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APEC WORKSHOP ON BILATERAL AND REGIONAL INVESTMENT RULES/AGREEMENTS

**Asia-Pacific Economic Cooperation
Committee on Trade and Investment
Investment Experts Group**

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**Asia-Pacific Economic Cooperation
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**Ministry of Economy
Mexico**

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OBJECTIVES

Objectives

The crucial importance of foreign investment is widely recognised all over the world. Foreign investment is seen both as the global market's "seal of approval" on a country's policies and prospects. It is far more than mere "capital": it is a uniquely potent bundle of capital, contacts and managerial and technological knowledge. It is the cutting edge of globalisation. Foreign investment is not an entitlement; it flows to countries where there is a reasonable rate of return on capital, stability, pro-business environment, and adequate protection.

One of the initiatives arisen from APEC Leaders Meeting at Blake Island, Seattle (1993) was the development of an Investment Code of Non-binding principles, which was materialized in Jakarta (November 1994) with the APEC Non Binding Investment Principles. The Bogor Declaration (1994) has, as an objective, the enhancement of trade and investment in the Asia-Pacific and a long-term goal of free and open investment: *"This goal will be pursued promptly by further reducing barriers to trade and investment and by promoting the free flow of goods, services, and capital among our economies"*. The Osaka Action Agenda (1995) establishes in the specific guidelines for Investment, that each APEC economy will: "explore expansion of APEC's network of bilateral investment agreements".

In pursuing these premises, the Workshop was designed:

- To have informal discussion and, roundtable debates, conducive towards gaining a greater understanding of the issues relevant to investment agreements, based on a program of common interest to member economies,
- To have a better understanding on what investment agreements are, how they can be used as an effective instrument for foreign investment promotion and protection,
- To provide a useful forum to address best policy practices/instruments in APEC member economies concerning investment protection, and
- To explore the possibility to expand APEC's network of investment agreements.

Session One - International Capital Flows: Recent Trends and Future Perspectives

Direct investment has accounted for about a quarter of total international capital outflows in the 1990s and appears to have grown, relative to other forms of international investment, since the 1970s.

The main purpose of this session is to obtain a picture of the current FDI flows' behavior worldwide, the determinants of FDI flows in developed and developing countries, FDI concentration, greenfield FDI, Mergers & Acquisitions and comparative data.

Session Two - APEC Instruments Relevant to International Rules on Investment

Investment has been at the heart of APEC and central to the development and dynamism of APEC economies. At this session we seek to discuss the links between APEC investment instruments and other agreements on investment.

Session Three - Regional Initiatives on Investment, Regional Policy and Regulatory Trends and Their Causes

Regional agreements are increasingly important in matters of FDI. It has been fully demonstrated that international trade and investment have been closely related since the beginning of the globalisation process. On this session we seek to discuss the interrelation and interaction between investment and trade rules in the regional context.

Session Four - General Features of Investment Promotion and Protection Agreements Signed by the APEC Economies

An international legal framework for FDI has emerged. It consists of many kinds of national and international rules and principles, of diverse form and origin. The entire structure rests on the twin foundations of national laws and regulations and on a multitude of international investment agreements and other legal instruments.

The main purpose of this session is to focus on the analysis of the different disciplines covered in investment agreements and their interpretation.

Session Five - The Interrelation and Interaction of Bilateral/Regional and Multilateral Investment Rules

In the past two decades, there have been significant changes in international policies on foreign direct investment. These changes have been both cause and effect in the ongoing integration of the world economy and the changing role of FDI in it. They have found expression in national laws and practices and in a variety of international instruments, bilateral regional and multilateral.

Given that the recent events confirmed that investment will be discussed in the next WTO Ministerial Conference, in this session we seek to evaluate the main connections (interrelation and interaction) of bilateral/regional and multilateral investment rules.

SYNTHESIS OF CONFERENCE
DELIBERATIONS

Synthesis of Conference Deliberations.

Session One – International Capital Flows: Recent Trends and Future Perspectives.

In her presentation on *Global and APEC FDI Trends*, **Ms. Padma Mallampally** from UNCTAD, explained how Foreign Direct Investment (FDI) has rapidly expanded during the past 20 years. Annual FDI flows rose every year during 1980-2000 except for 1982 and 1991. Despite the growth of FDI in a large number of countries, FDI was not evenly distributed among regions and countries. Much of this growth was concentrated in developed countries. However, if FDI is viewed in relation to the size of economies, the disparity between developed and developing host economies diminishes considerably. FDI flows relative to gross fixed capital formation (GFCF) were in fact slightly higher for developing countries, judging from data for 1997-1999. Likewise, the transnationality index constructed by UNCTAD which shows the relative importance of FDI flows and stock for a host economy relative to four different domestic aggregates (GFCF, GDP, exports and employment), showed wide disparity in the importance of FDI for countries.

The speaker also stressed the huge differences among developing countries with respect to the attraction of FDI flows. Concerning APEC Economies, FDI flows increased along with the growth in global flows. Further, during the period 1989-2000, the growth of flows to APEC Economies was higher than flows to developed countries until 1997.

Ms. Mallampally also mentioned that the upward trend in global FDI flows was interrupted again in 2001. The decline was concentrated in the developed countries and attributed mainly to a marked slowdown in world economic growth. On the whole, the decline in flows to APEC Economies in 2001 was larger than the decline in global flows, as well as flows to both developed and developing countries. However, with the economic recovery of the United States and of other major economies, FDI flows in the current year could be expected to recover.

Finally, Ms. Mallampally focused on cross-border Mergers and Acquisitions (M&A) and FDI by pointing out that FDI and the growth of international production have taken place mainly via M&A rather than via greenfield investment in the late 90s, and that an important part of the increase in FDI flows to developing countries was due to the privatisation of state-owned enterprises. She recognised that technological change affected FDI location in many ways since transnational corporations (TNC) were more and more efficiency-seeking. The task for attracting FDI is becoming more challenging; thus, beyond opening up to FDI, there is a need to develop attractive configurations of locational advantages. The “third generation” of investment promotion policies involves the difficulty of targeting foreign investors at the level of industries and clusters.

Session Two – APEC Instruments Relevant to International Rules on Investment.

Mr. Taeho Bark, Chairman of the APEC Investment Experts Group, pointed to the APEC region as one of the most powerful regional groups in the world economy, encompassing more than 50% of world GDP and trade volume, respectively. He also recognised the diversity in economic development stages and the heterogeneity of industrial structures within the region.

Mr. Bark introduced the different types of investment agreements; the APEC Investment Instruments; and, made an analysis of some investment agreements. Regarding the types of investment agreements, he referred to different multilateral agreements such as the Trade-Related Investment Measures Agreement (TRIMs) and the General Agreement on Trade in Services (GATS), as well as some multilateral works, agencies and groups in international organisations such as the Working Group on the Relationship between Trade and Investment. Concerning regional agreements, they have often been the harbingers of significant new trends in matters of investment law and regulation. As an example, he mentioned the North American Free Trade Agreement (NAFTA) and the Framework Agreement on the ASEAN Investment Area. Finally, with respect to Bilateral Investment Agreements (BITs) he stated that these agreements are easier to implement, but their main disadvantage is that their proliferation could lead to a complex net of inconsistent provisions that are difficult to apply and may distort investment flows.

In relation with APEC Investment Instruments, he explained how the Non-binding Investment Principles (NBIP) have worked as an investment code for facilitating investment flows within the region. He also mentioned the Menu of Options which was designed by the IEG to help economies identify policy tools that they may include unilaterally in their individual action plans (IAPs). This Menu has been expanded with the addition of texts on technology transfer, intellectual property rights, etc. It can be said that these two instruments follow standards that have come to be known as “soft law”. Finally, he referred to the IAPs and the Investment Guidebook which while not considered investment instruments *per se*, serve as useful tools in revealing investors an economy’s investment regime.

In the last part of his presentation Mr. Bark gave a general evaluation of APEC Economies’ Investment Agreements by explaining some of their disciplines, and outlined that there are varying degrees of practices which reflect the difficulty of achieving investment liberalisation due to domestic economic and political considerations.

Finally, he concluded that the APEC role in a multilateral investment agreement should be to continue facilitating trade and investment by improving member’s investment regimes through regularly updating their IAPs and Investment Guidebooks. APEC members should also endeavour to improve and implement the Collective Action Plans and other joint efforts such as the expansion of the Menu of Options.

Session Three – Regional Initiatives on Investment: Regional Policy, Regulatory Trends and their Causes.

Commented by Mr. Carlos García, from the Mexican Ministry of Economy, this session focused on the importance of regional agreements in matters of FDI and on the interrelation between investment and trade rules in the regional context.

In launching the third session **Mr. Marinus W. Sikkel**, Chairman of the Committee on International Investment and Multinational Enterprises from the Organisation for Economic Cooperation and Development (OECD), made a presentation on the different initiatives and instruments provided by the OECD, and the lessons we can learn from these works. In his introduction, he mentioned that the OECD was born out of the Marshall Plan and that one of its main characteristics is that its members share common ethics and values.

Through its committees, the OECD has proven capacity to develop international standards. Among the main works we can find the OECD Anti-Bribery Convention; a project concerning harmful tax competition; the OECD's 2000 Report on Bank Secrecy; the fight against money laundering, and the OECD 1998 Anti-Cartel Recommendation.

Concerning investment instruments, the speaker mentioned that the Code of Liberalisation of Capital Movements is the only plurilateral instrument covering the full range of capital movements in the long and short term. This code works as a legal instrument not only establishing rules of conduct for OECD Member governments, but also giving market participants certainty since no restrictions are imposed except for those appearing in the reservation lists. With respect to the 1976 OECD Declaration on International Investment and Multinational Enterprises, Mr. Sikkel gave a general description of its four instruments: the National Treatment Instrument, the Guidelines for Multinational Enterprises, Investment Incentives and Disincentives and, Conflicting Requirements, and give an explanation on why the Multilateral Agreement on Investment (MAI) negotiations failed; even though, he considered that the MAI was not a waste of time since a lot of work on clarification of rules was achieved.

At the end of his presentation the speaker concluded that the lessons learned from the OECD experience were to go step by step; that commitments should have a clear objective, and that to achieve this objective there was a need for a strong process and transparency.

The second presentation, *Investment Rules in NAFTA*, was in charge of **Mr. William A. Dymond** from Carleton University. Mr. Dymond introduced the topic by arguing that today the “suspicion” about FDI is over. Now, it is widely recognised that FDI can bring several benefits, and to achieve those benefits is not enough to offer a welcoming investment regime.

The Doha Declaration introduced the challenge for negotiating a broader investment agreement. In this respect, there exist three critical policy drivers: investment protection, non-discrimination and settlement of disputes, supported by an element of transparency. In his opinion, if countries were not ready to achieve commitments in these three aspects, there would be no sense to continue with the aim of negotiating a multilateral agreement.

Regarding NAFTA, the speaker mentioned that there are two ways to look at the Chapter XI (Investment): as something completely new for Canada and Mexico but not for the United States or as a part of a comprehensive Free Trade Agreement (FTA). But, looking at this agreement in an isolated way could give rise to a misunderstanding about the real motivation of the three countries for its negotiation. Canada was not seeking an FTA; Mexico looked at it as an integral part of a profound economic reform, and the United States were looking to solve border problems. Certainly, he stated, the motivation of the three countries was not free trade.

Finally, he stressed that the Doha Mandate should not be read literally and that investment negotiations should develop progressively, as trade negotiations did. However, the starting point for investment is different from trade since there already exists a great number of BITs. He was of the opinion that in practice it is not feasible to negotiate a low-grade multilateral investment agreement if there is a high-grade in BITs. Then, he argued that the question was which countries are prepared for a high-grade multilateral investment agreement. He recommended to work on achieving a better understanding of the dynamics between trade and investment as well as explaining critical differences in BITs since a multilateral investment agreement would require a stocktaking.

Mr. Carlos Herrera, from the National Commission of Foreign Investments and Technology of the Government of Peru, made the last presentation of this session entitled *Investment Rules in the Andean Community*. First, Mr. Herrera gave an overview of the Andean Community pointing out that its most important achievement has been the progressive creation of a free trade area among the Member States, accompanied by a surge of foreign investment and the rise of investment flows. Concerning investment regulations, he referred to the evolution of the common investment regime as a reflection of the evolution of the development policy of its Member States and the international trends. This regime is a “non-common regime for the treatment of foreign capital” since it gives Andean countries full freedom to regulate this field through their own national legislation; even though, it should be recognised that national legislation has tended to move toward facilitating foreign investment and giving national treatment in almost all aspects. At the same time, the Andean Countries began the process of negotiation of Bilateral Agreements for the Promotion and the Protection of Investments with third countries and even among themselves.

Second, the speaker described the Peruvian case since Peru is the only Andean Country participating in APEC. Peru’s opening process to foreign investment started in 1991 with the reform of the legal framework regarding private investment now based on the non-discrimination principle. Besides, in the past 10 years Peru has concluded several BITs containing disciplines such as transfers, performance requirements, key personnel, etc.

At the end of the presentation, Mr. Herrera outlined that international investment agreements should also have as an objective to enhance the ability of developing countries to pursue growth and development. He also mentioned that the Andean Countries are participating in the Free Trade Area of the Americas (FTAA) jointly and with a single voice, and that they recognised the importance of creating this hemispheric market.

Session Four – General Features of Investment Promotion and Protection Agreements signed by the APEC Economies.

Commented by **Mr. Stephen Brereton** from the Department of Foreign Affairs and International Trade of Canada, this session focused on the analysis of the different provisions covered by investment agreements and their interpretations.

Prof. M. Sornarajah from the National University of Singapore made a presentation on the importance of the scope and definition of foreign investment for the provision of protection in international investment agreements. He highlighted the initial intention of investment agreements as for overcoming existing deficiencies in customary international law. Prof. Sornarajah explained that under customary international law, the discussion of protection was initially confined to the physical assets of the foreign investor, but later, the protection of intangible property became mooted when contracts associated with foreign investment were rescinded by host states. However, the proposition that a breach of a foreign investment contract amounted per se to a violation of international law from which state responsibility arose never became a rule of customary international law; hence, in later times, investment agreements picked up such a proposition in view of the need for it to be supported by an international obligation. Yet, the increasing importance of multinational corporations resulted again in a shift away from the protection of physical property to the protection of shareholder interests. It implied a shift of emphasis from an entirely asset-based definition of investment to an enterprise-based theory, by which protection was progressively extended to transactions such as intellectual property rights. Prof. Sornarajah pointed out that, however, this was only treaty practice since international law did not congeal on this point. He mentioned the Barcelona Traction Case as an example against the development of an enterprise-based system of protection; case which reflected the customary international law as understood by the International Court of Justice.

Likewise, Prof. Sornarajah referred to the current forms of restricting the scope of investment agreements as a way to reconcile the interests of multinational corporations and the host states. He mentioned primarily three: i) wide definition of investment accompanied by an expressed exclusion of sectors; ii) confine the benefits of the investment agreement to “approved in writing” investments, and iii) subject protection to that investment made in accordance with the laws and regulations of the host state. In this latter case, some countries have gone beyond by widening the restriction through the formula “from time to time in existence”.

Finally, Prof. Sornarajah spoke about the definition of “investor” as an element that is crucial in determining the scope of an investment agreement. He said that the definition of natural persons poses few problems, contrary to the definition of a juridical person in which

the nationality factor becomes an issue because of the manner in which multinational enterprises are currently organised and operate in international business. He mentioned the three main tests used to identify corporate nationality: a) place of incorporation; b) the seat theory, and c) incorporation and organisation along with a criterion of ownership and control.

He concluded that the scope and definition are crucial in effecting a balance within an agreement between the competing interests of investment and investor protection and the extent of the control a state retains to protect its public interest and economic development goals. The success of an agreement depends on such a balance. Excesses in one or another side can lead to disenchantment.

Ms. Andrea Menaker from the NAFTA Arbitration Division of the U.S. Department of State discussed the topic *Standards of Treatment: national treatment, most favoured nation treatment and minimum standard of treatment* in light of the North America Free Trade Agreement (NAFTA). In the first part of her presentation, Ms. Menaker put on the table two issues pertaining to the national treatment (NT) and the most-favoured nation treatment (MFNT) provisions which, in her opinion, warrant careful attention by tribunals. The first deals with the failure to differentiate between discrimination on the basis of the national origin of a good and discrimination on the basis of nationality of an investor. A NT provision in an investment agreement provides protection against the latter type of discrimination; however, discrimination against goods based on national origin should be dealt with exclusively in trade provisions. Consequently, a claimant should not be able to establish a violation of NAFTA Article 1102 (NT) if it only demonstrates that a NAFTA Party provides a preference to goods containing U.S., Canadian or Mexican content.

The second issue concerns the misunderstood idea that a NT violation can be argued in a case where the only effect of the challenged measure on a claimant is that it is restricted in supplying a good or service to other NAFTA Party. In order for an investor to establish that it has been denied NT, it must demonstrate that it has been accorded less favourable treatment, on the basis of nationality, with respect to its investment. In this regard, if the measure does not restrict the claimant's ability to establish an investment in the other NAFTA Party, nor does the measure impair the claimant's ability to manage, operate, control or dispose of its investment in the other NAFTA Party, then the measure should not be considered a violation of NT.

Ms. Menaker also referred to the debate that has been raised on the scope of the obligation provided for in NAFTA Article 1105(1) – Minimum Standard of Treatment –, which requires a Party to “accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security”.

Ms. Menaker briefly described the interpretations urged upon tribunals by many of the claimants who have filed cases under Chapter Eleven. These claimants have contended that Article 1105(1): i) requires the NAFTA Parties to provide more than the minimum standard of treatment for aliens under customary international law; that is to say, the reference to “international law” encompasses all of international law, and not just customary

international law; ii) “fair and equitable treatment” is a standard to be applied without reference to customary international law. A tribunal need only decide whether it deems the action challenged by the claimant to be “unfair” or “inequitable”. Ms. Menaker mentioned that one claimant has even gone so far as to suggest that the standard to be applied under Article 1105 must respond to the question *Does it bother you?*. If it does, then there could be a breach to the minimum standard of treatment.

In this regard, Ms. Menaker summarized on what basis the United States Government has rejected such an approach. First, they looked to the OECD Draft Convention on the Protection of Foreign Property (revised in 1967) which is considered the most direct antecedent to the usage of the phrase “fair and equitable treatment” in international investment agreements. The commentary to the Convention Article 1 provides that the fair and equitable treatment standard conforms in effect to the minimum standard which forms part of customary international law. Moreover, in 1984, a survey carried out by the OECD Committee on International Investment and Multinational Enterprises confirmed that OECD Member States continue to view fair and equitable treatment as a reference to principles of customary international law.

Second, the bilateral investment agreements negotiated by the United States with numerous countries have been consented by its Senate with the notice that the general treatment provision incorporated a minimum standard of treatment based on customary international law. Finally, the United States also took note of Canada’s Statement of Implementation published on the day of entry into force of NAFTA. It notes that Article 1105 (1) “provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law.”

On the contrary, Ms. Menaker pointed out that claimants’ conclusions regarding the scope of Article 1105 (1) have relied primarily on writings of publicists, particularly on that written by F.A. Mann published in the British Yearbook of International Law in 1981. In that Article Mr. Mann opined that the obligation of fair and equitable treatment goes beyond the obligation to provide aliens with the minimum standard of treatment under customary international law.

Ms. Menaker stressed that even if the NAFTA Parties strongly disagree with that approach, some tribunals have gone beyond the letter of the agreement in their interpretations. Some examples are *Metalclad*, *S.D. Myers* and *Pope and Talbot* Cases. In *Metalclad*, a U.S. investor brought a claim against the Mexican Government. The tribunal found that Mexico had violated Article 1105(1) by failing to treat the claimant fairly or equitably, relying its decision on what the tribunal deemed a violation of the transparency objectives of NAFTA. In *S.D. Myers*, the tribunal decided that there was a breach of Article 1105(1) because there was a violation of the national treatment provision. Finally in *Pope and Talbot*, the tribunal found a breach of Article 1105(1) by determining that the standard of fair and equitable treatment was additive to the requirements of international law.

In order to put an end to the debate surrounding the correct interpretation of Article 1105(1), the NAFTA Free Trade Commission issued an interpretation clarifying the following:

Article 1105 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party. It makes clear - as NAFTA Parties have consistently contended - that the minimum standard of treatment is a reference to the customary international law, rejecting the view that article's 1105 reference to "treatment in accordance with international law" refers to all international law, including conventional law.

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. It confirms that the phrases "fair and equitable treatment" and "full protection and security" are to be applied only insofar as those terms are understood as part of the customary international law minimum standard treatment of aliens. It also makes clear that tribunals may only find a violation if the claimant has identified a rule of customary international law that has been breached by the NAFTA Party. In this regard, a tribunal may not predicate a finding of a violation based on the arbitrator's own subjective notions of the terms "unfairly" or "inequitably".

A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1). Based on the notion that a reference to "international law" is a reference to the customary international law minimum standard of treatment, this sentence explicitly provides that a claimant's establishment of a violation of a conventional international obligation does not establish a violation of Article 1105 (1); thus rejecting those tribunals' decisions in the cases of Metalclad, S.D. Myers and Methanex. Likewise, this interpretation rejects the argument that there is a violation if a NAFTA Party fails to adopt least trade restrictive measure to achieve its objective. That concept is derived from WTO jurisprudence and is a conventional treaty obligation; therefore, such principle is not a customary international law obligation, and no such requirement is consequently embodied in Article 1105(1).

Finally, Ms. Menaker invited participants to take into account these issues in future investment negotiations not only within APEC but, perhaps, in the broader context of the WTO.

From the Chilean Ministry of Foreign Affairs, **Mr. Alejandro Buvinic** introduced the main provisions used in investment agreements to protect foreign investment, taking a closer look at the rules on expropriation. He highlighted some concerns that have been raised around the concept of "indirect expropriation" such as that regarding the relationship between foreign investment protection and the regulatory power of the host country. The problem is to find the dividing line between the host country right to regulate an economic activity and the rights granted to a foreign investor. He mentioned *Ethyl* as the first case that has shown what a country could face in the event it considers necessary to adopt regulations affecting investments; practice whose consequences could be financially catastrophic for a developing country.

Ethyl Corporation, a U.S.-based company, filed a notice of intent to submit a NAFTA Claim for US\$200 million against the Government of Canada by arguing a harm to its subsidiary Ethyl Canada - the manufacturer of a gasoline additive used in Canadian gasoline since 1977. Ethyl alleged that the Government of Canada breached its obligations under three NAFTA provisions: Art. 1110 (Expropriation and Compensation), Art. 1106 (Performance Requirements), and Art. 1102 (National Treatment). As part of the settlement, the Government of Canada had to remove the measure which unfairly banned the investor's product; to issue a statement clarifying that it had no evidence of harm caused by the product, and to pay the company CAD\$ 20 million approximately.

In this regard, Mr. Buvinic pointed out that some countries have sought to solve this problem by defining “indirect expropriation” or “a measure tantamount to expropriation” in the form of an illustrative list. However, he noticed that some conflicts could emerge in the many international fora.

Finally, Mr. Buvinic explained how investment protection is being addressed in the current regional and multilateral negotiations. He reviewed the FTAA and paragraph 20 and 22 of the Doha Ministerial Declaration.

