3). A second main gap between principles and practice is in the limited way APEC IIAs (considered as a whole) address the use of performance requirements. Third, this analysis demonstrates the comprehensive treatment given by APEC IIAs to APEC principles relating to expropriation and compensation (item 4), non-discriminatory protection in the event of war or civil disturbance (item 5), transfers of funds related to foreign investment (item 6), and in relation to dispute settlement mechanisms (item 9). Finally, additional protections not included in APEC investment instruments such as the fair and equitable

treatment standard and minimum standard of treatment are routinely included in APEC investment treaties.

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Annex 1 List of covered treaties

1. Canada - Chile FTA
2. Hong Kong, China - Thailand IPPA
3. Japan - Korea IPPA
4. Japan - Malaysia EPA
5. Japan - Mexico EPA
6. Japan - Singapore - EPA
7. Japan - Viet Nam IPPA
8. Japan - Philippines EPA
9. NAFTA
10. New Zealand - Singapore CEP
11. New Zealand - Thailand CEP
12. Australia-Thailand FTA
13. Peru - Singapore IPPA
14. Australia - United States FTA
15. Australia - Singapore FTA
16. 1998 Framework Agreement on the ASEAN Investment Area (and the 1987 ASEAN Agreement on the Promotion and Protection of Investments as affirmed)
17. United States - Uruguay BIT
18. Canada - Peru FIPA
19. Australia - Mexico BIT
20. Chile - Peru ALC
21. Chile -Korea FTA
22. Russia -Thailand BIT
23. Malaysia - Viet Nam IPPA
24. Lebanon - Malaysia IPPA
25. India - Indonesia IPPA
26. Germany - Philippines BIT
27. China - Germany BIT
28. Iceland - Mexico BIT

Annex 2

Terms of Reference: Identifying Core Elements in Investment Agreements in the APEC Region

Background

At the Investment Experts Group (IEG) at SOMI in Ha Noi, a friends' of the chair group was formed to consider how to proceed with a study proposed by New Zealand on identifying core elements on investment in regional and free trade agreements (RTAs/FTAs), other forms of economic partnership agreements (EPAs) and bilateral investment treaties (BITs). This proposal directly responded to Ministers' request for APEC to strengthen its work in the investment area, including studying the relationship between various agreements on investment.

Objectives

The main objective of this study will be to identify the core elements in investment agreements¹⁷ in the APEC region, including the range of approaches taken in respect of these elements. In identifying the core elements, careful consideration will need to be given to how these elements interact as this will impact on the investment environment that is created between partner economies. The relationship that already exists between the economies negotiating an investment agreement, including the degree of existing integration between these economies, will also have a bearing on its final form.

Given the ongoing rise in the number of investment agreements between APEC member economies, identifying core elements in investment agreements in the region could assist in meeting the Bogor goals of free and open trade investment in the region in a number of ways. These include by:

- helping to ensure that investment agreements effectively encourage investment and economic development in the region.
- allowing faster negotiation of investment agreements, in particular by assisting those with less experience in this area;
- mitigating the impact of the so-called spaghetti bowl effect on businesses; and
- facilitating the development of the current FTA architecture, including the evolution to larger plurilateral groupings, where this was considered desirable.

Approach

Step One – Identify core elements in APEC investment agreements.

This step will involve a stocktake on investment agreements in the APEC region, including the investment chapters of FTAs, RTAs and EPAs as well as BITs. Member economies will be asked to submit typical examples of their investment agreements and suggest other examples of investment agreements outside APEC that may be taken into account in the

¹⁷ The term investment agreement is intended to cover the investment chapters in FTAs, CEPs, EPAs and other regional trading arrangements as well as bilateral investment treaties.

stocktake where appropriate. Core elements of these agreements and the range of approaches adopted in respect to these elements will then be identified.

Step Two – Analyse the way in which these core elements assist in liberalising, protecting and facilitating investment in and between the Parties.

This step will require separating, where possible, the core elements into three main groups: investment liberalising provisions; investment protecting provisions; and investment facilitating provisions. To do so will require consideration of the nature of the provisions as well as how they interact with other provisions in the agreement. Some provisions are likely to fall in to more than one category. This step will also include analysing the purpose of these provisions and looking at any commonalities or differences in approach adopted by APEC member economies in these agreements.

The presentations and discussions at the non-discrimination and investor-State dispute seminars to be held at the end of this year may also assist in completing this step.

Step two may provide data for analysis of the economic and development implications of investment agreements should any economy wish to propose this work as a separate project in the future.

Step Three – Compare identified core elements in APEC investment agreements with existing APEC investment instruments including the Non-Binding Investment Principles (NBIP), Menu of Options (MoO) and Investment Transparency Standards.

This step will consider how existing investment instruments in APEC, such as the NBIP, MoO and the Investment Transparency Standards, are being taken into account in the core elements in APEC member investment agreements.