Mr. Ricardo Ramírez from Mexico’s Ministry of Economy, presented the subject *Investor-State Settlement of International Investment Disputes: recent cases and misinterpretations*. He made a brief overview of the procedural and substantive provisions of NAFTA Chapter XI and discussed the risks of a wrong application of a procedural rule and of a wrong interpretation of a substantive rule.

Mr. Ramírez stressed the role of the NAFTA Investor-State dispute settlement mechanism in the assurance of both equal treatment among investors of the Parties - in accordance to the principle of international reciprocity - and due process before an impartial tribunal. In fact, he looked back at the cases initiated under NAFTA Chapter XI: nine against Canada, eight against Mexico and eight more against the United States.

Mr. Ramírez introduced such a mechanism by explaining what principles and disciplines are protected by the dispute settlement rules, who may submit a claim, how an arbitral tribunal is constituted as well as other procedural matters. Likewise, he gave some examples of NAFTA cases in which the common denominator was a misinterpretation of either the procedural or the substantive rules.

With regard to misinterpretations of procedural rules, Mr. Ramírez presented the case of Ethyl. This U.S. company claimed \$250 million in damages for alleged breaches on national treatment, performance requirements and expropriation. The measure challenged was an Act issued by the Canadian Government which banned the importation of Manganese Tricarbonyl (MMT). Mr. Ramírez explained that according to NAFTA Article 1120.1 (Submission of a Claim to Arbitration), a disputing investor may submit a claim to arbitration provided that six months have elapsed since the events giving rise to a claim. However, in the case of Ethyl, such a company submitted the notice of intent (September 1996) before the enactment of the law which gave rise to the dispute (April 1997). Since there was reason to believe that no consultation or negotiation mandated by Article 1118

was even possible, it was argued that no purpose would serve by any further suspension of Claimant's right to proceed.

Concerning misinterpretations of substantive rules, Mr. Ramírez expanded what has been said before by Ms. Andrea Menaker regarding Article 1105 – Minimum Standard of Treatment. He commented that the inclusion of a “minimum standard” provision is necessary to avoid what otherwise would be a gap since a government might treat an investor in a harsh, injurious and unjust manner, but do so in a way not different than the treatment inflicted on its own nationals. Therefore, the minimum standard is a floor below which treatment of foreign investors must not fall, even if a government were not acting in a discriminatory manner. In this regard, he briefly introduced the case of Metalclad Corporation against the government of Mexico in which this NAFTA country failed to ensure a transparent and predictable framework for the company's business planning and investment. Metalclad, a U.S. company in the waste management business, had purchased a Mexican waste management firm that operated a waste transfer station. The problem raised when the Municipality denied Metalclad's application for a construction permit being that the Federal and the State permits to operate had already been granted so that the company had begun to do so. According to Mr. Ramírez, the totality of these circumstances demonstrated a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation to be treated fairly and justly in accordance to the NAFTA provisions. Likewise, Mr. Ramírez referred to the case of Pope and Talbot regarding the interpretation of Article 1105.

For all of the above, Mr. Ramírez concluded that it is fundamental the strict application of the NAFTA procedural and substantive rules in order for the system to be credible.

Session Five – The Interrelation and Interaction of Bilateral/Regional and Multilateral Investment Environment.

Commented by **Mr. Miguel Flores** from the Ministry of Economy of Mexico, this session evaluated the main connections of bilateral, regional and multilateral rules on investment.

In his presentation, *The contribution of uniform international investment rules to a predictable investment environment*, **Mr. Raymundo Enríquez** from Baker & McKenzie, gave a global picture of FDI flows. He explained that mergers and acquisitions (M&A) have been the most important vehicles for the expansion of FDI flows. Three factors were determinant for such an expansion: liberalisation of trade and investment regimes, technological process and corporate strategies.

Mr. Enríquez mentioned that greater access to sectors previously closed, full integration of the private sector in the global economy, forward and backward linkages with the local industry and easier technology transfer would be the main benefits of investment liberalisation to the private sector:

Mr. Enríquez stated that the private sector is convinced that a multilateral framework on investment would be beneficial because it would give legal certainty to the sectors that are

open to foreign investment, and will also contribute to transparency particularly with respect to the applicable laws related to the admission of investment. However, he recognised that any framework should reflect, in a balanced manner, the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest.

Prof. Julio Faundez from the University of Warwick, assessed the benefits and challenges of a multilateral framework on investment. In words of Prof. Faundez, the importance of this topic is underscored by the fact that after Doha the WTO is exploring the possibility of bringing investment rules within its sphere of activity. He addressed the question of why the transition from bilateral to multilateral investment rules is so difficult in three stages. First, he focused on aspects of the practice of states under BITs. Second, he considered some aspects of NAFTA experience under Chapter XI since this is the most comprehensive attempt at transforming BIT rules into rules that bind more than two states, and finally, he looked at aspects of the process that led to the collapse of the OECD Multilateral Agreement on Investment (MAI).

The first process, moving from a bilateral to a multilateral investment regime, took place in the area of international trade when in 1947 a multilateral legal framework - the GATT - replaced a complex, unworkable and largely defunct network of bilateral trade treaties. On the basis of this experience, many advocates of a multilateral investment framework appear to assume that if GATT proved useful as a device to place international trade relations on a multilateral footing, then why a similar mechanism could not be used in the area of investment (a sort of GATT for investment).

Although NAFTA is a relatively new institution, its experience under Chapter XI illustrates how difficult it is to transplant legal rules. What is happening is that, rules and procedures designed to protect foreign investment are now giving rise to an endless number of claims. Problems have arisen mainly in relation to a variety of regulatory measures and even judicial decisions, taken by the officials or courts from NAFTA parties. The flood of claims by investors has taken NAFTA governments by surprise since in different ways they all seek to obtain a review by NAFTA Panels of decisions that under their domestic laws are otherwise legal and legitimate.

In the final stage of his presentation, Prof. Faundez explained that, in order to understand the process that led to the collapse of the MAI, it is necessary to understand the objectives sought by the MAI draft. At one level, the MAI seemed to be merely an attempt to codify existing practice under bilateral investment treaties. Yet, insofar as it also sought to create a universal right of establishment, it sought to move beyond the structure of the majority of BITs.

Ms. Martha Lara from the Trade and Finance Division at the World Trade Organisation, made a presentation entitled *The Doha Mandate on Trade and Investment*. She explained that the Doha Declaration recognises the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term investment flows, particularly FDI. In accordance to the ministerial mandate, negotiations would start after the Fifth

Ministerial (Mexico 2003) on the basis of explicit consensus on the modalities of negotiations.

Ms. Lara pointed out that currently, the WTO Working Group on the Relationship between Trade and Investment (WGTI) is focusing on the clarification of the elements established in paragraph 22 of the Declaration: scope and definition, transparency, non-discrimination, pre-establishment commitments based on GATS- type, positive list approach, development provisions, exceptions and balance-of payments, consultation and dispute settlement among members. She stressed that any multilateral framework on investment will have to take into account: i) a balance of interests of home and host countries; ii) development policies and objectives of host countries; iii) the right to regulate in the public interest; and iv) the development, trade and financial needs of developing and least developed countries.

Ms. Lara also referred to paragraph 21 of the Ministerial Mandate regarding the need for technical assistance and capacity building for developing countries.

She concluded that APEC contribution to the Doha Mandate could be a cross work with APEC goals of liberalise trade and investment in the region, analysis of APEC Non-Binding Investment Principles, and the Osaka Action Agenda's guidelines/collective actions and Individual Action Plans. Technical co-operation and training activities in the region would promote the understanding of the Doha mandate dialogue process.

OPENING REMARKS

Opening Remarks

Mr. Juan Antonio García Villa
Vice-Minister of Regulations and Services to
Industry and Foreign Trade

Good Morning, Ladies and Gentlemen:

On behalf of the Government of Mexico let me warmly welcome all of you to the Workshop on Regional and Bilateral Investment Rules/Agreements. I would like to thank all the people who have made this event possible, in particular, the speakers, panelists, commentators, APEC members and non-members who have come a long way to take part in this gathering.

In early times, we have heard a strong demand for platforms in which policy-makers can engage in an open and inclusive dialogue to exchange views and experiences on emerging issues and build consensus on open policies, good practices and policy frameworks for international investment. This forum was created precisely in response to such a demand.

But, what do we expect from this event?

- We expect to get a comprehensive picture of the current trends in foreign direct investment. FDI plays a key role in the globalisation process, generating both challenges and opportunities for more and more nations. It will be interesting to discuss the elements that have determined the current flows on FDI and the expectations for the coming years, specially now that the global economy is apparently recovering from the economic slowdown of 2001.
- We expect to promote a valuable discussion on the role APEC investment instruments have performed in a broader framework of investment rules. Undoubtedly, investment has been at the heart of APEC activities; prove of it is the important number of initiatives launched during the last decade with the objective to reduce the investment barriers and promote the free flow of capitals. However, many of us are still wondering what is the real relationship between APEC initiatives and other investment agreements that form part of the international legal framework for FDI. This is a question that will be surely clarified.
- We also expect to get a better understanding of the relationship between trade and investment, as well as evaluate how the interaction between these two elements has impacted regional initiatives. It will be interesting to see the results that some regional examples such as NAFTA and the Andean Community have had in combining trade and investment liberalisation. In our experience, having Free Trade Agreements

comprising these both aspects have proved to be an efficient way to promote development. Moreover, in twelve years capital inflows in Mexico have increased threefold, averaging US\$12 billion a year.

- Likewise, we expect to encourage discussion on the many provisions covered by the investment agreements and how such disciplines have been adapted to the needs of each country. Besides, we consider that it will be quite interesting to analyse and take stock of the interpretations that have arisen from such provisions, and that ultimately can become part of the development of international law.
- Even if it has been recognised the convergence that has been reached on investment rules, it has also been argued that there is a strong need for international co-operation to address, in a comprehensive way, the subject of FDI. In our last session we will be having the opportunity of hearing different views on the interaction and interrelation between bilateral and regional initiatives and an eventual multilateral framework on investment.

Finally, let me stress once again my thanks to all of you for being here. I wish you not only a fruitful meeting, but a pleasant stay in Mérida as well.

Thank you very much.

SESSION I
International Capital Flows:
Recent Trends and Future
Perspectives

Global and APEC Trends in Foreign Direct
Investment

Padma Mallampally

Global and APEC trends in foreign direct investment*

Padma Mallampally

UNCTAD

Division on Investment, Technology and Enterprise Development

Foreign direct investment (FDI) has emerged as a major force in the process of globalization, growing steadily in significance as a means of integrating the production activities of firms across national boundaries. Developed as well as developing countries now view FDI as an important source of capital as well as technology, skills, managerial know-how and market access. In recent years, FDI has been the mainstay of net private financial flows to developing countries and economies in transition. Countries are increasingly open to FDI and many of them promote it actively. Liberalization of policies and regulatory frameworks with respect to FDI is particularly evident in developing countries. At the same time, competitive pressures are driving firms in developed as well as developing countries to expand their international production activities.

Overview of trends in FDI flows

FDI has expanded rapidly in the past 20 years. In 1980, world FDI flows amounted to a little over \$50 billion. In 2000, they reached a peak of over \$1,300 billion. Annual FDI flows rose every year during 1980-2000 Except 1982 and 1991.

During much of this period, FDI and sales by foreign affiliates of transnational corporations (TNCs) grew faster than global economic aggregates such as GDP, gross fixed capital formation, and exports of goods and non-factor services. Sales by foreign affiliates were more than twice the value of exports of goods and services in 2000. According to data collected by UNCTAD, by the late 1990s, more than 60,000 TNCs owned more than 800,000 affiliates abroad, with some 55 countries hosting more than 1,000 foreign affiliates, and with FDI stock valued at over 6 trillion.

Developed and developing regions as well as the economies in transition of Central and Eastern Europe (CEE) shared in the growth of FDI flows during 1980-2000. Growth of FDI in and from developing countries began later than in developed countries (in the late 1980s) and that of inflows to CEE, in the 1990s. As many as 65 countries experienced annual average growth in inflows of 30 per cent or more between 1986 and 2000 and another 29 countries, average growth of 20-29 per cent. The growth in global FDI flows continued

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- Prepared for presentation at the APEC Workshop on Regional and Bilateral Agreements/Rules, 17-18 May 2002, Merida, México. This paper is based primarily on information and analysis contained in UNCTAD's World Investment Reports, particularly World Investment Report 2000: Cross-border Mergers and Acquisitions and Development (New York and Geneva : United Nations, 2000) and World Investment Report 2001: Promoting Linkages (New York and Geneva, 2001) , and data from UNCTAD's FDI/TNC data base.

through most of the 1990s. Despite some adverse conditions in the latter part of the 1990s – including the financial crisis and ensuing recession in a number of Asian countries, the financial and macroeconomic instability in the Russian Federation and its resulting impact on some other countries, declining world GDP growth and trade and falling commodity prices -- global FDI flows continued to expand noticeably during 1997-2000. Much of this growth during these later years was concentrated in developed countries, but it also reflects growth in flows to Latin American and the Caribbean and the recovery of FDI in East and South-East Asian host economies from the impact of the financial crisis that began in 1997.

The upward trend in global FDI flows was interrupted again last year (2001). According to UNCTAD estimates, world FDI inflows dropped by some 40 per cent in 2001, down to \$760 billion from over 1.3 trillion in 2000. The decline was concentrated in the developed countries, where FDI inflows are estimated to have fallen by nearly half (in comparison with a decline of less than 10 per cent in developing countries and none in the transition economies of Central and Eastern Europe). It represented the first drop in global annual FDI since 1991 and the largest in the last three decades. It has been attributed mainly to a marked slowdown in world economic growth (1.3 per cent in 2001 as compared with 4.0 per cent in 2000). The expectation is that while the decline in 2001 is unlikely to be recouped this year (2002), it will be reversed once growth and consumer demand recover, since the basic factors determining FDI flows, such as the availability of skills, infrastructure and technological capabilities in host countries remain unchanged. This is supported by the results of surveys of TNCs (including a survey conducted by UNCTAD in collaboration with the Invest in France Agency and Andersen Consulting), which indicate that major TNCs plan to continue their international expansion.

FDI flows to APEC group of economies have increased along with the growth in global flows and those to other groups. During the period 1989-2000, growth of flows to the APEC economies was higher than that of flows to developed countries until 1997, and lower after that. In 2000, FDI flows to the APEC group were five times their average annual flows in 1989-1994 and those to the developed countries as a group, eight times their 1989-1994 average, while those to the developing economies were nearly four times their 1989-1994 average. FDI outflows from APEC economies also rose much less than those from developed economies as a group during that period and also, less than those from developing economies.

While estimates of FDI flows in 2001 for APEC economies as a whole are lacking, UNCTAD estimates for the developed-economy members of APEC suggest that FDI inflows to them decreased at a rate comparable to or slightly higher than that of flows to developed economies in general. FDI flows to developing-country APEC members probably fell more than those to developing countries in general; in fact most of the decline in FDI flows to developing countries in 2001 comprised the near-halving of FDI flows to Hong Kong, China, which had recorded unusually high inflows in 2000 – a decrease that was not compensated by an increase in flows to China and some other developing countries. Thus, on the whole, the decline in flows to the APEC economies in 2001 is likely to have been larger than that in global flows as well as flows to both developed and developing countries. However, with recovery in the United States and other major

economies, FDI flows in the current year can be expected, as in other regions, to recover at least partially.

FDI distribution and concentration

Despite the growth of FDI in a large number of countries during the past twenty years or so, FDI is not evenly distributed among regions and countries. The developed countries – mainly the triad (United States, The European Union and Japan) – attracted over three quarters of global FDI inflows during 1998-2000. The triad accounted for 85 per cent of FDI outflows and nearly 60 per cent of inward FDI stock and 78 per cent of FDI outward stock. The share of developing host countries in global FDI inflows, which had risen to 41 per cent in 1994, stood at around 22 per cent in 1998-2000, while that of Central and Eastern Europe has remained stable at around 2 per cent during most of the 1990s. At the other end of the spectrum, the 49 least developed countries, with more than one-tenth of the world's population and less than one per cent of world GDP, receive some 0.5 per cent of global FDI. Besides being unevenly distributed among regions and country groupings, FDI is highly concentrated in the principal host and home countries. In 2000, the top 10 host economies (including four APEC economies) received three quarters of global FDI inflows and the top ten source countries (including three APEC economies) accounted for 84 per cent of outflows. The top 30 host countries accounted for 95 per cent of global inflows and 90 per cent of stocks, while the top 30 home countries accounted for 99 per cent of global outflows and stocks.

If FDI is viewed in relation to the size of economies, however, the disparity between developed and developing host economies diminishes considerably. FDI flows relative to gross fixed capital formation (GFCF), which have been rising steadily in all regions during the 1990s, are in fact slightly higher for developing countries as a group than flows for developed countries, judging from data for 1997-1999. The ratio is highest for Latin America and the Caribbean. Among individual host economies, there are significant disparities in all regions: for example, among developed countries, FDI relative to GFCF in 1997-1999 ranged from less than 1 per cent for Japan to over 85 per cent for Belgium and Luxembourg. Among APEC economies (excepting Indonesia where the ratio had turned negative on account of continuing conditions of crisis) it ranged from, again, less than 1 per cent for Japan to 75 per cent for Hong Kong, China. The transnationality index constructed by UNCTAD, showing the relative importance of FDI flows and stocks for a host economy relative to four different domestic aggregates (GFCF, GDP, exports and Employment), also shows wide disparity in the importance of FDI for countries.

Cross-border M&As and FDI

Over the decade of the 1990s, FDI and the growth of international production have taken place mainly via cross-border mergers and acquisitions (M&As) – most of them acquisitions – rather than greenfield investment. According to data provided to UNCTAD by Thomson Financial, the value of completed cross-border M&As world wide involving more than 10 per cent equity acquisitions rose from less than \$100 billion in 1987 to over \$750 billion in 1999 and more than \$1,000 billion in 2000, with the lion's share of sales

concentrated in the European Union and the United States. In 2001, their value fell dramatically, to \$600 billion for less than 6,000 transactions (as compared with some 7,900 deals in 2000), leading to the sharp fall in FDI noted earlier.

Cross-border M&As reached nearly 80 per cent in value relative to global FDI flows by the end of the 1990s, reaching an exceptionally high level in value in 2000 on account of a large number of “mega deals”. They are particularly significant as a mode of entry for FDI in developed countries and in industries such as automobiles, pharmaceuticals and chemicals and food and beverages in manufacturing and telecommunications, energy and financial services sector. In developing economies, greenfield FDI, involving the establishment of new production facilities, is still dominant. FDI flows to developing countries associated with M&As have been on the rise, however; their value relative to total FDI inflows increased from roughly 10 per cent at the end of the 1980s to one-third at the end of the 1990s. A good part of the increase is due to privatization of state owned enterprises. In Central and Eastern Europe, due to fluctuations in cross-border acquisitions related to privatization, the share of M&As in total FDI inflows has varied widely from year to year.

The driving forces behind the growing role and dominance of cross-border M&As as a mode of FDI entry relate to the strategic objectives of corporations as well as changes in the global environment in which firms operate. M&As involving host country enterprises offer foreign investors two main advantages over greenfield FDI as a mode of entry: speed and access to proprietary assets. Firms may also undertake M&As in order to gain market power and market dominance, achieve size and economies of scale or gains from synergy, diversify and spread risks, exploit financial opportunities and/or obtain personal gains for top management. In light of these considerations, strategic responses by firms to defend and enhance their competitive positions in a changing environment –in which technology, regulatory frameworks and capital market changes offer new business opportunities as well as risks- have increasingly involved M&As not only within economies but across borders.

New factors determining FDI location

There are several influences that have always been important for FDI inflows. The most basic ones are political and economic stability and a welcoming environment for FDI and for private enterprise in general. Other important factors are ease of entry and exit, appropriate standards of treatment and dispute settlement, and a predictable and transparent regulatory framework. During the past decade or more, regulatory changes have increasingly been in the direction of more favorable FDI regimens. Developing as well as developed countries now typically have few restrictions on entry and operations, provide general standards of treatment (including guarantees in areas such as the transfer of funds, expropriation and dispute settlement and ensure, to a greater or less degree, a comparative market framework. In addition, host countries and sub-national regions increasingly recognize the need to undertake active investment promotion measures.

Once these general requirements for investment attraction prevail, it is the economic factors that drive inward FDI flows countries and regions and explain the disparities in flows to developed and developing countries and the concentration of FDI in a relatively small

number of countries. Traditionally, the most important of these have been large domestic markets (often reinforced, historically, by protection from imports), natural resource endowments and the presence of cheap (unskilled or semi-skilled) labor. While these factors remain relevant, they are diminishing in significance, particularly for the most dynamic end of international production, and new ones rising in importance. These new determinants of location reflect the impact of three developments: policy liberalization, rapid technical progress (particularly in transport, communications and information) and new management and organizational techniques. Together, these developments have altered many parameters of the location of international production.

Trade and FDI policy liberalization have, among others, reduced the need for FDI to skip tariff and access national markets, increased the need for technical efficiency and competitiveness of TNC activity wherever it is located, opened up new areas of international production (such as infrastructure provision) and, because of the greater competition they generate for firms, increased the importance of the presence of complementary factors and enterprises clusters that facilitate networking and specialization by firms in their core competencies. The increasing importance of the presence of other firms providing inputs, information and services means that the geography of international production reflects, among others, the cumulative effects of past FDI location as well as domestic enterprise development, giving a further edge to host countries that have a lead in these respects.

Technical change is affecting FDI location in many ways. Innovation-intensive industries are more transnational and grow faster than other industries, so that with rapid innovation, skills needed by these industries assume greater importance for attracting FDI than low wages per se. The rising costs of innovation also encourage internalization of technological advantages through FDI. At the same time, new transport, communication and information technologies intensify competition while allowing firms to spread and manager their activities more efficiently. These trends are manifested most in globally integrated production systems in which different steps in the production process are located, under TNC control, in different places to optimize cost efficiencies and logistics. Within these systems, high technology activities can be located in developing countries because labor-intensive processes can be economically separated and managed over distances. On the other hand, the pervasiveness of technological change means that *all* TNC activities, whether globally integrated or not, have to use technology effectively and upgrade it frequently. The ability of host countries to provide the needed skills, technological assets, infrastructure, suppliers and institutions for operating technologies efficiently thus becomes critical, forcing TNCs to differentiate between countries that have and those that do not have new FDI complementing factors in deciding where to locate.

Managerial and organizational factors are also strengthening the new locational determinants fostered by liberalization technological change. Increased emphasis on core competencies, flatter hierarchies and networking steer investments towards locations with advanced factors and institutions and where relevant, distinct industrial clusters. At the same time, new organizational methods allow more efficient management of global operations and encourage greater relocation of functions.

These shifts in locational factors pose important policy challenges for developing countries. Many countries, especially the less developed ones, risk becoming even more marginal to the dynamics of international production because of the new requirements for attracting FDI. Thus, beyond opening up to FDI and “marketing” host countries, there is a need to develop attractive configurations of locational advantages. This “third generation” of investment promotion policies involves the difficult task of targeting foreign investors at the level of industries and clusters and marketing regions and clusters with a view to matching the locational advantages of countries with the needs of the foreign investor.

SESSION II
APEC Instruments Relevant
to International Rules on
Investment

Harmonization of APEC Investment Instruments
with Investment Agreements of APEC Economies

Taeho Bark

APEC Instruments Relevant to International Rules on Investment: Harmonization of APEC Investment Instruments with Investment Agreements of APEC Economies

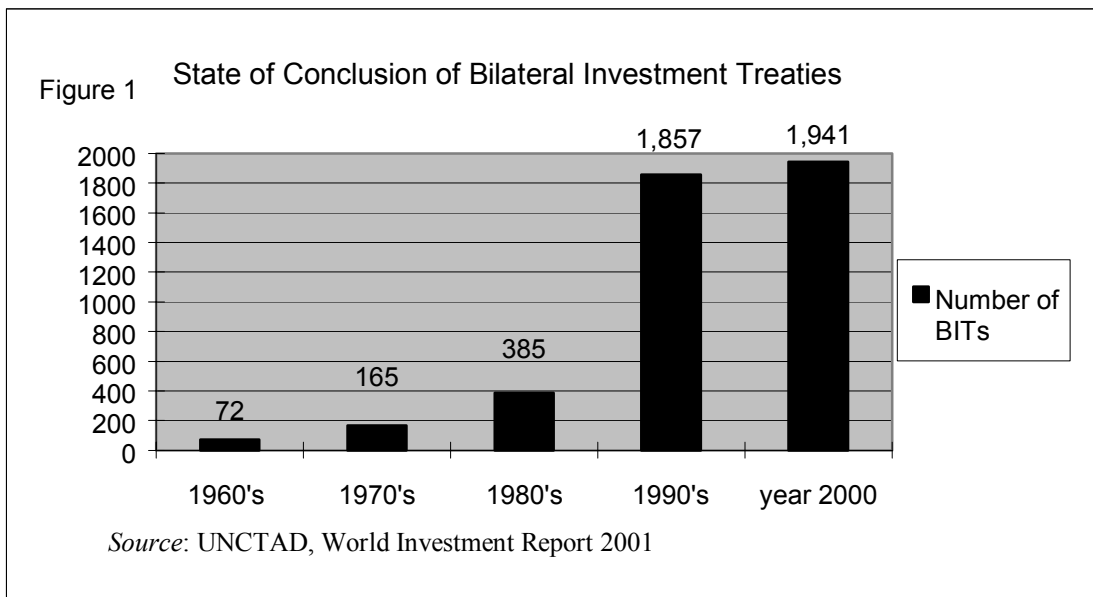
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This paper has been prepared for Mexico's Workshop on Regional and Bilateral Investment Rules/Agreements to be held in Merida, May 17th - 18th, 2002.

1. INTRODUCTION

The past two decades have been a time of investment liberalization, promotion and protection. Host countries seek to attract foreign investment by offering strict guarantees against measures seriously damaging the investors' interests. Indeed, following this trend, bilateral investment treaties (BITs) have continued to be negotiated in increasing numbers, so that by the end of 2000 a total of 1,941 treaties had been concluded¹ (Figure 1).



*The author acknowledges the research assistance of Soniel Han and Donghun Lee of SIAS, Seoul National University.

¹ See UNCTAD, 2001.

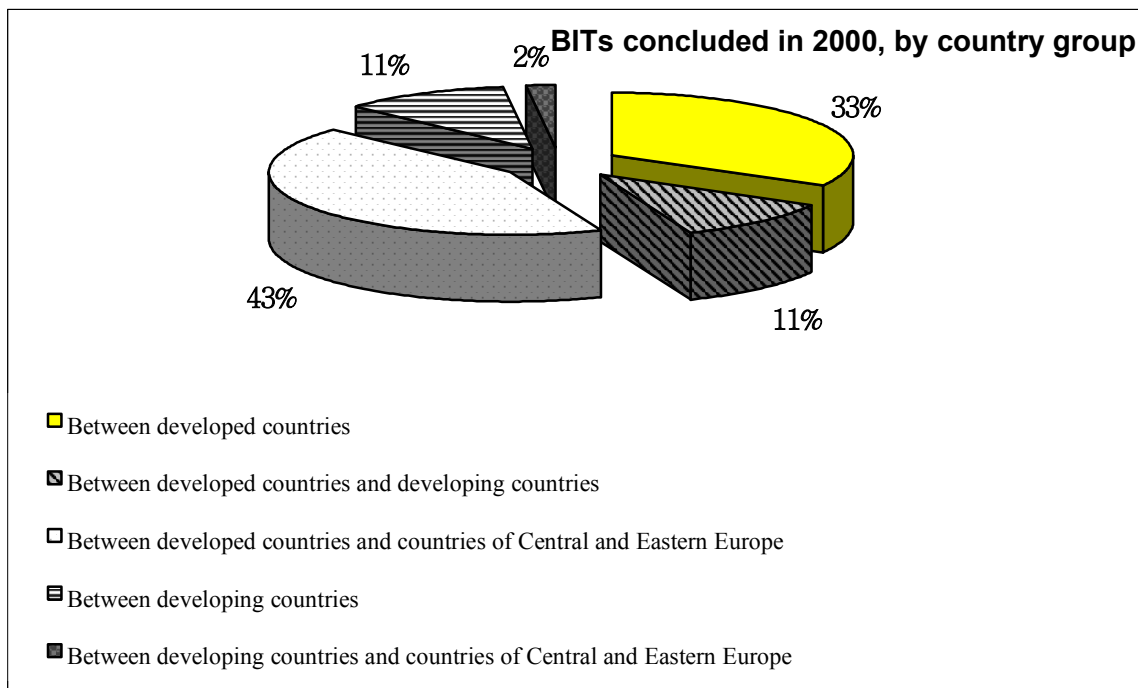
BITs were originally agreements concluded between a developed and developing country, in the 1990s BITs between developing countries or between developing countries and economies in transition have become much more common. The APEC region has emerged as one of the most powerful regional groups in the world economy, assuming more than 50% of world GDP and trade volume, respectively. The composition of APEC, with its diversity in economic development stages and heterogeneous industrial structures, offers a chance for APEC-internal agreements to spill over into the multilateral trading and investment system. In this context, this paper wishes to address the harmonization of APEC investment instruments with investment agreements of APEC member economies. For the purposes of this paper, APEC investment instruments are defined as the Non-binding Investment Principles and the Menu of Options².

This paper is broken down into four separate sections. Section two seeks to review the general characteristics of the different types of agreements among APEC member economies, those being multilateral, regional, prototype and bilateral investment agreements. Section three will then proceed to examine the APEC investment instruments relevant to examining the treaties. The fourth section will analyze the investment agreements with the above-mentioned APEC investment instruments. And finally, section five will conclude with possible policy implications for the further liberalization of investment in the region.

For the purposes of this paper, treaties are categorized into four different areas. They are the multilateral treaties of WTO GATS/TRIMs/TRIPs and the World Bank Group's MIGA; the regional treaties of NAFTA and ASEAN; the prototype bilateral investment treaties of Australia, Chile, China, Indonesia, Malaysia, Chinese Taipei and the US; and finally, the bilateral investment treaties between Canada-Chile, Hong Kong-Australia, Hong Kong-Japan, Hong Kong-Korea, Korea-Japan, New Zealand-Singapore, Thailand-Canada, Thailand-Chinese Taipei, and US-Vietnam. This is by no means a comprehensive list of all APEC member investment treaties, but the above mentioned agreements have been chosen as a sampling of APEC economies in different stages of development. They are agreements among developing and developed economies, in both the east and the west³ (Figure 2).

² Described in greater detail in Section 3.

³ The author wishes to thank member economies for their cooperation in this survey.



Source: UNCTAD World Investment Report 2001

2. TYPES OF INVESTMENT AGREEMENTS

2.1 Multilateral Agreements

The Punta del Este Declaration, which launched the Uruguay Round, included a set of discussions in the area of investment deemed to have restrictive and distorted effects on trade. In the Uruguay Round, however, investment *per se* was not on the negotiating agenda. The Final Act of the Uruguay Round contained a number of provisions dealing with issues, which were related to investment liberalization and protection. They are found in the General Agreement on Trade in Services (GATS), Agreement on Trade-related Investment Measures (TRIMs), and the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs).

The most important of these is the General Agreement on Trade in Services (GATS). This provision addresses the terms and conditions upon which an investor may enter a market, and the conditions of operation in the post-establishment phase. With regard to “establishment,” the most-favored-nation (MFN) commitment applies, but beyond that GATS market access concept permits governments to condition the extent to which (non-discriminatory) entry by foreign suppliers will be permitted.

With regard to post-establishment, by defining “national treatment” as an obligation that relates only to scheduled commitments and not as a principle of general

application, GATS is different from a number of other inter-governmental investment agreements in which national treatment has the same status as MFN. Moreover, GATS provides for national treatment to be granted only partially, or subject to specified conditions.

The TRIMs Agreement derives from Articles III and XI of the General Agreement on Tariffs and Trade (GATT). One of its primary objectives is to facilitate investment across international frontiers. It states that World Trade Organization (WTO) members shall not apply measures which require investors or producers to purchase their inputs locally to the exclusion of competing imported products (typically called local content requirements), or to sell their output domestically rather than exporting it (typically called domestic sales requirements). The aim in both cases is to discipline measures, which restrict or distort trade flows.

The TRIPs Agreement is regarded as a strong rule-based agreement likely to generate positive investment protection despite no detailed provisions dealing directly with the treatment of investment *per se*. It provides further protection for intangible assets that form the basis of the activities of multinational firms.

The Multilateral Investment Guarantee Agency (MIGA) was established in 1988 as a member of the World Bank Group to encourage foreign direct investment in developing countries. It provides investment guarantees to investors against the political risks of transfer restriction, expropriation, breach of contract, war and civil disturbance in the host country and technical assistance to host governments on means to enhance their ability to attract foreign direct investment.

In 1995, the Organization for Economic Co-operation and Development (OECD) Ministers agreed that to deal with the trend of globalization, there was a pressing need for a multilateral regime on investment, which offered a uniform, stable and predictable environment. Thus, negotiations on the Multilateral Agreement on Investment (MAI) began in 1995 among “like-minded” countries. It was expected to be the first multilateral agreement which combined all main disciplines in the key areas on foreign direct investment rule-making: especially, investment protection, investment liberalization and dispute settlement. Members emphasized the open character of the MAI allowing for accession by non-OECD members. Throughout the meetings there was shared dialogue with business and labor and with non-governmental organizations. However, the MAI negotiations eventually fell apart in December 1998 despite three years of negotiations. This experience suggests that investment is not an easy sector to conclude even among developed countries with seemingly similar interests.

Since 1997, WTO members have started to analyze the relationship between international trade and investment, and its implications for economic growth and development. The Working Group on the Relationship between Trade and Investment have examined a range of international investment instruments and existing agreements and have debated the possible pros and cons of negotiating a multilateral framework of investment rules in the WTO.

2.2 Regional Agreements

Regional economic integration agreements are a significant subcategory. They often involve a higher than usual degree of unity and cooperation among their members and sometimes are marked by the presence of “supranational” institutions, and it is therefore difficult to draw general conclusions from their provisions. Regional instruments have some of the characteristics of multilateral ones: the agreement of many countries is needed for their negotiation and conclusion, they often have important institutional structures and the generally provide for their continuing growth and development. However, the number of countries involved is smaller and they tend to be relatively homogeneous; the adoption of instruments that serve common interests in fairly specific fashion is more feasible. With respect to FDI, regional agreements have helped to change pre-existing structures of law and policy and to create important habits and patterns of expectations on a broader transnational level, even though not a universal one. As a result in recent years, regional agreements have often been the harbingers of significant new trends in matters of investment law and regulation⁴.

The North American Free Trade Agreement (NAFTA) was signed in 1992 between Canada, Mexico and the US. As a regional agreement, it is not limited to developed countries only and may indeed be extended to other countries. At first, APEC member economies expressed some anxiety lest NAFTA turn into a protectionist trade bloc. However, members reiterated their belief in ‘open regionalism’ and endorsed the view that regional and sub-regional trade arrangements should be outward-looking, GATT-consistent and support the process of broader trade liberalization. Indeed, NAFTA’s provisions on the subject of foreign direct investment (FDI) have significantly influenced other arrangements. It may in fact be considered as a characteristic of a recent trend for free trade agreements to include FDI in their scope. While the agreement covers only three states, their size and overall importance as well as the process of liberalization the agreement has set in motion, make it a particularly important treaty.

In October 1998, the governments of Brunei Darussalam, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam- the member states of the Association of South-East Asian Nations (ASEAN), concluded the Framework Agreement on the ASEAN Investment Area with a view to creating a more liberal and transparent investment environment in the area. This Agreement is focused on FDI alone. It seeks to promote investment in the area through the cooperation of the countries in the region in the liberalization of investment regulations, the provision of national treatment to all investors from the countries involved, increased transparency and an interstate dispute-settlement system. The ASEAN Investment Area Council, comprised of the Ministers responsible for investment and the Secretary General of ASEAN was established at the same time to supervise, co-ordinate and review the implementation of the Agreement.

⁴ See UNCTAD, 1999d.

2.3 Prototype Investment Treaties and Bilateral Investment Treaties

According to the 2001 World Investment Report, a dense web of 1,941 bilateral investment treaties have been formed to date, covering all corners of the globe. They were first introduced in the 1960s and have since remained largely unchanged in terms of their format and the issues they cover. These treaties focus solely on investment issues and make binding provisions on expropriation, compensation of losses due to armed conflict or internal disorder, and for the transfer of payments. Typically, these benefits are accorded on a national treatment or MFN basis. The definition of investment used is broad, covering both non-equity forms of investment and portfolio investment. Protection is only granted to investors with real links to one of the two partners to the agreement.

BITs can be tailored to the specific circumstances of the two parties more easily than other types of agreements, are relatively easy to conclude, and therefore can be realized more quickly than regional and multilateral agreements. Some of the disadvantages of BITs are related to the fact that a bilateral negotiation between parties with unequal bargaining power may disproportionately favor one party's interests. The proliferation of BITs may also lead to a complex web of inconsistent provisions that are difficult to apply and may distort investment flows. Furthermore, in contrast to their specificity with respect to investment protection, BITs are short on commitments on the liberalization of investment restrictions. Still, BITs may have a contributory role in the elaboration of regional and multilateral rules if the two types of agreements can be seen as mutually reinforcing⁵.

3. APEC INVESTMENT INSTRUMENTS

The case for new international rules to govern investment is built on four premises: that globalization is increasing, global firms face national policies, conflicts are inevitable, and the goals of both global firms and governments are legitimate⁶.

While international investment agreements by definition contain obligations that, by their very nature, limit to some extent the autonomy of participating parties, the need for a certain degree of flexibility to allow countries to pursue their development objectives in light of their specific needs and circumstances must be addressed. The non-binding nature of the APEC investment instruments, the non-binding investment principles and the menu of options specifically addresses these challenges.

3.1 Non-binding Investment Principles

The Non-binding Investment Principles (NBIP) was adopted in Bogor, Indonesia in 1994 as an investment code for facilitating investment flows within the region. As the code is non-binding some commentators argue that the NBIPs amount to a weak instrument for achieving a free and open investment regime in the region. Nonetheless, all recognize the code as a useful first step towards this end. The following is a list of investment principles

⁵ See UNCTAD, 1998.

⁶ See Graham, 1996.

set out in the investment code: transparency, non-discrimination between source economies, national treatment, investment incentives, performance requirements, expropriation and compensation, repatriation and convertibility, settlement of disputes, entry and sojourn of personnel, avoidance of double taxation, investor behavior and removal of barriers to capital exports.

3.2 Menu of Options

In 1997, in response to both government and business, the Investment Experts Group (IEG) at St. Johns, Canada, drafted the Menu of options to help economies identify policy measures that they may include unilaterally in their individual action plans. There was a consensus that the project should focus on concrete measures and the APEC ministers endorsed the Menu initiative at Vancouver. The Menu is devised so that APEC member economies may voluntarily select any of a number of options in order to make progress towards creating a free and open investment regime. It was intended as a reference tool for economies to refer to when updating their IAPs. The APEC approach to liberalization and facilitation of trade and investment is to recognize the diversity that exists among APEC member economies. The Menu of Options is consistent in this goal, recognizing diversity and providing members with a broad range of choices suitable for different circumstances. The items are not prescriptive and, where chosen, may be modified to suit particular circumstances. Since its initial drafting, the Menu of Options has been expanded by the IEG with the addition of texts on technology transfer, intellectual property rights, start-up companies/venture capital and domestic business environment so as to capture the benefits of APEC economies' increasing experience and changing views. The list of Menu items include: transparency, non-discrimination related to MFN and national treatment, expropriation and compensation, protection from strife and similar events, transfers of capital related to investments, performance requirements, entry and stay of personnel, settlement of disputes, intellectual property, technology transfer, avoidance of double taxation, start-up companies and venture capital, competition policy and regulatory reform and business facilitating measures to improve the domestic business environment.

It can be said that APECs NBIPs and Menu of Options follow standards that have come to be known as “soft law”. These standards are not always legal in the traditional sense, in that they are not formally binding on states or individuals, but they may still possess considerable legal and political authority, to the extent that they often represent widely held expectations that affect in a variety of ways the actual behavior of economic and political actors. The exact legal status of soft law has long been a matter of controversy. To the extent that such standards represent widely shared expectations, they may, through repeated invocation and appropriate utilization, move to the status of becoming binding and enforceable rules⁷.

Furthermore, the APEC process relies on a consensus-based approach, which promotes discussion of wide ranging initiatives. While members may not implement these initiatives immediately, regular meetings and reports and the peer pressure associated with these provides impetus for member countries to be seen to be doing something substantial

⁷ See UNCTAD, 1999d.

to liberalize their investment regimes. As Graham points out, the APEC experience in crafting investment principles demonstrated two things. The first was that a diverse group of nations, including some of the most dynamic of the newly industrializing economies, were willing to discuss and international convention on direct investment. The second was that although these principles are non-binding, it does represent the beginning of a dialogue⁸.

In its review of the provisions of the NBIPs in 1995, the Eminent Person's Group (EPG) suggested that five of the provisions, namely, transparency, non-discrimination, expropriation, settlement of investment disputes and tax measures, were the equivalent of international practice in investment treaties. However, the Group claimed that five provisions- relating to national treatment, performance requirements, investment incentives, repatriation and convertibility, the entry and sojourn of foreign personnel – failed to measure up to international best practice standards⁹.

3.3 Investment Guidebook and Individual Action Plans

While not considered as investment instruments *per se*, the Investment Guidebook and Individual Action Plans (IAP) serve as useful tools in revealing to investors an economy's investment regime.

The Collective and Individual Action Plans were to put in place specific measures that could be taken by individual economies and by APEC collectively to promote trade and investment liberalization, trade and investment facilitation and economic cooperation. Individual and collective actions are to take place across a broad range of areas, such as those included in the NBIPs and menu of options. The IAPS are voluntary commitments submitted by each member economy to liberalize and facilitate trade – primarily through a lowering of tariffs and other barriers – and to liberalize rules for foreign investment. The APEC Business Advisory Council (ABAC) points to two specific needs in IAPs. One is the need to be more transparent in setting out the steps that economies intend to take to achieve liberalization and the policy intention behind those steps. The other is the need to be more specific as opposed to making vague suggestions about “adhering to the non-binding investment principles”. It also recommended that the contents of the action plans be more friendly. Furthermore, ABAC has suggested that the action plans were not comprehensive in that they did not take into account liberalization measures that had been adopted since the Asian financial crisis in 1997. ABAC claims that concrete liberalization initiatives need to be set out along with a timetable for their implementation. These criticisms suggest that translating good intentions into concrete action is very difficult in the investment arena¹⁰.

The Investment Guidebook published by the APEC Secretariat serves as a useful guide on the laws most relevant to investment. However, the information provided in the guidebook depends almost entirely on the information that member economies provide to

⁸ See Graham, 1996.

⁹ See Bishop, 2001.

¹⁰ See Bishop, 2001.

the Secretariat, and shows that some member economies are more diligent than others in providing comprehensive information.

4. EVALUATION OF APEC ECONOMIES' INVESTMENT AGREEMENTS

4.1 MFN Principles

Bilateral investment treaties use two different standards to prevent discriminatory treatment of different classes of investments, the MFN treatment standard and the national treatment standard. The MFN standard is a core element of international investment agreements, which seeks to prevent discrimination against investors from foreign countries on grounds of their nationality. The MFN standard gives investors a guarantee against certain forms of discrimination by host countries and is crucial for the establishment of equality of competitive opportunities between investors from different foreign countries.

In principle, one can distinguish several types of MFN clauses. They can be either unilateral or reciprocal, conditional or unconditional, limited (by territory, time, or substantive scope) or unlimited¹¹. MFN clauses in investment matters are usually reciprocal, unconditional and apply to all investment-related matters. Although MFN clauses are characterized by a basic similarity in terms of structure and substantive coverage, they nevertheless differ in one important area, namely, whether they apply only at the post-entry stage or also at the pre-entry stage. The majority of BITs do not include binding provisions concerning the admission of foreign investment. This means that there is an obligation to apply MFN under these terms only after an investment has been made. With regard to the pre-establishment phase, contracting parties are usually encouraged to create favorable conditions for foreign investors and admit their investments in accordance with their domestic laws. Some BITs, most notably those of the US and Canada and some regional agreements such as NAFTA offer a pre-and post-entry MFN standard.

There are several exceptions to the MFN standard, such as general exceptions (national security reasons), exceptions based on reciprocity considerations (taxation and intellectual property), exceptions related to special privileges accorded to members of a customs union or a free trade area, and individual country-specific exceptions.

The US Prototype as well as NAFTA contain a provision state that MFN applies only to investors and investments that are in “like situations” or in “like circumstances”. Thus, signifying different treatment is justified if they are in different objective situations.

The US Prototype Agreement and the US-Vietnam Treaty both state that intellectual property rights concluded under the auspices of the World Intellectual Property Organization do not fall under the MFN provisions.

Chinese Taipei's Investment Guidebook outlines that it follows a case-by-case approval procedure for investors from China. The approval procedure is also used for

¹¹ See UNCTAD, 1999b.

foreign companies with more than 20% ownership by the people of the PRC, with a gradual relaxation under way.

4.2 National Treatment

The foundation of a liberalized investment regime is the absence of distinction between domestic and foreign investors. National treatment is the principle whereby a host country extends to foreign investors treatment that is at least as favorable as the treatment that it accords to national investors in like circumstances. While this is an important standard, it is perhaps the most difficult to achieve, as it touches upon politically and economically sensitive issues. The exceptions to national treatment are general exceptions based on reasons of public health, order and morals, and national security. Such exceptions are present in almost all multilateral regional, prototype and bilateral agreements. Subject specific exceptions which exempt specific issues from national treatment, such as intellectual property, taxation provisions in bilateral tax treaties, prudential measures in financial services or temporary macroeconomic safeguards. Country specific exceptions also whereby a contracting party reserves the right to differentiate between domestic and foreign investors under its laws and regulations – in particular, those related to specific industries or activities – for reasons of national economic and social policy.

The ASEAN model offers a temporary list of national treatment exclusions, reviewed every two years, and to be progressively phased out by 2010 by all Member States, with the exception of late entrants. This is very progressive in the sense that it accounts for national treatment in sectors such as manufacturing, agriculture, fishery, forestry, mining and quarrying, as outlined in the Protocol to Amend the Framework Agreement on the ASEAN Investment Area.

The New-Zealand-Singapore Agreement also has a provision that the Parties undertake to review at least every two years the status of the limitations on national treatment.

In the Investment Guidebook and IAPs, all member economies have listed restrictions on national treatment to foreign investors.

4.3 Performance Requirements

Investors may object to performance requirements because they impede the management of their investment and may require the investor to conduct the business in ways that reduce its efficiency and profitability. It has also been argued that because they regulate imports and exports, certain performance requirements may also distort international trade.

According to the provisions outlined in the treaties, they are well followed. However, the Investment Guidebook and IAPs suggests that there are many exceptions to the rule.

Chile maintains the right to impose performance requirements with requirements to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research in its territory. Chile's National Television Council establishes that as a general requisite, up to 40% of transmissions must be Chilean productions. Furthermore, Law N 16.624 about Mining Copper Activities, stipulates that copper productive entities that produce more than 75.000 tons yearly of blister copper, must establish a local reserve that benefits local manufacturing entities.

China's entry in its Investment Guidebook also stipulates local content requirements for some industries are included in government policies such as automobiles.

Malaysia has extended the waiver on the equity policy in the manufacturing sector until 31 December 2003, Applications for manufacturing projects received until this date will be allowed 100% foreign equity ownership without export conditions. This waiver does not cover 7 products/activities, which are SME in nature, where specific guidelines requiring joint ventures apply. These products/activities are paper packaging; plastic packaging (bottles, films, sheets and bags); plastic injection moulded components; metal stamping and fabrication; wire harnesses; printing and steel service centers. In addition, the relaxation on export conditions for existing manufacturing companies has also been extended until 31 December 2003 by allowing existing companies to well up to 100% of their output in the domestic market.

The Philippines imposes local content requirements for motor vehicle development and detergent manufacture. Motor vehicle development is also subject to foreign exchange requirements, but the Philippines government has filed with the WTO Council for Trade in Goods' (CTG) to request for an extension of an additional one and a half years from and after 31 December 2001 (or up to 30 June 2003) to phase out the local content and foreign exchange requirements under its Motor Vehicle Development Program.

Chinese Taipei's IAP entry states that it has already committed to the abolishment of local-content requirements for automobiles and motorcycles/scooters upon accession to the WTO.

According to Vietnam's IAP, local content requirements are applied for some manufacturing industries, including automobile, motorcycle, electric and electronic; and 24 industrial products which the market demand is satisfied by domestic production, are required to export at least 80%. However, Vietnam states that it intends to cut down the list of products, which are required to export at least 80% of products.

4.4 Expropriation and Compensation

Practically all the agreements examined adopt some variation of the traditional rule of international law that a State may not expropriate the property of an alien except for a public purpose, in a non-discriminatory manner, upon payment of compensation, and in accordance with due process of law. This provision of the NBIP aims at facilitating rather than liberalizing investment. Its inclusion stems from the fact that many investments are long-term and before making such a commitment, foreign investors need to be confident

that their property cannot be taken by the state other than for public purposes and then only if prompt adequate and effective compensation is paid to them. The provision adopts the highest international standards with regard to expropriation and compensation.

The expropriation and compensation clauses are well followed according to the bilateral, prototype and regional agreements. The US and Chile prototypes as well as the Canada-Chile BIT and NAFTA contain very detailed provisions in this regard.

It is noteworthy that the Chile-Korea treaty expanded coverage of this provision so that investors affected have the right to prompt access under the law of the contracting party making the expropriation to review the amount of compensation and legality of any such expropriation or comparable measure.

4.5 Repatriation and Convertibility

The provisions on the transfer of payments are considered by both investors and countries as among the most important in an investment agreement. There are aspects here in which the interests of the host country and the foreign investor may differ widely. The Eminent Person's Group found this provision in the NBIP to be weaker than comparable international standards primarily because it appears to allow member economies to move at their own pace towards totally free movement of capital flows related to foreign investment projects. While most economies in the region have now adopted Article 8 of the IMF provisions related to free movement of capital, many of these economies still have onerous bureaucratic requirements in place and some have not yet adopted freely convertible currency regimes. The repatriation and convertibility provision seeks the removal of these restrictions¹².

Repatriation and convertibility were in most cases well followed. Several agreements stated exceptions to prevent a transfer; those being bankruptcy, insolvency, or the protection of the rights of creditors; issuing, trading or dealing in securities; criminal or penal offenses; ensuring compliance with orders or judgments in adjudicatory proceedings. Such exceptions were listed in the treaties of the US and Australia Protocol Agreements, New Zealand-Singapore, NAFTA, Canada-Chile, Korea-Japan and Thailand-Canada.

In addition, the US' IAP states that transfers are freely permitted except for reasons of essential security and several exceptions described in the Investment Guidebook. The Investment Guidebook outline restrictions on foreign payments to governments or nationals of Cuba, DPRK, Iraq and Libya among others.

Papua New Guinea's Investment Guidebook entry states that taxation clearance certificates are not required for the purchase of goods and services, but are required for the transfer of capital, or payment of dividends in excess of K50,000 per calendar year"

¹² See Bishop, 2001.

4.6 Settlement of Disputes

Provisions for the settlement of disputes are important as a means of ensuring that the standards of treatment and protection granted by a treaty are effectively implemented and enforced. The presence of effective mechanisms for the resolution of disputes is the ultimate guarantee of protection for foreign investors. The most commonly accepted forum for resolving state-foreign investor disputes is the international arbitration institution established under the International Convention for the Settlement of Investment Disputes (ICSID). The provision also takes account of traditional East Asian preferences for informal resolution of disputes by specifically requiring consultations and negotiations prior to more formal dispute resolution procedures.

The settlement of disputes provisions in the treaties vary greatly in scope and detail among the agreement examined, but do generally follow the NBIPs and menu of options.

4.7 Entry and Sojourn of Personnel

The efficient operation of an investment may require the application of specialized knowledge possessed only by foreign nationals. For these reasons host countries need to find a reasonable balance between their right to exclude aliens and their desire to provide a favorable investment climate, necessitating the admission of certain aliens. Thus, as Bishop points out, when we consider each member economy's entry in the Investment Guidebook we find that the provisions relations to the stay of foreign personnel are often the most lengthy and complex part of the entry. An examination reveals that each economy has its own system for issuing visas and work permits, with little standardization evident across the region. A precursor to any liberalization may be some degree of policy harmonization¹³.

The treaties examined do not all contain provisions providing for the entry and sojourn of personnel. However, those that do follow the general APEC provisions.

4.8 Avoidance of Double Taxation

The provisions for the avoidance of double taxation in the APEC instruments is arguably weak in that it appears only to encourage the formation of double taxation agreements rather than attempt to harmonize their provisions. For this reason, ABAC has made a number of recommendations on the issue. However, separate from the APEC provisions, the avoidance of double taxation measures appear to be well followed as most economies have provisions in their bilateral investment treaties dealing separately with double taxation. The Investment Guidebook and IAP entries provide an extensive list of the number of double taxation treaties covered to date in each economy.

¹³ See Bishop, 2001.

4.9 Intellectual Property Rights

Perhaps due to the “newness” of this issue, its provisions are only found in the Korea-Japan treaty signed in March 2002. Yet the provisions are very rudimentary as they are lacking in Menu of Options items 10.03-10.05. Nevertheless, this agreement signals the beginning stages of implementation of this measure for future agreements.

4.10 Technology Transfer

Most BITs do not mention technology as such and this issue is only specifically treated in the US-Vietnam agreement signed in July 2000. However, it is noteworthy that the Menu of Options provisions reads as a positive statement outlining parties duties to reduce restrictions and provide protection on the transfer of technology. The USA-Vietnam clause reads as a negative statement of what each contracting party shall not mandate or enforce on the other party. Thus, this is an issue that needs further implementation and surveillance.

4.11 Transparency

Transparency is an important feature of a favorable investment climate. Foreign investors are more likely to invest in a country if they believe that they can ascertain the laws that will govern their investments. The transparency of laws and other government measures has many facets, from simply disclosing and publicizing all government measures in accordance with a country’s legal system, to specifically notifying and making available certain types of measures to an international body or to officials of another country.

In this respect there are not too many transparency clauses in the agreements examined. They can only be found in the USA-Vietnam, Korea-Japan, Australia-Hong Kong and ASEAN treaties. However, the Investment Guidebook and IAPs thoroughly cover the transparency provisions of each member economy.

4.12 Business Facilitating Measures

The Menu of Options entry on business facilitating measures is quite lengthy with 13 different points under its heading. Yet not one agreement examined incorporates its provisions in their multilateral, regional, prototype or bilateral treaties. The US-Vietnam agreement has a list of provisions on business facilitation but this list does not correspond to that of the Menu of Options.

The Investment Guidebook and IAPs do a better job of incorporating some of these principles in their respective entries.

4.13 Newly Emerging Issues

The following are newly emerging issues, and there is no mention in the multilateral, regional prototype and bilateral treaties on the topics of start-up companies and

venture capital, removal of barriers to capital exports, investment behavior and competition policy.

5. CONCLUDING REMARKS

As Section Four outlines, there are varying degrees to which different non-binding investment measures are followed. Provisions in areas such as MFN and Settlement of Disputes are extremely well accounted for, whereas issues in Transparency, Performance Requirements, Repatriation and Convertibility and Expropriation and Compensation could be better implemented to match the APEC investment instruments. It is noteworthy that there are a surprising number of areas in which no action has been taken for implementation into the multilateral, regional, prototype and bilateral investment treaties. These are issues in the areas of Competition Policy and Regulatory Reform, Investment Behavior, Start-up companies and Venture Capital. In fairness, it should be noted that some of the under-implemented provisions are included in the Investment Guidebook and IAPs of each APEC economy. However, the test of whether liberalization is truly heeded is if measures are made legally binding under a treaty setting. Despite APEC's efforts to liberalize investment, it appears that harmonization of APEC investment instruments and multilateral, regional, prototype and bilateral treaties has been difficult to achieve due to the economic and political considerations of individual member economies. In fact, even the provisions which have been well implemented contain several exceptions to the general case¹⁴.

When comparing the provisions of the NBIPs and the Menu of Options, it is clear that the Menu items are more detailed. Perhaps due to these characteristics, many of the treaties examined failed to implement most of the measures in the Menu of Options. In areas such as Transparency, Repatriation and Convertibility, Intellectual Property Rights, Technology Transfer, and Business Facilitating Measures to Improve the Domestic Business Environment steps were taken by many treaties to incorporate aspects of the APEC instruments. Thus, these steps partially implement measures rather than fully incorporate all Menu items in their provisions. However, this should not act as a barrier to creating more provisions as more options reflect better ways in which a country can liberalize its investment regime. Indeed, the recently signed treaties of Korea-Japan, and US-Vietnam show that there is a movement in incorporating the newly emerging issues in the investment environment such as intellectual property rights and technology transfer. This momentum should be encouraged as new BITs are negotiated and signed between APEC member economies.

One suggestion for the APEC investment instruments is that it may do well in adding 'subrogation' to its provisions as the vast majority of treaties incorporated this measure into their agreements. The provision typically states if a contracting party makes a payment to its investor under a guarantee it has given in respect of an investment in the territory of the other contracting party, the latter contracting party recognize the assignment

¹⁴ Examples include MFN Principles, Performance Requirements and Repatriation and Convertibility, as described in Section 4.

of all the rights and claims of the indemnified investor. The addition of this provision in the NBIPs and Menu of Options would aid it to become a more comprehensive list.

If it is difficult for APEC member economies to implement these instruments amongst themselves, then how much more difficult will it be in a multilateral setting with all the various countries bringing their own issues to the negotiating table. Despite this difficulty, it remains a stark fact that global FDI trends are on the rise. The need will arise sooner or later for multilateral rules on investment. APEC members must individually strive towards facilitating this inevitability by improving their investment regimes through regularly updating their IAPs and Investment Guidebooks. APEC members must also collectively endeavor to improve and implement the Collective Action Plans and other joint efforts such as expanding upon the Menu of Options. Only then can the Group take this one step further in providing concrete suggestions and guidelines for a multilateral arena for investment. The ultimate goal is to provide input into the WTO Working Group on the Relationship between Trade and Investment to relay the benefits and challenges of implementing non-binding investment measures. There are many difficult areas in the road ahead, especially with the advent of new issues such as intellectual property rights, technology transfer and start-up companies and venture capital. Yet, if APEC members are successful in proving that liberalization is possible using their investment tools, it can act as a springboard for stimulating a real dialogue and action at the WTO.

Appendix 1

APEC Investment Instruments

Menu of Options (1997)

Non-binding Investment Principles (1994)

Investment Treaties between APEC Members
(arranged by signing date)

Multilateral/Regional Investment Treaties

GATS	(04/1994)
TRIMs	(04/1994)
TRIPs	(04/1994)
MIGA	(11/10/1985)
NAFTA	(17/12/1992)
ASEAN	(07/10/1998)

Prototype/Bilateral Investment Treaties

Australia	
Chile	
China	
Indonesia	
Malaysia	(02/1998)
Chinese Taipei	
USA	

Bilateral Investment Treaties

Australia-Hong Kong	(15/09/1993)
Chinese Taipei-Thailand	(30/04/1996)
Canada-Chile	(05/12/1996)
Thailand-Canada	(17/01/1997)
Japan-Hong Kong	(15/05/1997)
Hong Kong-Korea	(30/06/1997)
USA-Vietnam	(07/2000)
New Zealand-Singapore	(01/01/2001)
Korea-Japan	(22/03/2002)

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SESSION III

Regional Initiatives on Investment, Regional Policy and Regulatory Trends and Their Causes

International Investment
Disciplines

Marinus Sikkel

INTERNATIONAL INVESTMENT DISCIPLINES

by Marinus Sikkel

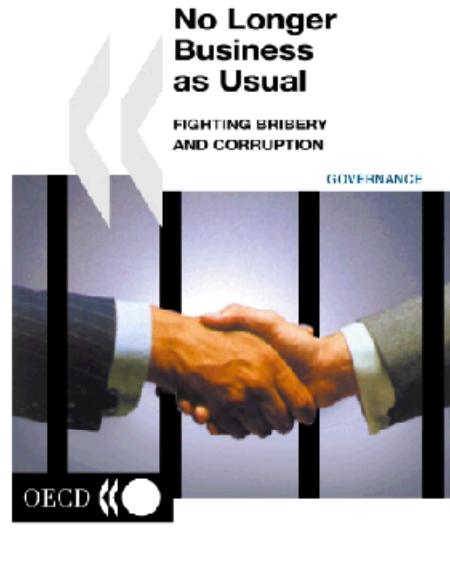
- The “rules of the game” at OECD
- Did they help?
- Lessons

The OECD: a poor man 's club

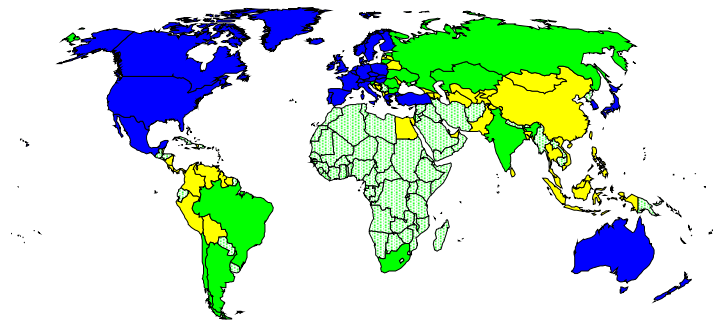
Born out of the Marshall Plan



● Sharing common ethics and values



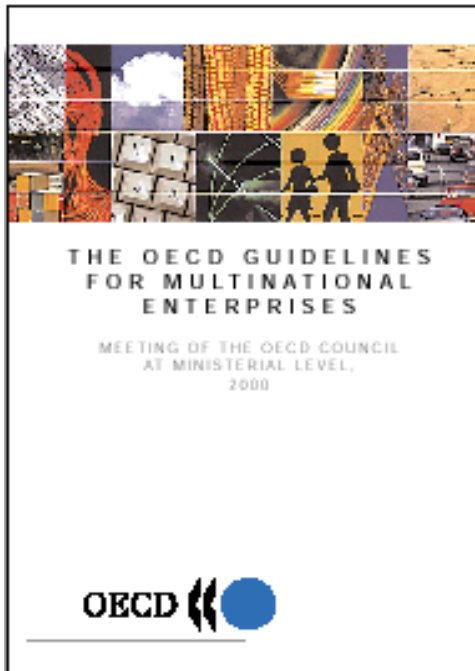
Open to the world



■ Co-operation programmes	(49)
■ Co-operation programmes and participation in OECD bodies*	(16)
■ OECD Members	(31)

* Non-Members not participating in OECD bodies take part in OECD meetings and activities upon *ad hoc* invitations.

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OECD Principles of Corporate Governance

- *The full text of the Principles is available below in HTML and can also be downloaded in [PDF file format](#) or ordered via the [OECD Online Bookshop](#). It is also available in [French](#), [German](#), [Russian](#) and [Spanish](#). For more information on the Principles please visit our ["Q&A pages" on Corporate Governance](#).*

The OECD Council, meeting at Ministerial level on 27-28 April 1998, called upon the OECD to develop, in conjunction with national governments, other relevant international organisations and the private sector, a set of corporate governance standards and guidelines. In order to fulfil this objective, the OECD established the Ad-Hoc Task Force on Corporate Governance to develop a set of non-binding principles that embody the views of Member countries on this issue.

The OECD Anti-Bribery Convention

- In force since 1999, signed by both OECD Members and non-Members.
- It requires parties to:
 - make bribery of a foreign public official a criminal offence, and apply effective, proportionate and dissuasive sanctions;
 - provide ways of pursuing nationals for bribery committed abroad;
 - facilitate mutual legal assistance.

Harmful Tax Competition: the OECD project

- Harmful tax regimes in OECD and offshore tax havens have been defined and identified.
- The aim is to:
 - curb evasion and improper avoidance of tax, which create injustice and distortions
 - and raise international standards of information sharing and transparency.

Bank Secrecy: the OECD's 2000 Report



- All OECD Members should permit access to bank information for all tax purposes to domestic tax authorities and their treaty partners.
- A set of specific measures are identified that would assist countries in achieving this objective,
- consistent with legitimate needs for confidentiality.

The fight against money laundering

- Led by FATF -- comprised of OECD Members and Non-Members.
- Recommendations to improve criminal justice; financial system regulations, and international co-operation...
- supported by strict monitoring mechanisms.
- countries and jurisdictions identified as non-co-operative.

The OECD 1998 Anti-Cartel Recommendation:

- Explains how cartels overcharge customers, distort trade, waste resources, and retard growth.
- Calls for better investigation tools, sanctions, and international co-operation.
- Invites non-Members to associate themselves with the Recommendation.

investment instruments

- **1961: Codes of Liberalisation of Capital movements** and Current Invisible Operations
- **1976: OECD Declaration** on International Investment and Multinational Enterprises
- **1994: MAI**
- **2000: revised Guidelines**

In the beginning

- Initial task to rebuild Europe's war-torn economies
- Focus on liberalisation of trade in goods and services and related payments: adoption of the first version of the Current Invisibles Code 1951
- Progressive liberalisation of capital movements since 1961 following adoption of the Capital Movements Code

CODES - COVERAGE

- The Capital Movements Code: the only plurilateral instrument covering the full range of capital movements
- The Current Invisibles Code: eleven areas of services, including financial services

STATUS

- legal instruments establishing rules of conduct for OECD Member governments

OBJECTIVES

- Eliminate between Members restrictions on capital movements and invisible transactions.
- Liberalise beyond the requirement that transfers are free of exchange control restrictions.
- The underlying transactions themselves should not be frustrated by laws, regulations or administrative approval processes.

BASIC OBLIGATIONS

- gradual liberalisation through a process of lodging and maintaining reservations where full liberalisation is not yet achieved
- non- discrimination among Members

TRANSPARENCY

- updated lists defining each country's current liberalisation commitments on the OECD website
- an immediate assessment of a country's individual position at any given moment
- market participants can be confident that no restrictions are imposed except those appearing in the reservation lists

PROCEDURES

- notification
- exceptions for reasons of public order and security
derogations for short-term operations in case of temporary economic difficulties
- Member countries discuss application and implementation of the Codes through the unique peer review process.

PEER REVIEW PROCESS

- consultation, discussion and examination
- no sanctions or negotiations
- countries are encouraged to liberalise by “benchmarking” rules and regulations against those of peer members
- this review process has proved a powerful tool for liberalisation in a plurilateral setting

ACHIEVEMENTS AND BENEFITS

- High transparency
- Virtually no capital controls remain
- Backtracking has disappeared
- More financing instruments
- Domestic business became international
- Supportive of broader governance reform efforts
- Economic stability

LIVING INSTRUMENT

- **1989-1992:** Major revision of the Codes to cover short-term and all financial services
- **2002:** Full application of Code's disciplines to investment abroad by institutional investors
- **2002>:** Addition of new insurance provisions to the Current Invisibles Code

THE DECLARATION - COVERAGE

- Political commitment
- Balanced framework for government and corporate responsibility:
 1. **National Treatment Instrument**
 2. **Guidelines for Multinational Enterprises**
 3. **Investment Incentives and Disincentives**
 4. **Conflicting Requirements**

NATIONAL TREATMENT INSTRUMENT

- For established foreign-controlled enterprises
- No less favourable treatment than that accorded to domestic enterprises in like situations
- Obligation to notify measures

IMPLEMENTATION

- Monitored by CIME
- Peer pressure for progressive liberalisation
- Decisions by OECD Council by consensus
- Publication of country positions

MULTILATERAL AGREEMENT ON INVESTMENT

- An attempt to find a synthesis
- Why negotiations failed
- 3 years of intense work by 33 OECD and non-OECD governments available
- Visit : www.oecd.org/daf/mai

OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES

- A response to globalisation
- Supported by business, labour unions and NGO's
- Recommendations by governments on business conduct
- Universal application
- Supplement applicable law

Comprehensive

- sustainable development
- human rights
- labour relations
- suppliers and subcontractors
- transparency

Unique follow-up institutions

THE “NATIONAL CONTACT POINTS”

- Promote the Guidelines
- Handle inquiries
- Can be approached by anyone
- Assist in solving problems
- Liase with other NCPs
- Report annually to OECD

Lessons learned

- Step by step
- Transparency is key
- Clear commitment
- Strong process

Investment Rules in NAFTA

William A. Dymond

Investment rules in NAFTA

W. A. Dymond

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Chapter Eleven (Investment) of the North American Free Trade Agreement (NAFTA) concluded in 1993 between Canada, the United States, and Mexico, provides a model of a modern comprehensive investment protection agreement. Its principal aim is to ensure that there is a secure, certain, and predictable environment for investment. NAFTA Chapter 11 marked a significant change in the international regime for all three NAFTA parties. It was the first time that two developed countries with highly integrated economies had agreed to such a comprehensive code governing state behaviour. It was also the first time that Mexico agreed to be bound by international rules on investment.

An increasing number of studies¹ suggest that the FTA and NAFTA have clearly met the objectives and expectations of the US, Canadian, and Mexican governments and business interests; freer trade has been an important contributor to changing Canada's industrial structure from being largely resource-based to one encompassing many value-added industrial and service sectors including high-end knowledge-based activities. Mexico has experienced similar fundamental restructuring; the fastest growing sectors in both countries have been those that have become more specialized and more integrated into the North American economy. Given the enormous size of the US economy the impact on the United States has been both more modest and more difficult to track. What impact there has been, however, has been positive, with many firms and industries taking advantage of increased trade and investment opportunities.

The direct trade impact of both the FTA and the NAFTA has been extensive and, on the whole, beneficial in all three countries. During free trade's first decade, two-way Canada-US trade grew by an astonishing 140 percent, reaching more than a billion dollars US of two-way trade every day. Two-way trade in goods and services between Canada and the United States reached US \$ 420 billion in 1999, representing more than 80 percent of Canada's total trade and 23 percent of total US trade. The figures for US-Mexico trade are more modest, totaling about half the Canada-US figures (US \$ 215 billion in two-way trade in 1999), but US-Mexico trade started from a much smaller base and has grown much faster over the past decade. Canada-US trade grew at about 10 percent a year over the past decade, while US-Mexico trade grew at about 20 percent annually. Canada-Mexico trade

¹ Useful surveys of current research and attitudes can be found in two tenth-anniversary volumes on the Canada-US FTA: L. Ian MacDonald, ed., *Free Trade: Risks & Rewards* (Montreal and Kingston: McGill-Queen's University Press, 2000) and Mordecai E. Kreinin, ed., *Building a Partnership: The Canada-United States Free Trade Agreement* (East Lansing, MI: Michigan State University Press, 2000).

remains at disappointing levels, totaling about US \$ 6 billion annually, a little more than one percent of Canada-US trade.

The fears expressed by the FTA's and NAFTA's opponents proved either exaggerated or ill-founded. Adjustment, while initially painful in both Canada and Mexico, ended up being both manageable and worthwhile. Adjustment in the United States was hardly noticed, and certainly did not include any 'sucking sounds' to either the south or the north. Claims in all three countries of unacceptable collateral effects on such non-trade matters as the capacity of governments to pursue their own health care or environmental protection objectives turned out to have little foundation.

The globalization of trade and investment has made the contribution of trade ever more important to North Americans' collective prosperity. The place of cross-border transactions — exports and imports of goods, services, and technology — in the Canadian, US, and Mexican economies has grown exponentially over the past two decades, from the equivalent of some 50 percent of GNP to 90 percent in Canada, from less than 20 percent to about 25 percent in the United States, and from about 30 percent to nearly 70 percent in the case of Mexico. The role of foreign investment has similarly expanded. The leading sectors of all three economies are those most engaged in international exchanges, and in all three countries, the basis of prosperity is now trade-based production.

Changes in investment policy have been critical to this development. The combination of technological developments, market discipline, and freer trade unleashed forces that had always existed but which previous policy had kept in check. Canadians, Americans, and Mexicans enjoy greater prosperity today because they live in more entrepreneurial and more open economies ushered in by the decision to become freer traders.

The following describes the principal provisions of the investment chapter of the NAFTA.

National Treatment

The NAFTA requires that each country grant national treatment to the investors and investments of the other parties. This means that the investors and investments of the other parties be treated at least as well as domestic investors and investments, including the treatment accorded by the states and provinces of each country. These obligations are accompanied by a commitment to accord the better of either national or most-favoured-nation treatment, the first time a developing country has undertaken such an obligation.

It is important to note that the national treatment obligation is qualified by a 'like circumstances' criterion. This means that a foreign investor and domestic investor should be treated in the same manner where the circumstances are broadly the same. It does not mean, for example, that environmental regulations applying to a foreign investor in one part of the country need to be the same as those for a domestic investor located in another part of the country where the 'circumstances' of the environment may be different.

Most-Favoured-Nation Treatment

The NAFTA requires that each country accord treatment no less favourable than it accords to the investors and investments of any other country to the investors and investments of any other party. Generally, this treatment has been freely extended to all other countries with the exception of access to dispute settlement systems of the Agreement.

Establishment

The NAFTA treats pre- and post-establishment in the definitions of investment and investor. The definitions set out what constitutes an investment and an investor and what does not. Any investment or investor of any of the parties falling within the definitions are, *ipso facto*, entitled to the treatment provided for in the chapter. Establishment issues are also treated in the listing of sectors (Annexes 1 to 7 of the NAFTA) in which foreign investment is restricted or in some cases prohibited. For example, Mexico's primary energy sectors and railroads, US airlines and radio communications, and Canada's cultural industries are all listed sectors. In some cases, the Annex permits existing restrictions on foreign investment to be maintained so long as the restrictions are not made more severe and any unilateral liberalization is not subsequently reversed. Similarly, any investment within a sector that is restricted is entitled to the treatment of the chapter for that portion of the sector that is not restricted. For example, a foreign investor might be limited in the degree of ownership permitted in a sector but that portion which is permitted is entitled to the treatment provided for in the chapter. Treatment under the chapter obviously does not arise for sectors in which foreign investment is prohibited.

Investment Screening

The NAFTA makes no explicit provision for the screening and approval of foreign investment. Under the national treatment rules, such screening and approval would be forbidden unless it were also required of domestic investments under no more favourable terms. However, the Annex provides an exception for Canada and Mexico to screen investments above a certain value, as defined in the agreement.

Performance Requirements

The NAFTA provisions on performance requirements are more detailed and rigorous than the WTO TRIMs Agreement. The list of prohibited practices covers export performance, import substitution, domestic content and sourcing, trade balancing, product mandating, and technology transfer requirements. Most existing requirements falling within the list were to be phased out over periods of up to ten years. Some non-trade related performance requirements are allowed, for example, commitments on worker training, the construction or expansion of facilities and research and development. By comparison, the TRIMs Agreement is far more limited, covering essentially domestic content and trade balancing requirements

Expropriation

The NAFTA prohibits the direct or indirect nationalization or expropriation of an investment, or any measure tantamount to the expropriation except for a public purpose, on a non-discriminatory basis, in accordance with due process of law including the minimum standard of treatment (see below) and on payment of prompt, reasonable, and freely transferable compensation.

Minimum Standard of Treatment

The NAFTA contains a minimum standard of treatment article requiring the application of treatment to the investors and investments of the other party in accordance with international law, including fair and equitable treatment and full protection and security. The minimum standard provision is designed to address a situation where a government treats a foreign investor in an arbitrary and unjust manner but in a manner that is no different from the treatment inflicted upon its own investors. The minimum standard should be seen as the floor for the treatment of foreign investment even if the treatment is non-discriminatory as between domestic and foreign investors.

Environment

The NAFTA allows each country to require that investors adopt pollution abatement and other environmental technologies and meet specified requirements such as the undertaking of environmental impact analyses. In addition, it contains a best endeavours commitment that national environmental standards not be lowered in order to attract or retain investment but provides no remedies except for consultations if such actions occur. In addition, a so-called side agreement — the North American Agreement on Environmental Cooperation — provides that the NAFTA countries will observe environmental and procedural principles, and generally enforce their own national laws.

Investment Incentives

The NAFTA has no provisions on investment incentives except in an exception from the prohibition on performance requirements in certain cases where incentives are given, for example research and development

Transparency

The NAFTA requires, in Chapter 18 respecting all the articles of the agreement, the publication, in advance if possible, of its laws, regulations, procedures, and administrative rulings, advance notification of any proposed measures, an opportunity for interested persons to be heard, and procedures for review and appeal.

Dispute Settlement

The NAFTA provides for two dispute settlement procedures for investment. The first, set out in Chapter 20, is applicable to all NAFTA obligations and allows governments to

challenge alleged breaches of the agreement in a manner analogous to WTO dispute settlement procedures. The second, set out in Section B of Chapter 11, permits investors to obtain relief directly rulings against a government in an international forum according to rules established by the World Bank's International Center for the Settlement of Disputes (ICSID) or the UN Commission on International Law (UNCITRAL).²

² For a discussion of the disputes to date, see "NAFTA 11 to date: The progress of a Work in Progress" by Professor J. Anthony Vanduzer at www.carleton.ca/ctpl--NAFTA Chapter 11 Conference.

Investment Rules in the Andean
Community

Carlos A. Herrera

Investment Rules in the Andean Community

Carlos A. Herrera

National Commission of Foreign Investments and Technology
Government of Peru

It is a real pleasure to be in Merida among my distinguished colleagues from the Investment Experts Group, to jointly explore on the Regional and Bilateral Investment Rules and Agreements.

Thanks to the government of Mexico for hosting this event and for let us know this beautiful city.

Y would also like to thank my dear friends Carlos García Fernández and Miguel Flores, and their team, for their tireless efforts, and for giving me the opportunity to share with me your experiences.

Y will begin my presentation with an overview of the Andean Community, before I proceed to the main subject of our Workshop.

The member States of the Andean Community include Bolivia, Colombia, Ecuador, Peru and Venezuela, which have a combined population of more than 113 million, total GDP of about 300 billion dollars, and a total trade of 80 billion dollars.

The Andean integration process began in 1969, two years after the birth of ANSEAN. Perhaps its most important achievement is the progressive creation of a Free Trade Area between the Member States. Trade among the Andean countries increased almost three times between 1990 and 2000. This trade expansion also has been accompanied by a surge of foreign investment and the rise of investment flows among the Member States.

In addition, the majority of the Member States currently applies a Common External Tariff. The mechanism has a four-tier structure with basic levels of 5%, 10%, 15% and 20% and a series of tariff deferral arrangements that allow the countries to move away from the basic structure through rules that are stipulated in the decision itself.

In addition to the free circulation of goods, the Andean Community is undertaking a process that will lead to the total liberalization of the trade in services within the Andean Community by the year 2005.

At their Eleventh meeting, in Cartagena, Colombia in May 1999, the Presidents of the Andean Countries assumed a commitment to “establish the Andean Common Market by the year 2005, at the latest, by creating the conditions for adding to the free circulation of goods, the unimpeded movement of service, capital, and people in the Sub region.”

Last year, the Presidents of the Andean Community Member Countries, gathering at the Presidential inauguration of Alejandro Toledo in Peru, expressed their firm political intention to approve a new common tariff before the next Andean Presidential Council. This instrument, combined with the execution of commitments in regard to the circulation of people, the Andean passport, and border integration and development, are supposed to ensure the establishment of the Andean Common Market by the year 2005.

Investment Regulations

The evolution of the common investment regime is a reflection of the evolution of the development policy of its Member States and the international trends.

From 1970 to 1992, Bolivia, Colombia, Ecuador, Peru and Venezuela, applied a common regulatory framework for the treatment of foreign capitals that established a clear regime of privileges to the national and sub-regional capitals, framed within protectionism policies on domestic matters and integration. At the same time, a regime for the development of Andean Multinational Enterprises, as a vehicle to promote the integration of sub-regional capitals, was established including the national treatment and the guarantee for the transfer of payments.

The common regime on foreign investment established the requirement of prior authorization; a qualification of the enterprises based on the participation of national investors as a parameter for the application of the regulatory measures. Specific sensible (as those related to the exploitation of natural resources, public works and infrastructure) were reserved for the State. Restrictions were established for the “Foreign companies” to access domestic credit. The transfer of profits and dividends were limited to a percentage of the registered investment and restrictive regulations were applied on the transfer of technology and the transfer of royalties. The possibility to access to international arbitration for the settlement of investment disputes was denied; and restrictions to access the benefits of the regional program for the liberalization of the regional market established to reach the free trade area were also established.

But, in the early 90’s the Andean economies began internal economic reforms in order to open their markets and promote foreign investment. Consistent with this new policy, the Andean Countries decided, in 1992, to liberalize the common regime by enacting the Decision 291, currently in force.

Decision 291, the “Regime for the Common Treatment of Foreign Capital and Trademarks, Patents, Licensing Agreements and Royalties”, enacted in March 1991, involves a narrow definition of foreign direct investment based on the enterprises concept and, as a heritage of the previous regimen, it still classifies local enterprises into national, mixed, and foreign, according to the participation of national investment.

The decision was supposed to clearly set out the rights and obligations of foreign investors, but its provisions in general yield to the stipulations of national legislation on the main topics.

At the same time, decision 292, approved in March 1991, pretended to improve the development of Andean multinational enterprises allowing a 40% of foreign participation.

These enterprises enjoy national treatment in regard to the public procurement of goods and services; they also enjoy provisions to double taxation of income and on the transfer of capital; and facilities for the hiring of Sub regional personnel (qualified personnel of Sub regional origin are considered to be national personnel for purposes of the application of quotas of foreign workers).

The Andean Regimen on Foreign Investment can therefore be said to give the Andean countries full freedom to regulate this field through their own national legislation. So, we can say the Andean Community has a “non-common regime for the treatment to foreign capitals”.

it should be recognized, even so, that national legislation on the subject has tended, since the mid 1980's. to move toward facilitating the entry of foreign investment and giving it national treatment in almost all aspects, with the results that there is a large degree of coincidence among the laws of the different countries.

This is the result of the application of a standard economic conception for the entire region and the application and evolution of multilateral rules and regulations, particularly those of the GATT and TRIMS (Agreement on Trade Related Investment Measures).

At the same time, as part of the liberalization of their economies and specifically on their domestic regimes on foreign investment, the Andean Countries began the process of negotiation of bilateral agreements for the promotion and protection of investment, with third countries and even among themselves.

Up to date, 85 bilateral investment treaties have been concluded by Andean economies, including 8 bilateral treaties among themselves.

Some disciplines considered in the Investment Agreements concluded by the Andean Countries.

Thus, we can say that the regulations governing foreign direct investment in the Andean economies are content in the Community Regime, the domestic legislation, and the bilateral investment treaties concluded by the economies.

The Peruvian Case

Peru is the only Andean Country participating in the APEC. In the specific case of Peru, the opening process started in 1991 with the reform of the legal framework for private investment. In mid-1991, the Government enacted the Foreign Investment Promotion Law, which meant the radical change of the policy on foreign capitals in force up to that moment. Further, the juridical scheme was complemented with the Framework Law for the Growth

of Private Investment, and the Law for the Encouragement of Private Investment in Public Works and Infrastructure.

The legal framework for private investment is based on the non-discrimination principle. That means national treatment is applied to foreign investment in the country. Prior authorization and restrictions to transfers were removed, and foreign investors are entitled to engage insurance abroad. During 1993- 1997, an aggressive program of privatization leads the attraction of foreign capitals, and the investment opportunities gradually attract capitals to the different sectors of the economy especially in commodity-producing and services sectors.

The foreign Investment Promotion Law, approved by Legislative Decree 662, 1991, is based on the equal treatment to national and foreign capital.

Rights granted by the law to the foreign investor:

- Non-discriminating treatment against the national investor.
- Free remittance of profits or dividends
- Free re-exportation of his capital
- Unrestricted access to the domestic credit
- Free acquisition of technology and remittance of royalties
- Freedom to acquire shares owned by national investors
- Freedom to contract abroad insurances for his investment
- Possibility to conclude with the State Law Stability Agreements for his investment in the country

Law Stability Agreements

Empowered by the Political Constitution, by the foreign Investment Promotion Law and under the Framework Law for the Growth of the Private Investment, the State guarantees the law stability to foreign investors and to the enterprises where they investment, through the subscription of agreements with contract-law status, and abide by the general provisions on contracts established in the Civil Code.

Guarantees granted by the State to the Foreign Investor

- Equal treatment, by which the national legislation does not discriminate against investors participating in enterprises, due to their status of foreign person.
- Stability of the Income Tax System in force when the agreement is concluded.
- Stability of the system of free availability of foreign currency and remittance of profits, dividends and royalties.

Guarantees granted by the State to the Enterprises receiving the investment

- Stability of the systems of labor engagement in force when the agreement is concluded.

- Stability of the system of export promotion applicable when the agreement is concluded.
- Stability of the Income Tax System.

Consolidating the friendly environment for investment

Having in mind the future role of our economy in the globalization process, the improvement of our competitiveness requires to promote foreign investment and transfer of technology. Experiences obtained in the regulation of investment shall be considered for the formulation of the guidelines for the future. Our objective is to consolidate a stable and predictable environment for private investment; in order to foster the development of productive investment projects in those areas where we could offer comparative and competitive advantages, looking for the development of industrial cluster that will sustain the economic development. Thus, we would not come back to the restrictive regimes from the 70s and 80's.

In the past 10 years, Peru has concluded negotiations on bilateral investment treaties with 30 economies, 27 agreements are already in force, and negotiations with 6 more economies are undergoing. It is worth to mention that during the recent visit of the US President to Peru, last March, it was announced the reactivation of the negotiations for the bilateral treaty on investment with the United States. Let's have a glance to some of the disciplines on those agreements.

The "Investment" definition

Unlike to the narrow concept of investment adopted by the Andean Common Regime on Investment, the bilateral investment treaties concluded by Peru and the other Andean economies have adopted a broad, open-ended, "asset-based" definition of the term "investment", illustrated by a non-exhaustive list of examples.

But we are also concerned about those capitals flows that may not be considered as an investment, since they do not have the characteristic of an investment.

Post establishment or Pre establishment

As in the case of most of the treaties concluded by Andean economies, except for the agreement between Bolivia-United States, Ecuador-United States, and the investment chapter on the free trade agreement between Mexico, Venezuela and Colombia (known as the G-3), the treaties concluded by Peru are focused on the post establishment phase, that means that they guarantee the national treatment and the most favored nation principles to investments once they are established.

The purpose of the national treatment standard is for the host State to grant investment and/or investors of another Party a treatment no less favorable than that granted to its investments –and investors.

According to market liberalization tendencies, Peru is open to negotiate the application of the investment treaty disciplines not only in the post establishment stage but also in the establishment or acquisition stage. In those cases, a negative list of country-specific reservations should be considered, taking in mind the existing domestic restrictions and the specific development policy of the country.

Notwithstanding, one thing is not clear enough yet is the way to clearly determine the phase of establishment and acquisition, as well as the rights of the potential investor to be under the protection of the treaty.

Transfers

As to transfer of funds relating to an investment, the principal objective of the agreements is to guarantee that transfers be made freely and without delay. Notwithstanding, the Contracting Parties may hinder the transfer by the equitable and non discriminatory application of their legislation in cases like bankruptcy or insolvency or protection of creditor's rights; criminal or administrative infringements; guarantee of enforcement of decisions in administrative proceedings; non-compliance of obligations under prevailing tax laws; etc.

A specific restriction on transfers in case of balance of payments difficulties may be also considered, as long as these restrictions are applied in good faith and on a temporary, equitable and non-discriminatory basis.

Also, in case of exceptional or serious difficulties in the balance of payments, each Contracting party shall have the right, to temporary limit transfers, in equitable and non-discriminatory way and in accordance with principles internationally accepted.

Performance requirements

Some investment agreements, concluded in the last years, include the principles contained in the Agreement on Trade Related Investment Measures (TRIMs) of the World Trade Organization (WTO). Those principles provide for prohibited performance requirements, which affect trade in goods since they are contrary to the principle of national treatment (Article III of the GATT 1994) and to general obligation of eliminating quantitative restrictions (Article XI of GATT 1994).

Certainly, this kind of clause is not considered in the bilateral treaties concluded by Peru, neither in case of most of bilateral treaties concluded by the other Andean economies. As far as we are a part to the TRIMs Agreement, and we have already eliminated the performance requirements in the early 90s, we consider that none performance requirement may be established through the adoption of investment measures non-compatibles with TRIMs disciplines or their eventual development.

Key personnel

Some investment treaties in the Americas provide for the temporary entry of managers and other key personnel relating to an investment. Some agreements expressly allow investors to hire not only top managerial personnel but any other “key personnel” of their choice, regardless of nationality.

On this respect, it certainly we agree that a country shall not impair, the free management of the investments, we shall consider that one of the direct effects expected by the countries when applying private investment policies is the improvement of the labor level and the enhancement of the local technical managerial skills.

In that sense, the Peruvian legislation as well as the other Andean economies, establishes specific quantitative restrictions to the hiring of foreigners. Under the Peruvian legislation, the foreign personnel may not exceed 20% of the total employees in a company.

Enhancing the development dimensions on International Investment Agreements.

Beyond the creation of a stable, predictable and transparent framework for FDI flows; international investment agreements should also have as a objective to enhance the ability of developing countries to pursue growth and development.

International investment agreements should allow host countries the flexibility and opportunity to pursue their development objectives in the context of their own national economic situations.

Looking for a more comprehensive framework

In order to achieve investment agreements which contribute to establish an appropriate climate for development, it may be required a more comprehensive treatment of the issue of investment, which goes beyond the traditional scopes of regulation. Most agreements for the promotion and reciprocal protection of investments, that are currently in force, and those that are currently under negotiation, include provisions in their structures that are limited exclusively to the legal protection of investments and have not considered the importance of establishing mechanisms to actively promote investments and the transfer of technology. Maybe we should further discuss on this topics.

If the objective of a normative framework to protect investments is to promote the flow of investments, it makes no sense to deprive said framework of its dynamic counterpart: promotion, which has precisely the same objective.

On the other hand, investment is an important source of new production techniques, specialized management and, in general, of intangible wealth that a developing economy wishes to attract. On this regard, technology transfer is one of the most important contributions expected from foreign investment. It may be contradictory if in any case a

bilateral investment treaty establishes restrictions on the possibility of promoting the research and innovation or the transfer of technology.

Joint participation in the FTAA negotiations

Finally y want to make some comments about the active participation of the Andean Countries, in the negotiations for the establishment of a Free Trade Area of the Americas (FTAA). Where we are participating jointly and with a single voice.

The Andean Countries recognize the importance of forming this great hemispheric market, not only because it will be one of the main destinations for their exports, but because of the potential it will open up.

One of CAN's the objectives is to "ensure that the negotiation of FTAA results in the formulation of an agreement that will offer the necessary conditions for the equitable participation of Andean countries, considering their varying levels of development and the different sizes of their economies"

Thank you very much.

Comments on Session Three

Carlos García-Fernández

Comments

Carlos García Fernández

General Directorate for Foreign Investment
Ministry of Economy, Mexico

Dear Colleagues:

First of all, I would like to thank Marinus Sikkel, William Dymond and Carlos Herrera for their excellent presentations. Undoubtedly, their reflections and experiences have largely contributed to enrich the debate on the interaction between trade and investment in the regional context.

Many of us have felt the need to come together to exchange views and ideas on the role regional investment mechanisms have played – and are playing - as important elements of this broad patchwork of rules that makes up the current international legal framework for FDI.

Listening to Marinus Sikkel's presentation, I could not help but recognise the outstanding work of the OECD in the development of international rules relating to capital movements, international investment and trade in services. Member governments have set “rules of the game” for themselves and for multinational enterprises established in their economies and abroad by means of legal instruments to which all Members must adhere.

These instruments have been regularly reviewed and strengthened over the years to keep them up-to-date and effective. The Codes of Liberalisation and the Declaration and Decisions on International Investment and Multinational Enterprises contain the main legal commitments of OECD Members and provide an essential yardstick in assessing the extent to which candidates for OECD membership adhere to standards set by these instruments.

Definitely, the OECD has proven capacity not only to develop international standards but also to integrate members and non-members' common ethics, values and concerns in such standards. The Anti-Bribery Convention, the Project on Harmful Tax Competition, the 2000 Report on Bank Secrecy, the Recommendations on Money Laundering and the Anticartel Recommendation are all living instruments calling for a clear commitment on corporate and governmental responsibility.

In this chain of efforts, special mention needs to be addressed to the Multilateral Agreement on Investment (MAI). Even if the MAI was not concluded, the Members Countries should feel proud of this initiative since the MAI was the fruit of the long expertise of the OECD in the field of FDI. As Marinus Sikkel concluded in his presentation, the lessons learned from the OECD experience are to go step by step; that commitments should have a clear

objective, and that to achieve this objective there was a need for a strong process and transparency

Let me also stress the role that the North America Free Trade Agreement (NAFTA) has played not only in the creation of greater opportunities for trade and investment among NAFTA countries, but in the stimulation of multilateral trade liberalisation as well.

When we negotiated NAFTA, we did so aware of the peculiarities of the trade and investment relationship, specially, the contribution of FDI to the export outcome of the host countries. NAFTA members recognised that a successful commercial liberalisation is possible only if it is accompanied by a liberalisation of productive capital flows, generating fresh resources, more transfer of technology, better managing practices and jobs. This correlation explains in part why NAFTA is not only limited to goods and services but it also covers FDI. Further, in the absence of multilateral rules on investment, we considered appropriate to adopt common rules among members in an effort to provide legal security and certainty to our investors and their investments.

NAFTA has undoubtedly strengthened and enhanced Mexico, the United States and Canada economic relations. The numbers clearly speak for themselves. Since 1994, trade between these countries has grown by 128 percent, surpassing US\$676 billion today. With regard to investment, the provisions of Chapter XI have granted legal security and predictability to our investors and their investments, leading to a significant increase in the investment flows which tripled for Mexico up to an annual average of 13 US billion beginning in 1994.

But for Mexico, investments are certainly not only bigger, but also better. They have translated into jobs, technology transfer, export opportunities and training for workers and executives. In this regard, I believe that the fears once expressed by NAFTA opponents had proved, to some extent, exaggerated or ill-founded. On the contrary, all the changes on investment policy that NAFTA countries had to carry out have been critical to our development.

The Andean Community is another live example of regional mechanisms containing provisions on investment. Together with NAFTA and other Latin America initiatives, the Andean Community has led the foundations for a broader and comprehensive framework on trade and investment in the hemisphere: The Free Trade Area of the Americas (FTAA). At their Eleventh Meeting, Presidents of the Andean Community assumed the commitment to establish the Andean Common Market by 2005. As Chairman of the Negotiating Group on Investment, I can tell you that the economies represented in the Negotiating Group are certainly seeking to establish clear and transparent rules in order to protect investors, their investments and related flows. Up to date, 85 bilateral Investment Treaties have been concluded by Andean economies, including 8 bilateral treaties among themselves. Andean Community and Peru, are key to setting the rules of the game emphasizing the development dimension of the FTAA.

Today, we have learned more about the positive correlation between trade and investment. It has been explained why countries have tended to create international instruments to promote and protect investment flows in line with an international legal framework to

promote the export and import of goods and services. Tomorrow, we will explore the reasons in favour of uniform international investment rules and the Doha Mandate as the engine to achieve this goal.

Thank you for your attention and, thanks to my friends, Marinus Sikkel, William Dymond and Carlos Herrera, for their contributions to this fruitful discussions; to all of you for your participation; to the enthusiastic team headed by Miguel Flores and to all the people behind this exercise in the office of Gerardo Traslosheros and José Acevedo. And last but not least, to the Under-minister Juan Antonio García Villa for his vote of confidence for the hosting of this workshop in the APEC spirit, which is also the Mérida spirit.

SESSION IV

General Features of Investment Promotion and Protection Agreements Signed by the APEC Economies

Scope and Key Definitions of Investment Agreements

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The Scope and Definition of Foreign Investment

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The scope and definition of foreign investment lies at the heart of every investment treaty.¹ The function of such treaties is to provide protection and standards of treatment for foreign investment. It is obvious that what is to be protected has first to be defined if that function were to be performed satisfactorily. It is best to begin by looking at the evolution of customary international law on this point before looking at the various treaty definitions and the policies behind these treaty definitions. Treaties, initially at least, were intended to overcome deficiencies that existed in customary international law and for this reason, the exploration of the position in customary international law has added relevance. The paper will then address the different treaty definitions of foreign investment and explore the policy reasons behind the extension of the definition of foreign investment beyond the obvious categories.

1. The Scope of Protection under Customary International Law.

Under customary international law, initially at least, the discussion of protection was confined to the physical assets of the foreign investor. This was but natural as it was such assets that were involved in foreign investment. The act against which protection was designed was the taking of the physical assets of the foreigner by the host state. The factual situation in the context of which protection had to be designed was not complicated. The industries in which investments were made were usually confined to the exploitation of natural resources, agriculture and less often, manufacturing. The context in which the law was shaped involved capricious takings of physical property by totalitarian regimes or takings by revolutionary regimes in the course of programs associated with the redistribution of property. In the first half of the twentieth century, the law was concerned exclusively with such problems.

The protection of intangible property first became mooted when contracts associated with foreign investment were rescinded by host states. The argument then came to be made that breaches of these contracts would give rise to responsibility without more. The literature suggests an intensive debate on the proposition. It would have been a startling situation from a theoretical standpoint.² For such a proposition to be recognized, a foreign investor or a foreign corporation should have personality in international law. Otherwise, the breach of a contract between the foreign investor and the host state, being located in domestic law, could technically have no impact in international law. But, multinational

¹. A useful survey is in UNCTAD, Scope and Definition (UNCTAD Series on Issues in International Investment Agreements, 1999). Also see Rudolph Dolzer and Marguerite Stevens, Bilateral Investment Treaties (1995).

². The literature is surveyed in CF Amerasinghe, State Responsibility for Injuries to Aliens (1965) pp.66-95.

corporations and developed states were interested in ensuring that such a proposition was developed.³ There was great resistance, particularly by Latin American states, towards the development of such a proposition. In later times, the investment treaties were to put the issue beyond doubt.

But, these treaties can only be understood in the context of the theoretical struggle that had existed in the field prior to their advent. The rule that a breach of a foreign investment contract amounted per se to a violation of international law from which state responsibility arose never became a rule of customary international law, despite its strong espousal and advocacy by many international lawyers. The Calvo doctrine sought to localize such contracts within the host state's laws and mandated that the remedy be sought in accordance with local laws before local tribunals. Given the conflict, despite the evolution of a course of arbitration awards which sought to give legitimacy to the proposition, there was a need for a treaty transformation of the proposition for it to be supported by an international obligation.

The arguments relating to contracts were necessitated by the fact that investments were not being made by small time operators but by large multinational corporations which took their operations overseas or engaged in projects overseas. Though this pattern had already emerged in the petroleum and natural resources sector, it became widely prevalent in other sectors as well. Along with the protection of contracts, other problems were thrown up by the fact that multinational corporations were increasingly becoming the purveyors of foreign investment. This again resulted in the shift away from the protection of physical property to the protection of shareholder interests and raised the issue of corporate nationality when it came to espousal of claims of the corporation that was affected. There was a shift of emphasis from an entirely assets based definition of investment to an enterprise based theory as shareholder protection assumed importance due to corporate structures through which investments were made. As local foreign investment laws began to mandate that vehicles such as locally incorporated joint ventures should be the form through which foreign investment is made there was a need to shift the emphasis to shareholder protection rather than asset protection. The corporation held the assets. It is the interest in the corporation that had to be protected.⁴ Progressively, when emphasis came to be placed on the value of intangible property and rights in contracts, protection had to be extended to the types of transactions which created these rights. Contractual rights in concession agreements as well as intellectual property rights which were central to transactions such as technology transfers required protection and the law was progressively extended to cover these transactions. By the time treaty practice took hold, practice in the area had begun to reflect this movement from asset based protection to enterprise and transaction based protection. International law however had not congealed on these points for there was considerable doubt as to the extent of the types of foreign investment that

³ . The high point of this theory of internationalized contracts is the award of Dupuy in the Texaco Arbitration. For a discussion of the theory of internationalization of foreign investment contracts, see M Sornarajah, The Settlement of Foreign Investment Disputes (2000).

⁴ . This is manifested by the complicated litigation on corporate nationality, particularly in the context of ICSID arbitration.

could be protected. Thus, for example, the Barcelona Traction Case,⁵ which reflected customary international law as understood by the International Court of Justice, stood against the development of an enterprise based system of protection as it undermined the possibility of shareholder protection by the state of nationality of the shareholders. There was a need for change. The change was effected by investment treaties, which, given the doubts that existed in customary international law, sought to establish rules as between the parties by recognizing the protection of shareholder interests. In this sense, the treaties were initially designed not to create customary law but to remove doubts in customary law at least as between the parties to the treaties. If this is indeed the purpose of bilateral investment treaties, their ability to create customary international law must be doubted.

Customary international law had achieved the protection of physical assets of the foreign investor. There was some rudimentary emergence of the protection of contractual rights, though authority was divided on this. There was also problems as to the procedures that had to be satisfied. The mere violation of defined property rights were insufficient for an international claim to arise. There had to be satisfaction of the rule relating to the exhaustion of local remedies. There was also the procedural problems relating to espousal of claims and the issues presented by the requirement of the nationality of claims, all of which entailed problems. Given this situation, bilateral investment treaties provided a basis for the parties to iron out what the rules of investment protection as between them would be. The scope of all rules, both procedural and substantive, relating to investment protection is dictated by the manner in which investments are defined.

Understanding investment treaties as seeking to remedy the deficiencies of the customary international law has important consequences. It brings out the divisions that had existed in the past and may continue to exist in the present as to the nature of the protection that is permissible in terms of international law. Devising standards of protection is intensively intrusive of domestic sovereignty and there was an understandable reluctance to permit this. Treaties, particularly bilateral treaties, permit a negotiated reconciliation of these difficulties. Multilateral or regional treaties are more difficult as it involves a larger group with disparate interests. Yet, where there is a swing towards a particular view due to changes in external circumstances, they could well be brought about.

2. Definitions in Bilateral Investment Treaties.

The practice of bilateral investment treaties began in 1959, with the first treaty being regarded as the treaty between Germany and Pakistan. Since that time, it is estimated that there have been some two thousand treaties. There was a sudden spurt in treaty activity when hostility in the developing world, characterized by its espousal of the New International Economic Order, subsided and a new belief in economic liberalism swept across the world in the 1990s. These political changes as well as the changes that were taking place in the structures through which foreign investments were made as well as strategies that were adopted by both host states and multinational corporations were progressively captured in the bilateral investment treaties.

⁵ . [1964] ICJ Rpts 12.

Early definitions of foreign investment in the treaties were assets based, reflecting the developments in customary international law. Rights in tangible property are comprehensively defined. Reference usually is to "movable and immovable property as well as other rights in rem, such as mortgages, liens and pledges". There was reference to the protection of contractual rights, particularly those contracts that were made in the natural resources sector. After Barcelona Traction Case, clearly in response to the opinion taken in that case, the treaties begin to reflect a need to protect interests in multinational enterprises such as shareholdings. The usual phrase would refer to "shares of companies and other kinds of interests in companies".

Some writers unfortunately infer from this reference to other kinds of interests in companies an intention in the treaties to protect portfolio investments. This is inappropriate. It is response to the situation created by the Barcelona Traction Case that reference was made initially to shareholder protection. The intention clearly was to protect the primary shareholders in companies created as vehicle for foreign investment. Despite the use of comprehensive phrases, such as "shares, stocks and debentures", this was no reference to portfolio investments. The criterion probably is to protect those assets in a company in which the foreign investor would have a definite interest if the company were to be liquidated. The preoccupation whether portfolio investments should be included within the definition of investments protected came much later in time.

Around this time, joint venture companies were becoming the common vehicles for the making of foreign investments. Often, the foreign investment laws of the developing states mandated the establishment of joint venture companies as the vehicles for the making of foreign investments. In these circumstances, it became necessary to provide for shareholder protection. Unlike in the past where individual investors made investments through the acquisition of physical assets overseas, foreign investment increasingly consisted of multinational corporations making alliances with other companies in developing countries as required by the laws of these states. The protection of enterprise structures became important and the treaties responded to this need by protecting shareholdings in corporate structures.

Likewise, the division of views that existed as to contractual protection was also solved by the inclusion of contractual rights, particularly in the natural resources sectors within the definition of foreign investments protected by bilateral investment treaties. Though these contractual rights were created within the domestic legal system of the host state and the process of investment operated entirely within its territory, these rights acquired in domestic law were internationalized through the process of the treaty. This has always been the strategy of the multinational corporations in devising a strategy of contractual protection. With the support of arbitral tribunals, the use of private power had sought to create a system whereby contracts relating to petroleum and other natural resources were governed by an external, supranational system of law. The success of the creation of such a system is variously assessed. But, where a treaty exists which defines such contractual rights as being subject to treaty protection, there is little doubt that these rights are effectively internationalized and subjected to the protection of the regime created by the treaty. The provision also seeks to tackle the doubts created by the doctrine of permanent sovereignty of natural resources which subjected such resources as a matter of

international law to domestic sovereignty and control. One purpose of the treaty definition is to counteract the impact of this doctrine. Whether this is successfully accomplished remains a moot point, for if the argument is accepted that the doctrine of permanent sovereignty over natural resources is a *ius cogens* norm, then, treaty provisions must yield to it. There is a division of opinion among international lawyers as to the status of the doctrine. But, investment treaties serve to add their weight to the debate for states do make the treaty fully aware of the existence of the doctrine and obviously seek to counteract it. The difficulty is to assess the extent to which a later government is bound by the treaty commitment made in violation of a *ius cogens* norm.

One important change in addressing contractual rights and shareholder rights is that the treaties had already moved into the realm of intangible rights associated with investments that had to be protected. In one sense, the distinction is artificial because in association with physical assets, rights such as mortgages, liens and pledges had already been referred to and these are intangible rights associated though with physical property. In the 1980s, the focus was turning onto intellectual property rights. In the sphere of investments, a strategy of maximising benefits to multinational corporations entering through joint venture companies was to unpackage the associated benefits that the corporation could bring to the joint venture by making separate management or technology transfer agreements with the joint venture. Industries based on new technologies such as computer industries were also beginning to appear. Intellectual property was seen as a means of making foreign investment. The reaction was to ensure protection of these intangible rights through unilateral and bilateral means. Unilateral action was taken through the amendment of the Trade Act, creating a special amendment to s. 301 of that act linking trade preferences to enforcement of intellectual property standard. Bilaterally, investment treaties began to include strong provisions on the protection of intellectual property.⁶ US treaty partners are expected to ensure that their internal laws conform to the TRIPS Agreement obligations so that there will be meaningful protection.⁷ There were also separate bilateral intellectual property treaties negotiated to address the protection of these rights. They usually provided for higher and more detailed standards of protection for such rights than the general provisions contained in the investment treaties or in multilateral treaties.

The further stage of the definition in bilateral investment treaties is the protection of licenses and other permits associated with the foreign investment. Increasingly, developing states were instituting screening mechanisms in order to scrutinize whether the influx of the foreign investment was beneficial to their economic objectives. These screening procedures were dependent on the issue of licenses to the foreign investor. The licenses were indispensable for the process of foreign investment for their withdrawal or termination would mean that though the foreign investor was left undisturbed in the possession of his physical plants, he could not operate them legally. The licenses are provided by the administrative and regulatory agencies of the host state. In treaties which establish pre-

⁶. F Abbott, "Protecting First World Assets in the Third World" (1989) 22 Vandberbilt J Trans'n'l L 689; Peter Drahos, "BITS and BIPS : Bilateralism in Intellectual Property"

⁷. US Office of Investment Affairs, "The US Bilateral Investment Treaty Program : Fact Sheet" on web.

entry rights of establishment, the scope for such screening does not exist. But, licensing may apply to other matters such as planning and environmental controls apart from entry clearance. There is a tendency in modern treaties to include such administrative licenses that are necessary for the process of foreign investment within the definition of foreign investment. Interference with these licenses is protected in the takings clause by requiring that there should be due process safeguards accompanying such takings.

The inclusion of administrative licenses within the definition of foreign investment nicely illustrates how other provisions in the investment treaty interact with the provision on definition. Such inclusion meant that withdrawal of administrative licenses, devices created exclusively within the host state by the host state's laws, had to amount to a taking. Hence, the taking provision had to be widened to include within the definition of taking, "anything tantamount to a taking", thus capturing situations where there are withdrawals of licenses and other regulatory interference with the functioning of foreign investment. This, of course, raises the whole issue of whether regulatory takings should be regarded as compensable takings. To some extent, the issue is narrowed down by the provision within the takings provision that the taking should have been accompanied by due process requirements so that what amount to the impropriety is not the regulation but the absence of due process in its exercise.⁸ The relevance of this extension of the concept of taking and the inclusion of due process accommodates the problem of licenses. But, the inclusion of licenses within the definition of foreign investment creates problems for dispute resolution. The issue is whether the withdrawal of an essentially domestic license by the state in the public interest could at once be taken to an overseas tribunal by the foreign investor by-passing the domestic courts. This is an issue that raises constitutional problems, particularly in a state which is based on a doctrine of separation of powers. It is a problem which has not been carefully thought out.

The more recent development is the issue as to whether portfolio investments should be included within the definition of foreign investment. There are obvious instances of more recent treaties which have included portfolio investments within the definitional provisions of investment treaties. The issue arises as to whether such investments should be included. Certainly, their inclusion goes against the grain as portfolio investments do not fall within the accepted definitions of foreign direct investment for which investment treaties have so far been devised.

Sovereignty and the Scope of Protection.

The problem that arises with treaties on investment is that they seek to internationalize processes that take place entirely within the territory of a state. Unlike the principles of international trade, which apply to measures such as tariff and are confined to issues that apply to entry at the borders of states, foreign investment treaties deal with operations of the multinational corporation within the territory of the host state. These treaties therefore intervene in matters that would normally be considered essentially within the domestic control of the host state. As a result, the obligations in investment treaties restrict the sovereign control that a state might otherwise have had over the foreign

⁸ . See Amco v Indonesia; Billoume v Ghana; and Metalclad v Mexico.

investment. There is a clear conflict of interests here. On the one hand there is a need to bring about of external standards of foreign investment protection, as it promotes investment flows. On the other, there is a need for the protection of sovereign control over foreign investment both from the point of view of maximizing the benefits of foreign investment and avoiding the harmful effects of it. A successful investment treaty must bring about an effective reconciliation between these two different interests.

There are several strategies that have been adopted in effecting this reconciliation between these seemingly incompatible interests. The manner of the reconciliation of these interests will always have an effect of restricting the scope of the treaties.

The first is that attempted in NAFTA and the United States bilateral treaties. This is to craft a treaty containing wide definitions of foreign investment. But, it leaves out of the definition of investments such flows of capital as would not have the beneficial effects that are normally attributed to foreign direct investment in any significant measure. Loans to enterprises are expressly excluded. When referring to concessions as falling within the definition of foreign investments, the NAFTA provision restricts this to concessions having a "commitment of resources in the territory of a Party to economic activity in such territory".⁹ But, otherwise, the definitional provisions are located in a treaty that provides very effective standards of protection and treatment to foreign investment, seemingly leaving little control in the host state. Host state control, however, is provided by the fact that there could be exclusion of sectors of the economy from the scope of the investment Chapter of NAFTA. The United States itself has a list of these sectors. Mexico has a longer list. The merit of this approach is that it provides effective investment protection. However, the leeway it provides the host state is limited as the emphasis is almost entirely on the protection of foreign investment. Also, there could be progressive pressure brought upon weaker states with which treaties have been concluded to remove sectors from the list in the course of later bargaining. The NAFTA model is weighted in favour of the interest of investment protection and does not reconcile effectively the competing interest of sovereign control in the public interest.

The second method that could be found in South-east Asian treaties is to confine the benefits of the investment treaties to "approved" investments. This technique is used in many South-East Asian countries, including Singapore. The practice is widespread, the regional investment treaty, the ASEAN Treaty on the Promotion and Protection of Foreign Investment contains the limitation that it applies only to investments "approved in writing". The protection of the treaties is confined to investment that have the approval of these states, even in situations where the treaty partners are prepared to give blanket approval to all investments. This shows the inequality in status between the treaty partners. Between the partners, especially in the situation of bilateral treaties, both do not receive equal amounts of investment. The developing state which receives the large amount of the investments is more conscious of the need to protect its sovereignty than the developed state partner which may receive just a trickle and is quite confident that its sovereignty will in no way be impacted by the treaty. The developing states which use this method seek to

⁹ . Para (d) and (i) of the definition provision.

ensure that the protection of the treaty is confined to those investments which have gone through their approval procedures and are found to enhance their economic objectives.

A third method used in some treaties is to define the foreign investment that is protected in such a manner as to subject protection to the laws and regulations of the host state. This ensures that the foreign investment is able to claim protection only to the extent that it complies with the laws and regulations of the host state. The formula used is to protect foreign investment made "in accordance with the laws and regulations from time to time in existence". This is a wide and subjective restriction which can be found in the treaties of Indonesia, Australia, China and more recently, Malaysia. While there is no doubt that such a restriction conserves the sovereignty of the host state, the question that it raises is whether such a wide restriction creates any meaningful obligations between the parties. Subjective reservations like the one found in the US-Russia treaty have been held to emasculate the investment treaties of any meaningful content. The restriction of the protection of foreign investment to those made "in accordance with the laws and regulations from time to time in existence" has the effect of robbing the treaty of any definite obligation as the foreign investment could be moved in and out of treaty protection by changing laws or regulations. True it is that sovereign control over foreign investment is ensured by the use of this formula but the formula makes the investment treaty almost as useless as a non-binding comfort letter.¹⁰ It is in the context of the existence of such a large number of these treaties that the lofty opinions that investment treaties can create customary international law is becomes a laughable proposition.

Yet another technique is to preserve control over certain regulatory activity by excluding them from the scope of the investment treaty. The Canadian investment treaties adopt this strategy as far as environmental measures are concerned. This may also have been as a result of Canadian experience with the Ethyl Case. The position may also have been influenced by the opposition to the Multilateral Investment Agreement by environmental groups which thought that the MAI emphasized protection of multinational corporations without paying any regard at all to the capacity of multinational corporations to cause pollution. If the problem of the abusive multinational corporation has to be meaningfully dealt with, there should not be piecemeal addressing of issues but a whole range of factors, including human rights violations and violations of labor standards will have to be dealt with. But, the Canadian treaties evidence a breach having been made in the practice of at least one influential state. Bringing about exceptions that are so broad again will have the impact of adding to the problems that already exist. The issue has relevance to the taking provision as the fear is that environmental measures may, otherwise exempted, amount to a taking. But, so could other public interest measures that are taken. It could well be that these provisions may eventually work towards the creation of a code of conduct for multinational corporations. This is quite the reverse of creating a customary law on investor protection as these treaties originally designed to achieve such an objective may lead to the creation of norms that indicate the behavior of multinational corporations. They could make

¹⁰ . There was much debate as to whether the subjective declaration of the United States on the basis of the Connolly Amendment could create any obligation in respect of the Optional Clause referring disputes to the jurisdiction of the International Court of Justice. The better view was that it did not create any obligation in terms of international law.

protection dependent on the conduct of multinational corporations in host states. These are also norms advocated in some investment instruments, particularly the APEC Guidelines.

Exclusion of interests: Another technique is to identify the type of transactions that are not protected. This technique to a large extent depends on the understanding of foreign investment as involving assets that are taken in to another state to be used in ventures that last for long periods and produce profits. Once this definition is accepted, it is obvious that certain types of cross-border transfers of economic interests cannot be regarded as investments and should not be protected by the treaties. These types of interests are often identified in the treaties and are specifically excluded from their scope.

Portfolio investments : The most obvious among these interests are portfolio investments. Some treaties do specifically include portfolio investments. But, some specifically exclude them.¹¹ The case for the inclusion of portfolio investments is that if the promotion wealth flows are the primary motive behind treaty protection of investments, their inclusion may appear logical. The trend towards liberalisation in the movement of capital assets also favours such inclusion. But, the successive economic crisis indicate that the sudden flight of capital could have adverse effects on the economy. The Asian economic crisis certainly led to the belief at least among many Asian states and commentators that untrammelled flows of portfolio capital may not be advantageous. The capital controls instituted by Malaysia certainly did indicate that there could be investment flows despite the fact that the equity markets come to be strictly regulated and liberalisation of asset flows are curtailed.

From the point of view of dispute settlement, the problems attending the inclusion of portfolio investment within the definition of foreign investment were evidenced by the decision in Fedax v Venezuela. In that case, promissory notes issued by the government of Venezuela to one of its citizens was involved. The situation was, obviously not covered by any investment treaty as a non-national from a treaty state was not involved. The notes were then transferred to a company in the Dutch Antilles whose investments were protected by the Holland-Venezuela treaty. The tribunal, which had jurisdiction under the treaty provisions upon their invocation by the investor, provided relief to the Dutch company for non-payment on the notes. Some may find the situation a difficult one to explain. Relief is created merely by transfer from a non-protected person to a protected person. The extent of the obligations of the treaty and to whom they are owed cannot be known at any stage by the state as these instruments keep circulating. A state which voluntarily assumes these obligations must have to bear the burden. But, the issue is whether the state had really contemplated the possible situations when it made the treaty.

Fedax also throws light on how an arbitral tribunal would approach the issue of the definition of investments. In the ICSID convention, the term investment was left undefined, though the Convention itself was intended to apply to foreign investment disputes.¹² The

¹¹ . Eg. The ASEAN Framework Agreement on Investment contains a whole article which indicates that portfolio investments are not protected by the agreement.

¹² . The first draft of the Convention had defined investment as "any contribution of money or other assets of economic value for an indefinite period, or if the period be defines, for not less than five

argument of Venezuela was that promissory notes did not qualify as investments as investment "in an economic context means the laying out of money or property in business ventures, so that it may produce a revenue or income". The Tribunal rejected this view, focussing on the definition of foreign investment in the Venezuela-Netherlands treaty which included "titles to money, or other assets or any performance having an economic value". Though portfolio investment may not be similar to promissory notes, the fact is that they are not primary instruments and circulate in the market. Their inclusion in treaties could mean that the simple expedient of transferring them to a corporation that has protection will engage treaty protection.

Claims to money: NAFTA makes a distinction between loans made to enterprises and loans that arise in connection with other transactions such as sales or other commercial transactions.¹³ The former, in certain circumstances, is regarded as investment but the latter is not. The distinction, obviously hinges on whether the capital that flows produces value that benefits the host state and is therefore worthy of protection by the state.

Economic Development and the Scope of Definition of Foreign Investment.

There is lip service paid to the idea that foreign investment should promote the economic development of the poorer states and that this should be reflected in the investment treaties that are made. The declarations of states on the subject include pious hopes that investment treaties address the issue of economic development. The accommodation of economic development objectives in the scope and definition of investment in treaties will pose great problems. If the view of economic liberalism that foreign investment uniformly benefits economic development is accepted, there will be no problems in this regard. That is the assumption that is made in most of the literature that has appeared on the subject of investment treaties. Since foreign investment promotes economic development through capital formation, infrastructure upgrading and employment creation, the assumption made is that a strong treaty with great scope and comprehensive definition of foreign investment will promote economic development. That has not been borne out by experience.

Competing views would have it that host states should seek to ensure that foreign investment meshes in with their economic objectives. But, this possibility may be defeated by treaties that contain inflexible standards that restrict the control of the host state by creating strong external standards. The use of performance requirements is a case in point. They are now barred by TRIMS as well as by provisions in some bilateral and regional investment treaties.¹⁴ It is to conserve their control over foreign investments and ensure that they tie in with their development objectives that developing states seek to restrict the scope of the protection of the investment treaties to those investments that are "approved in writing" or those that are made "in accordance with the laws and regulations from time to time in existence". But, such restrictions considerably whittle the scope of protection of investments and make the balance tilt too far against investment protection. The dilemma of

years". Clearly, portfolio investments for short duration or any short term capital would have been excluded.

¹³ . The distinction appears in NAFTA. Para d, i and h.

¹⁴ . NAFTA and the US treaties provide the best examples.

course is that there can be no definition that can embrace all possibilities. There must be a decision on every investment on an ad hoc basis. The screening procedures are designed to achieve this. The intent in the existing formulae is to preserve the conditions attached to entry. But, care must be taken to ensure that the host state does not have the power to withdraw the protection of the treaty simply by enacting legislation. The existence of such a power would make the treaty devoid of any meaningful obligations.

Yet, the preservation of the host states interests must be reflected in the definition and the scope of the foreign investment. Most of them are stated in the investment codes of the different states. The problem is to capture them in the treaties. Thus, for example, the host state would be keen to see that there be no soaking up of internal savings by the foreign investor and that the foreign investor brings capital from outside the host state to make the investment.¹⁵ This should be reflected in the treaty by confining the meaning of foreign investment to capital brought from outside so that there is real foreign investment that could benefit economic development. So too, in the case of technology transfer, the issue of whether there is meaningful and effective transfer made, the circumstances under which compulsory licensing is permissible will have to be ironed out. A blanket protection of technology cannot achieve the objective of economic development. Protection of concessions relating to natural resources again must be proportionate to the benefits that investments bring into the state, a controversial issue from old times.

Many developed states like Canada advocate flexibility in treaties so that regulation in the public interest is not curtailed by investment treaties.¹⁶ In the case of developing states, that public interest is accentuated by the need to promote economic development. The dilemma for developing states in participating in investment treaties is made greater for while their treaty partners will concentrate on protection, they have to secure their interests by using their weaker bargaining power to secure their developmental interests. They may not be able to succeed entirely. In their eagerness to attract foreign investment, they may accept such unbalanced treaties. But, the problems arise only after such treaties are made. Investment treaties that emerge may not contain the required balance to make them successful. The challenge is to make a treaty with the required balance.¹⁷

The principal way that states in the Asian region seek to capture their developmental goals in the investment treaties is to preserve their control at the point of entry of investment. This is the reason why protection is confined to investments "approved in writing". The ASEAN Investment Treaty goes further by spelling out that protection is

¹⁵ . An issue raised in Amco v Indonesia, where despite the fact that there was no proof that capital was raised from outside the state, there was relief provided to the foreign investor, by the arbitration tribunal.

¹⁶ . WTO Working Group on the Relationship between Trade and Investment, Communication from Canada, WT/WGTI/ W/113 (12 April,2002) : "It will be important for such a definition (of foreign investment) to embody flexibility, both for development and other policy objectives" Also see para. 9: "Investment activity by foreign firms supplements domestic sources of capital and know-how, and in general is of net benefit to the host economy. While we therefore believe that the international framework should not in general provide for discrimination nor capricious activity, at the same time it should accommodate sufficient flexibility for the state to regulate in the public interest".

¹⁷ . It is necessary to note that the argument that unbalanced treaties are unequal treaties has been made.

subject to conditions imposed at the time of entry being honoured by the multinational corporation. These conditions almost always will be to ensure that development goals are respected.¹⁸ The other technique is adopted in the treaties of China which confines protection to foreign investment "made in accordance with the laws and regulations of China". This again ensures that control is exerted at the point of entry to ensure that there are sufficient directions given to the investor to ensure that the investment promotes development goals of the state. These limitations are based on the state's undoubted control over admission of aliens. They can legitimately be resorted to by states which have not accepted pre-establishment rights in multinational corporations of other state parties.

The Canada-Thailand treaty incorporates in an annex virtually the whole of the Thai laws on foreign investment which reflect that country's development objectives.

The formula used in the Indonesian, Australian and the newer Malaysian treaties goes a bit further. As indicated this formula adds the phrase "from time to time in existence" to the phrase indicating subjection of the foreign investment to the laws and regulations of the host state. This addition would mean that foreign investment that is initially given protection could move out of the protection due to later changes in the law. Such a situation is unsatisfactory from the point of view of protection and as earlier concluded, it is to be doubted whether such treaties create meaningful obligations.

Limiting Scope through Definition of the Investor.

The definition of an investor is also crucial in determining the scope of the investment treaty. Customary international law, as indicated earlier, operated on the basis of nationality and the diplomatic protection of nationals abroad as the basis of investment protection. The link of nationality was crucial and it was established by such factors as citizenship, long residence and other factors indicating loyalty and intentions of the individual. In situations where the investor had the nationality of both the claimant and the respondent states, it is the dominant nationality which mattered. The situation is not different under investment treaties, which seldom spell out the nature of the link that is necessary for protection. They leave the matter to customary international law.¹⁹ The definition of an investor is crucial to the investment treaty as treatment standards, rights of repatriation of profits, investor-state dispute resolution are made available to the investor and a structure is created within the context of which investor rights are created. The creation of such rights in a multinational corporation is an innovative feature of modern international law achieved by treaty. Given the enormous economic and political power that a multinational corporation wields in international relations, the significance of this elevation in its status as a wielder of direct power should not be underestimated.

¹⁸ . For an interesting instance of such a condition being litigated see *Amco v Indonesia*. The condition was that the project should be capitalized from outside Indonesia.

¹⁹ . The Multilateral Investment Guarantee Agreement deals with the issue by making the nationality of the host country prevail but this is a multilateral treaty that provides insurance guarantees and operates in a different context.

In the case of natural persons making foreign investments, the problem does not arise with the same acuity as it does in the case of multinational corporations. The nationality of natural persons is largely dealt with in treaties the same way that it would be dealt with in customary international law or is sometimes dealt with in accordance with the domestic constitutional and other laws of each state party to the treaty.. Dual nationality poses a problem in situations where the foreign investor has the nationality of both contracting states. Case law exists which deals with such issues.²⁰ In that context, the definition of natural persons poses few problems.

It is the nationality of corporations that causes concern. The definition of corporations entitled to protection becomes an issue because of the manner in which the modern multinational corporation is organized and operates in international business. The network of parent and subsidiaries throughout the world makes the linkages that are the basis of nationality diffuse. As a result, the issue of precise definition of the link that is necessary for the basis of protection becomes difficult. For the purposes of analysis, three different tests could be isolated. In a sense, the different tests follow the practices that are adopted by the different legal systems as to the identification of corporate nationality.

Incorporation : The first is based on the place of incorporation. The corporation's nationality belongs to the state in which it is incorporated. This is the test that most accords with customary international law as recognised in the Barcelona Traction Case. It also accords with the practice of the United Kingdom which is followed by the states of the Commonwealth. As a result, the test receives a wide geographic coverage. Incorporation is the test that is used in English company law as well as English conflicts of law for the identification of corporate nationality and is followed in the common law world, with the exception of the United States.

The advantages of the test is that it is certain. But in terms of protection, it leads to artificial results. A corporation totally unrelated to a state may have to be given protection simply because it is incorporated in that state though it does not have any other significant link like doing a volume of business in that state. Some host states may not mind this. Some states like Singapore, a small entreport state, encourage companies setting up there and moving business to other states like Indonesia or China from there as some flows of money move through Singapore as a result. Such a platform concept disregards the issue as to whether the company has to be protected as protection, both under customary international law and under treaty law is discretionary. But, not all states would take such a position.

They may refuse to give protection to corporations which do not have real links with their state. The host state also has an interest in the situation because it will not want to give protection to corporations of third states which seek protection through the device of incorporation in the home state. This may be because the third state does not have the obligation of investment promotion, which is an aspect, albeit illusory, of investment

²⁰ . There is recent and rich case law on double nationality generated by the Iran-US Claims Commission. See Charles Brower and Jason Brueschke, The Iran-US Claims Tribunal (1998) pp.288-320.

treaties. Also, reciprocity, (again illusory because most investment flows are one way, there being a dominant partner in all these treaty relationships), is the hall mark of investment treaties. For these reasons, some states insist on additional requirements besides incorporation.

The seat theory: The seat theory of corporate nationality is prevalent in continental legal systems and the treaties of European states adopt this theory in their statement of corporations entitled to treaty protection. Its use is exemplified in Article 48 of the European Community as follows:

"Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of Member States".

The provision in Europe is relevant particularly for ensuring establishment rights of a company incorporated in one country in another member country and to that extent has parallels with investment treaties.²¹ The treaties of France, Germany and Switzerland use the seat theory and the theory has found its way into treaties of states influenced by civilian systems. Thus, the ASEAN Investment Treaty strangely requires incorporation and effective management of the corporation in a member state before protection could be given.²²

The seat theory gets over the problem of the so called mail-box companies but its practicalities in the modern world where management is split or need not take place through actual presence are to be doubted. Companies can be managed effectively without the physical presence of senior management without its presence through video-conferencing or e-mail. The concentration on management in situations where production of the modern multinational corporation is split between several states is impractical. It is a theory that was meant for more salubrious days. It lacks the simplicity and certainty of the incorporation theory.

The American practice: The United States treaties have developed their own practice in this regard. They adopt a test of incorporation or organization along with a criterion of ownership and control. This ensures that there is a genuine link between the state and the corporation which claims protection. But, the country of ownership or control may be a fluctuating criterion, particularly if the shares of the company are traded on international stock markets. It may create some uncertainties. Where ownership or control criteria are used, it is usual to require majority control which means over 50 per cent of the shares in the company. The Algiers Accord setting up the Iran-US Claims Tribunal used such a formula and there is considerable case law on this. Again, such quantitative criteria

²¹ . Peter Behrens, "International Company Law in View of the Centros Decision of the ECJ" (2000) 1 European Business Organization Law 125.

²² . Strangely because of the original members who made the treaty, Singapore, Malaysia and Brunei are common law states. Thailand and Indonesia are civilian influenced systems. The Philippines which has consistently used the requirement of effective management in its treaties is a mixed system.

may be meaningless in situations where minority groups control a company due to various factors depending on the company structure or acceptance of their superior management skills by the other shareholders.

Mihaly International Corporation v Sri Lanka is a recent case which raised issues of corporate organization and structure in a multinational context.²³

Conclusion.

The scope and definition in a foreign investment treaty are crucial in effecting a balance within the treaty between the competing interests of investment and investor protection and the extent of the control a state retains to protect its public interest and economic development goals. The success of the treaty depends on the bringing about of such a balance. Excessive emphasis on protection will lead to disenchantment, particularly where a state feels that it has been locked into a situation in which it cannot protect its national interests. Excessive concern for state sovereignty will result in treaties that may not promote the desired inflow of foreign investment. These concerns must be kept in mind in ensuring that the treaty that is made reconciles effectively the competing interests of the participating states.

²³ . ICSID, ARB/00/2.

Standards of Treatment: National Treatment,
Most Favored Nation Treatment and Minimum
Standards of Treatment

Andrea Menaker

“Standards of Treatment: National Treatment, Most Favored Nation Treatment & Minimum Standards of Treatment”

Ms. Andrea Menaker

NAFTA Arbitration Division
U.S. Department of State

It's a pleasure to be here today in Mérida at APEC's investment conference, and I'm honored to speak in the company of the distinguished members of this panel. Today, I've been asked to talk generally about the treatment provisions that exist in the North American Free Trade Agreement, and to specifically focus on the general treatment provision in light of the Free Trade Commission's Interpretation of that provision. I hope that these comments are useful to you, and that they provide you with some food for thought as you all continue to negotiate investment agreements within the APEC community and, perhaps, even in the broader context of the WTO.

Very briefly, let me describe to you my position with the U.S. Government. I am an attorney-adviser in the Office of the Legal Adviser for the U.S. Department of State. Our office defends the United States in international arbitrations of claims brought by Canadian and Mexican investors pursuant to Chapter Eleven (the investment chapter) of the NAFTA. My office also makes submissions in cases brought against Canada and Mexico, pursuant to a provision of the NAFTA which provides that a non-disputing State Party may make submissions concerning interpretations of the treaty in cases in which it is not a respondent.

Today, I'm going to make a few very brief remarks on national treatment and most-favored nation treatment. I will reserve the bulk of my presentation to address the minimum standard of treatment as set forth in NAFTA Article 1105(1) and, I will focus particularly on the NAFTA Free Trade Commission's interpretation of that Article. The remarks that I make today are reflective of positions taken by the United States in cases brought against it and in cases against Canada and Mexico in which the United States has made submissions. I invite you all to take a look at these various submissions, which explore these issues in greater depth than I can do here in this limited time. These submissions are posted on the Department of State's website and can be accessed at www.state.gov/s/l.

National Treatment & Most-Favored Nation Treatment

Articles 1102 and 1103 of the NAFTA provide for national treatment and most-favored nation treatment, respectively. The national treatment provision obligates a NAFTA Party to accord to investors and investments of investors of another NAFTA Party treatment that is no less favorable than it accords in like circumstances to its own investors and their investments with respect to the establishment, acquisition, expansion,

management, conduct, operation, and sale or other disposition of investments. The most-favored nation treatment provision is the same except it provides that this treatment must be no less favorable than the treatment accorded by the NAFTA Party to investors and investments of investors of third Parties. Both of these provisions establish relative standards of treatment. Under these provisions, the treatment to which the investor is entitled is dependent upon the treatment that the host country accords to its own nationals or to the nationals of a third country, as the case may be.

The determination of whether there has been a national treatment or most-favored nation treatment violation is very fact specific. For instance, there are bound to be disputes regarding who or what group is in like circumstances with the claimant. Today, however, I will briefly comment on two issues that have arisen in cases in which the United States is a respondent and which, I believe, deserve some attention.

Both issues stem from the disturbing tendency of claimants to fail to fully comprehend what constitutes an investment dispute, as opposed to a trade dispute. The first issue I want to address is a failure to differentiate between discrimination on the basis of national origin of a good, on the one hand, and discrimination on the basis of nationality of an investor, on the other. As you all know, a national treatment provision in an investment agreement provides protection against the latter type of discrimination, that is, discrimination against investors on the basis of nationality. Discrimination against goods based on national origin is dealt with exclusively in trade provisions.

So, for example, a claimant will not be able to establish a violation of Article 1102 if it only demonstrates that a NAFTA Party provides a preference to goods containing U.S., Canadian or Mexican content. Instead, a claimant must establish that the NAFTA Party accords better treatment to U.S., Canadian or Mexican investors that manufacturer or market a certain good or to U.S., Canadian- or Mexican-owned investments that manufacture or market a certain good. This issue has arisen in at least one claim against the United States – a claim filed by *ADF Group*.¹ We just recently concluded the oral hearing in that case so we do not yet have a decision on this point. We believe, however, that this is an important point of distinction between trade and investment, and we hope that tribunals understand this.

The second issue concerns the fact that in order for an investor to establish that it (as opposed to its investment) has been denied national treatment, it must demonstrate that it has been accorded less favorable treatment, on the basis of nationality, with respect to its

¹ See, e.g., *ADF Group, Inc. v. United States of America*, Transcript of Proceedings (Apr. 17, 2002) at 576-77 (ADF claiming that because “that inventory has 1-percent content other than the United States, that inventory cannot be used to do business with us . . . [and, thus] [t]he measure facially discriminates on the basis of nationality in respect of that investment.”); compare with *id.* at 723 (United States claiming that Article 1102 “does not preclude discrimination based on the national origin of a particular good. . . . [However,] [o]ne may not discriminate against an investor on the basis of its nationality, and one may not discriminate against an investment based on the nationality of that investment’s investor”). See also *ADF Group, Inc. v. United States of America*, Counter-Memorial of Respondent United States of America on Competence and Liability (Nov. 29, 2001) at 38-39; *ADF Group, Inc. v. United States of America*, Rejoinder of Respondent United States of America on Competence and Liability (Mar. 29, 2002) at 27-28.

investment. NAFTA permits investors to file claims on their own behalf, as well as on behalf of their investments.² An investor may only file a claim on its own behalf, however, if it has incurred loss or damage in its capacity as an investor.

Some claimants, however, have argued that they can establish a national treatment violation where the only effect of the challenged measure on the claimant is that the claimant itself is restricted in supplying a good or service to the other NAFTA Party. In these instances, the measure does not restrict the claimants' ability to establish an investment in the other NAFTA Party. Nor does the measure impair the claimants' ability to manage, operate, control or dispose of its investment in the other NAFTA Party.

This issue has arisen in the *S.D. Myers* case filed against the Government of Canada, and in the *Methanex* and *ADF* cases brought against the United States. In all three cases, claimants have alleged that they (in addition to their investments, in some cases) were denied national treatment. The challenged measures, however, all impacted the claimants' ability to provide a cross-border good or service.

For example, in *Methanex*, California's proposed ban of MTBE had the effect of limiting the amount of methanol that Methanex would import into the United States from its plant in Canada. In *ADF*, the regulations providing that U.S.-origin steel be used in certain highway projects had the effect of prohibiting ADF from exporting steel that it had fabricated in its plant in Canada to the United States for use in those projects. In neither of these cases was the investor prevented from operating its investment in the other NAFTA Party in the manner in which it chose.³ In each of these cases, any foreign supplier of the good or service at issue would have been impacted by the challenged measure in the same manner as was the claimant, regardless of whether that supplier had an investment in the NAFTA Party that had adopted the challenged measure.⁴ This fact demonstrates that the treatment accorded to these claimants was not treatment with respect to the claimants'

² Compare NAFTA art. 1116(1) ("An investor of a Party may submit to arbitration . . . a claim . . . that the investor has incurred loss or damage") (emphasis added) & NAFTA art. 1102(1) (Each Party shall accord to investors of another Party treatment") (emphasis added) with NAFTA art. 1117(1) ("An investor of a Party . . . may submit to arbitration . . . a claim . . . that the enterprise has incurred loss or damage") (emphasis added) & NAFTA art. 1102(2) (Each Party shall accord to investments of investors of another Party treatment") (emphasis added).

³ See *Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility & the Proposed Amendment (Apr. 12, 2001) at 52-53 (stating that it is insufficient for Methanex to allege that it suffered harm as a result of its position as a supplier of methanol to the global market, and that its alleged injury must have been suffered by it in its capacity as an investor to implicate Chapter Eleven); *ADF Group, Inc. v. United States of America*, Counter-Memorial of Respondent United States of America on Competence and Liability (Nov. 29, 2001) at 42-43 (arguing that the measure did not negatively impact ADF Group with respect to the expansion, management, conduct or operation of its investment, ADF International); see also *id.* at 47-48 (stating that although S.D. Myers was "prevented . . . from importing PCB waste from Canada to remediate at S.D. Myers' plant in the United States, [the export ban] did not restrict S.D. Myers' ability to make investments in Canada, including investments in companies that marketed or provided PCB remediation services in Canada. This treatment of S.D. Myers, therefore, was not "treatment . . . with respect to . . . investments."").

⁴ See *Methanex Corp. v. United States of America*, Transcript of Proceedings (July 12, 2001) at 329-30; *ADF Group, Inc. v. United States of America*, Rejoinder of Respondent United States of America on Competence and Liability (Mar. 29, 2002) at 28 n.44.

investments. Rather, it was treatment that was accorded to those claimants solely in their capacity as suppliers of goods or services, and not as investors.

This too, we believe, is an important issue that warrants careful attention by tribunals. If this distinction is lost on tribunals, any claimant will be able to use investor-State dispute resolution to challenge a measure that relates solely to trade and does not affect the claimant in its capacity as an investor.

There are, of course, many more issues pertaining to the national treatment and most-favored nation treatment provisions in the NAFTA. Unfortunately, given the time constraints today, I will not have an opportunity to discuss these issues. Again, I invite you to review the United States' submissions made in the Chapter Eleven cases which are posted on the Department of State's website for a more detailed discussion of these obligations.

Minimum Standard of Treatment

I will now turn to discuss the main topic of my presentation, which is the general treatment provision. In the NAFTA's investment chapter, this provision is contained in Article 1105. Article 1105(1) requires a NAFTA Party to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." Unlike the national treatment and most-favored nation treatment obligations that I just discussed, the minimum standard of treatment is an absolute obligation. A NAFTA Party must provide this level of treatment regardless of the level of treatment it provides to investments of its own investors.

Over the course of several cases involving all three NAFTA Parties, a debate ensued over the scope of the obligation provided for in Article 1105(1). All three NAFTA Parties agreed that the obligation contained in Article 1105(1) was an obligation to accord investments of investors the minimum standard of treatment under customary international law.⁵ The "international minimum standard," is a reference to a set of rules regarding the treatment of aliens and their property that over time have crystallized into customary international law.⁶ Customary international law standards may be established by a showing of a general and consistent practice of States followed by them from a sense of legal obligation.⁷

The three NAFTA Parties also unanimously agreed that the references to "fair and equitable treatment" and "full protection and security" in Article 1105(1) did not expand

⁵ See, e.g., *Methanex Corp. v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 39-43; *Methanex Corp. v. United States of America*, Second Submission of Canada Pursuant to NAFTA Article 1128 (Apr. 30, 2001) at ¶ 26; *Methanex Corp. v. United States of America*, Letter of Mexico Pursuant to NAFTA Article 1128 (May 15, 2001) at ¶ 9.

⁶ See *Methanex v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 43.

⁷ See *ADF Group, Inc. v. United States of America*, Rejoinder of Respondent United States of America on Competence and Liability (Mar. 29, 2002) at 31.

the Parties' obligations beyond that provided for in customary international law.⁸ Indeed, the language of the Article compels this conclusion: you'll recall that Article 1105(1) provides that the Parties shall accord investments of investors treatment in accordance with international law, including fair and equitable treatment and full protection and security. The language thus makes clear that "fair and equitable treatment" is not an obligation that exceeds the Party's obligation under international law but, rather, is a concept that is to be applied as and to the extent that it is recognized in international law. And, as I mentioned, the three NAFTA Parties all agree that "international law" in Article 1105(1) references customary international law and, specifically, the customary international law minimum standard of treatment of aliens.

Before I summarize on what basis the United States came to these conclusions concerning the scope of the obligation provided for in Article 1105(1), I will describe the contrary interpretation urged upon tribunals by many of the claimants who have filed cases under Chapter Eleven. These claimants contend that Article 1105(1) requires the NAFTA Parties to provide more than the minimum standard of treatment for aliens under customary international law.⁹ They claim that the reference in Article 1105(1) to "international law" encompasses all of international law, and not just customary international law. Thus, according to these claimants, all of the conventional treaty obligations that a NAFTA Party has entered into are incorporated into that Article.¹⁰

In addition, they argue that the term "fair and equitable treatment" is a standard to be applied without reference to customary international law.¹¹ According to these claimants, a tribunal need only decide whether it deems the action challenged by the claimant to be "unfair" or "inequitable."¹² If it determines that it is, these claimants contend that there is a violation of Article 1105(1). One claimant has even gone so far as to

⁸ See, e.g., *Methanex Corp. v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 39-42 & n.53; *Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and The Proposed Amendment (Apr. 12, 2001) at 23-27; *Methanex Corp. v. United States of America*, Response of Respondent United States of America to Methanex's Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation (Oct. 26, 2001) at 6; *Methanex Corp. v. United States of America*, Second Submission of Canada Pursuant to NAFTA Article 1128 (Apr. 30, 2001), at ¶¶ 33, 39; *Methanex Corp. v. United States of America*, Letter of Mexico Pursuant to Article 1128 (May 15, 2001) at ¶¶ 9, 12.

⁹ See, e.g., *Methanex Corp. v. United States of America*, Claimant Methanex Corporation's Counter-Memorial on Jurisdiction (Feb. 12, 2001) at 8-11 & n.4; *Methanex Corp. v. United States of America*, Claimant Methanex Corporation's Rejoinder to the United States' Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment (May 25, 2001) at 33-35; *ADF Group, Inc. v. United States of America*, Memorial of the Investor (Aug. 1, 2001) at ¶¶ 221-228, 238, 243.

¹⁰ See, e.g., *id.*

¹¹ See, e.g., *id.*

¹² See, e.g., *Methanex Corp. v. United States of America*, Claimant Methanex Corporation's Submission in Response to the NAFTA Free Trade Commission Interpretation of July 31, 2001 (Sept. 18, 2001) at 3 (Article 1105 requires [the Tribunal] to determine, based on all the relevant facts and circumstances, whether the United States and the State of California treated Methanex and its investors fairly and equitably"); *ADF, Group, Inc. v. United States of America*, Memorial of Investor (Aug. 1, 2001) at ¶ 243 ("the Tribunal need only look at the treatment and determine itself whether or not such treatment – on its own – is in itself 'fair' and 'equitable.'").

suggest that the standard to be applied under Article 1105(1) is “Does it bother you?”¹³ If a tribunal finds that the challenged action does, indeed, “bother” it, then, according to this claimant, it may find a breach of Article 1105(1).¹⁴

Needless to say, the United States, along with Canada and Mexico, strongly disagree with this approach. Now, I’ll take a few moments to summarize on what basis the United States rejected claimants’ contentions regarding Article 1105(1) and the support it gathered for its conclusions regarding that Article’s scope.

First, the United States looked to the OECD Draft Convention on the Protection of Foreign Property, first proposed in 1963 and revised in 1967. Most scholars trace the use of the phrase “fair and equitable treatment” in international investment agreements back to this Draft Convention.¹⁵ The commentary to Article 1 of the OECD Draft Convention provides that the fair and equitable treatment standard “conforms in effect to the ‘minimum standard’ which forms part of customary international law.”¹⁶ More than fifteen years later, in 1984, the OECD’s Committee on International Investment and Multinational Enterprises surveyed the OECD member States on the meaning of the phrase “fair and equitable treatment.” The committee confirmed that the member countries continued to view the phrase “fair and equitable treatment” as a reference to principles of customary international law.¹⁷

The phrase “fair and equitable treatment” also appears in the general treatment provision in a series of bilateral investment treaties that the United States has negotiated with numerous countries. When the United States submitted those treaties to the United States’ Senate for advice and consent, in its submittal letters, it noted that the general treatment provision incorporated a minimum standard of treatment based in customary international law.¹⁸

¹³ *ADF Group, Inc. v. United States of America*, Transcript of Proceedings (Apr. 16, 2002) at 203-04. *See also id.* at 529-532 (containing U.S. response).

¹⁴ *See id.*

¹⁵ *See* UNITED NATIONS CONFERENCE ON TRADE & DEVELOPMENT, *BILATERAL INVESTMENT TREATIES IN THE MID-1990S* 54 (1998) (“The use of the standard of fair and equitable treatment in BITs dates from the OECD 1967 Draft Convention on the Protection of Foreign Property.”).

¹⁶ OECD, 1967 Draft Convention on the Protection of Foreign Property, *reprinted in* 7 I.L.M. 117, 120 (1968).

¹⁷ OECD, Committee on International Investment & Multinational Enterprises, *Intergovernmental Agreements Relating to Investment in Developing Countries*, ¶ 36 at 12, Doc. No. 84/14 (May 27, 1984) (“According to all Member countries which have commented on this point, fair and equitable treatment introduced a substantive legal standard referring to general principles of international law even if this is not explicitly stated”). *See also* UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS & INT’L CHAMBER OF COMMERCE, *BILATERAL INVESTMENT TREATIES 1959-1991* at 9 (1992) (“fair and equitable treatment . . . is a general standard of treatment that has been developed under customary international law.”).

¹⁸ *See, e.g.*, Dep’t of State, Letter of Submittal for U.S.-Armenia Treaty Concerning the Reciprocal Encouragement and Protection of Investment, Sept. 23, 1992, *reprinted in*, S. Treaty Doc. 103-11 at viii (1993) (provisions addressing “fair and equitable treatment” and “full protection and security” “set[] out a minimum standard of treatment based on customary international law”); *accord* Dep’t of State, Letter of Submittal for U.S.-Ecuador Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Aug. 27, 1993, *reprinted in* S. Treaty Doc. 103-15 at ix (1993); Dep’t of State, Letter of Submittal for U.S.-Estonia Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Apr. 19, 1994, *reprinted in* S. Treaty Doc. 103-38 at ix (1994); Dep’t of State, Letter of Submittal for U.S.-Georgia, Treaty

Finally, the United States took note of Canada's Statement of Implementation, published on the day that the NAFTA entered into force. That Statement notes that Article 1105(1) "provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law."¹⁹

In support of their contrary conclusion regarding the scope of Article 1105(1), claimants relied primarily on writings of publicists. In particular, claimants placed heavy emphasis on an article written by F.A. Mann published in the *British Yearbook of International Law* in 1981.²⁰ In that article, Mr. Mann opined that the obligation to provide "fair and equitable treatment" goes beyond the obligation to provide aliens with the minimum standard of treatment under customary international law.²¹

Decisions by Chapter Eleven Tribunals and Domestic Courts

I will now briefly describe several Chapter Eleven decisions that have addressed the general treatment provision prior to the issuance of the Free Trade Commission's interpretation of that provision.

The first Chapter Eleven tribunal to address the scope of Article 1105(1) was the *Metalclad* tribunal in a claim brought by a U.S. claimant against the United Mexican States. In August 2000, the *Metalclad* tribunal issued its decision finding, among other things, that Mexico had violated Article 1105(1) by failing to treat the claimant "fairly or equitably."²² In reaching this result, the tribunal relied on what it deemed to be violations of the

Concerning the Encouragement and Reciprocal Protection in Investment, Mar. 7, 1994, *reprinted in* S. Treaty Doc. 104-13 at viii-ix (1995); Dep't of State, Letter of Submittal for U.S.-Jamaica Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Feb. 4, 1994, *reprinted in* S. Treaty Doc. 103-35 at viii (1994); Dep't of State, Letter of Submittal for U.S.-Moldova Treaty Concerning the Encouragement and Reciprocal Protection of Investment, Apr. 21, 1993, *reprinted in*, S. Treaty Doc. 103-14 at ix (1993); Dep't of State, Letter of Submittal for U.S.-Mongolia Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Oct. 6, 1994, *reprinted in* S. Treaty Doc. 104-10 at viii (1995); Dep't of State, Letter of Submittal for U.S.-Trinidad & Tobago Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Sept. 26, 1994, *reprinted in* S. Treaty Doc. 104-14 at viii-ix (1995); Dep't of State, Letter of Submittal for U.S.-Ukraine Treaty Concerning the Encouragement and Reciprocal Protection of Investment, Mar. 4, 1994, *reprinted in*, S. Treaty Doc. 103-37 at ix (1994); Dep't of State, Letter of Submittal for U.S.-Uzbekistan, Treaty Concerning the Encouragement and Reciprocal Protection in Investment, Dec. 16, 1994, *reprinted in* S. Treaty Doc. 104-25 at viii (1996).

¹⁹ Dep't of External Affairs, *North American Free Trade Agreement: Canadian Statement on Implementation*, in CANADA GAZETTE 68, 149 (Jan. 1, 1994) (emphasis added).

²⁰ F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 *Brit. Y.B. Int'l L.* 241 (1981).

²¹ *Id.* at 244 ("The terms 'fair and equitable treatment' envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words. A tribunal . . . will have to decide whether in all the circumstances the conduct in issue is fair and equitable or unfair and inequitable. . . . The terms are to be understood and applied independently and autonomously.").

²² *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB (AF)/97/1 (Award) at ¶ 101 (Aug. 30, 2000).

transparency objectives of the NAFTA.²³ In the view of the United States and its NAFTA partners, the *Metalclad* tribunal wrongly relied on norms outside of the customary international minimum standard in applying Article 1105(1).²⁴

A few months later, in November 2000, the *S.D. Myers* tribunal held that the terms “fair and equitable treatment” and “full protection and security” “must be read in conjunction with the introductory phrase . . . treatment in accordance with international law.”²⁵ That tribunal, however, went on to find that a violation of Article 1102 – the national treatment provision – could, in some instances, and did, in that instance, establish an Article 1105(1) violation.²⁶ The United States, along with its NAFTA Partners, also took issue with this analysis.²⁷

The next tribunal to address Article 1105(1) was the *Pope & Talbot* tribunal. In April 2001, that tribunal found that Canada had breached Article 1105(1). In so finding, it made a determination that the standard of “fair and equitable treatment” was “additive to the requirements of international law.”²⁸ It made this finding despite indicating that the language of Article 1105(1) itself was at odds with this result.²⁹ All three NAFTA Parties

²³ *Id.* at ¶ 88 (“The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA.”); *id.* at ¶ 99 (“Mexico failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA.”).

²⁴ *See, e.g. Methanex Corp. v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 42-43; *Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment (Apr. 12, 2001) at 27-28 n.33.

²⁵ *S.D. Myers v. Canada* (Partial Award) at ¶ 262 (Nov. 13, 2000). In his separate opinion, Dr. Bryan Schwartz opined that “The interpretation and application of Article 1105 must, I tend to think, also take into account the letter or spirit of widely, though not universally, accepted international agreements like those in the WTO system and those typical of BITs.” *S.D. Myers v. Canada* (SEP. OP. of Dr. Bryan Schwartz) at ¶ 234 (Nov. 12, 2000). The United States disagrees with Dr. Schwartz’s statement. *See Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment at 30-31 & n.39 (setting forth disagreement).

²⁶ *S.D. Myers v. Canada* (Partial Award) at 66 ¶ 266 (Nov. 13, 2000). One of the arbitrators, Edward C. Chiasson, Q.C., disagreed with the majority on this point. He reasoned that “[b]reach of another provision of the NAFTA is not a foundation for [finding a breach of Article 1105(1)]”. *Id.* at ¶ 267.

²⁷ *See, e.g., Pope & Talbot, Inc. v. Canada*, Fifth Submission of the United States of America (Dec. 1, 2000) at ¶¶ 3-5.

²⁸ *Pope & Talbot, Inc. v. Canada* (Award) at 48 ¶ 110 (Apr. 10, 2001) (emphasis in original).

²⁹ *Id.* (“It is true that the language of Article 1105 suggests otherwise, since it states that the fairness elements are included within international law.”). Despite Article 1105(1)’s language, the tribunal found that the “fair and equitable treatment” standard was “additive” because it concluded that the language in the United States’ bilateral investment treaties did not subsume “fair and equitable treatment” under the umbrella of customary international law. *Id.* at 49 ¶ 111 & 52-55 ¶¶ 113-118. It then reasoned that the NAFTA Parties would not have intended to accord each other treatment that was less favorable than that which they granted to other countries in their bilateral investment treaties. *Id.* at 53 ¶ 115. The United States disagrees with the tribunal’s conclusion that the bilateral investment treaties contain a general treatment standard different from that contained in the NAFTA. *See Methanex Corp. v. United States of America*, Memorial on Jurisdiction and Admissibility of Respondent United States of America (Nov. 13, 2000) at 40-41 & n.53; *Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction,

found fault with the *Pope & Talbot* tribunal's reasoning.³⁰

The next significant decision on this issue was rendered by the Supreme Court of British Columbia. Mexico moved before this court to set aside the *Metalclad* award on a variety of grounds. In May 2001, that court issued its decision. For our purposes today, I will focus on the part of the decision that dealt with the Article 1105(1) claim. The British Columbia court found that the *Metalclad* tribunal had exceeded its jurisdiction by basing its finding of a breach of Article 1105(1) on conventional treaty obligations that were outside the scope of Chapter Eleven.³¹ It held that the phrase "international law" in Article 1105(1) referred to customary international law, as distinguished from conventional international law.³² The court held that the *Metalclad* tribunal exceeded its jurisdiction because it had "misstated the applicable law to include transparency obligations and it then made its decision on the basis of transparency" rather than "interpret[ing] the wording of Article 1105."³³

In its decision, the British Columbia court also noted its disagreement with the *Pope & Talbot* tribunal's analysis. It reasoned that the *Pope & Talbot* tribunal had ignored the express language in Article 1105(1) by interpreting the "fair and equitable treatment" obligation to go beyond that required by international law.³⁴

Free Trade Commission Interpretation

On July 31, 2001, the Free Trade Commission issued an interpretation of Article 1105(1) that should put an end to the debate surrounding the correct interpretation of this Article.³⁵ The Free Trade Commission is comprised of the trade ministers of the three

Admissibility and the Proposed Amendment (Apr. 12, 2001) at 26; *ADF Group, Inc. v. United States of America*, Rejoinder of Respondent United States of America on Competence and Liability (Mar. 29, 2002) at 40-41.

³⁰ See, e.g., *Methanex Corp. v. United States of America*, Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment (Apr. 12, 2001) at 26.

³¹ *United Mexican States v. Metalclad Corp.*, Supreme Court of British Columbia, 2001 BSCS 664 (May 2, 2001) at 27 ¶ 71 ("beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11.")

³² *Id.* at ¶ 62.

³³ *Id.* at ¶ 70. See also *id.* at ¶ 72 ("[T]he Tribunal made its decision on the basis of transparency. This was a matter beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11.")

³⁴ *Id.* at ¶ 64.

³⁵ See also RUDOLPH DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 59 (1995) ("Some debate has taken place over whether reference to fair and equitable treatment is tantamount to the minimum standard required by international law or whether the principle represents an independent, self-contained concept."); UNITED NATIONS CONFERENCE ON TRADE & DEVELOPMENT, *BILATERAL INVESTMENT TREATIES IN THE MID-1990S* 53-54 (noting debate); UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *KEY CONCEPTS IN INTERNATIONAL INVESTMENT ARRANGEMENTS & THEIR RELEVANCE TO NEGOTIATIONS ON INTERNATIONAL TRANSACTIONS IN SERVICES* 12 (1990) (same); Stephen Vasciannie, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, 70 *Brit. Y.B. Int'l L.* 99, 102-04 (1999) ("At least two different views have been advanced as the precise meaning of the term 'fair and equitable treatment' in investment relations. One possible approach is that the term is to be given its plain meaning The second approach to the meaning of the term suggests that fair and equitable treatment is synonymous with the international minimum standard in international law.")

NAFTA countries. Article 2001(2) of the NAFTA provides that the Commission shall, among other things, “resolve disputes that may arise regarding [the Agreement’s] interpretation or application.” Article 1131(2) of the NAFTA provides that “[a]n interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under [Section B of Chapter Eleven].”

On July 31, 2001, the Free Trade Commission issued an interpretation of certain provisions of the NAFTA. Specifically, the Commission issued interpretations pertaining to issues of confidentiality – which I won’t discuss here – and an interpretation of Article 1105(1), the minimum standard of treatment article. With respect to that latter interpretation, the Free Trade Commission came down clearly – and not surprisingly – on the side of the NAFTA Parties. It unambiguously stated that Article 1105(1) prescribes exactly what the NAFTA Parties had unanimously been telling tribunals that it does. The FTC Interpretation provides, in pertinent part, that:

- B. Minimum Standard of Treatment in Accordance with International Law
 - 1. Article 1105 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
 - 2. 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.
 - 3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

Paragraph one of the interpretation makes clear that the minimum standard of treatment in Article 1105(1) is, in fact, a reference to the customary international law minimum standard of treatment of aliens. It rejects the view that Article 1105’s reference to treatment in accordance with international law refers to *all* international law, including conventional law. Rather, as the NAFTA Parties have consistently contended, the standard of treatment to be afforded to investments of investors is that of *customary* international law.

Paragraph two of the interpretation confirms that the phrases “fair and equitable treatment” and “full protection and security” are to be applied only insofar as those terms are understood as part of the customary international law minimum standard of treatment of aliens. The interpretation thus rejects claimants’ position that those terms are to be applied without regard to customary international law. In particular, the interpretation makes clear that tribunals may only find a violation of Article 1105(1) if the claimant has identified a rule of customary international law that has been breached by the NAFTA Party. A tribunal may not predicate a finding of a violation on its determination that the NAFTA

Party has acted “unfairly” or “inequitably” based on the arbitrator’s own subjective notions of those terms.

Like the first paragraph of the interpretation, the third paragraph clarifies that Article 1105’s reference to “international law” is a reference to the customary international law minimum standard of treatment, and is not a reference to the entirety of international law. Thus, the third paragraph explicitly provides that a claimant’s establishment of a violation of a conventional international obligation does not establish a violation of Article 1105(1). This aspect of the interpretation clearly rejects the *Metalclad* tribunal’s approach of basing a violation of Article 1105(1) on a finding of a violation of transparency-related obligations that were not shown to be a customary international legal obligation. Similarly, the interpretation makes clear that the *S.D. Myers* tribunal’s approach of predicating its finding of a breach of Article 1105(1), not on a breach of a rule of customary international law, but, rather, on a breach of the conventional obligation contained in Article 1102, is incorrect.

Finally, this third paragraph indicates that arguments, such as those made by Methanex, which claims that the United States has breached Article 1105(1) by failing to comply with the WTO Technical Barriers and Sanitary and Phytosanitary Measures Agreements, should be rejected.³⁶ Similarly, arguments that Article 1105(1) is violated whenever it can be established that a NAFTA Party has failed to adopt the least trade restrictive measure to achieve its objective should also be rejected.³⁷ That concept is derived from WTO jurisprudence and is a conventional treaty obligation. In the United States’ view, the least trade restrictive principle is not a customary international law obligation, and no such requirement is therefore embodied in Article 1105(1).³⁸

* * *

That concludes my discussion today on the standards of treatment found in the NAFTA’s investment chapter. The next few months promise to be interesting as tribunals in cases filed against all three NAFTA Parties may be issuing decisions concerning the scope of NAFTA Articles 1102, 1103 and 1105(1). I hope that you’ve found these remarks useful, and at the close of the presentations, I will be happy to answer any questions you may have. Thank you.

³⁶ See *Methanex Corp. v. United States of America*, Claimant Methanex Corporation’s Draft Amended Claim (Feb. 12, 2001) at 58-65; .

³⁷ See, e.g., *Methanex Corp. v. United States of America*, Claimant Methanex Corporation’s Rejoinder to United States’ Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment (May 25, 2001) at 56-57.

³⁸ See *Methanex Corp. v. United States of America*, Rejoinder Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment (June 27, 2001) at 34-39.

Protection and Guarantees in Investment
Agreements

Alejandro Buvinic

Protection and Guarantees in Investment Agreements

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I. Introduction

The aim and purpose of all Bilateral Investment Agreements (BITs) is to grant protection to foreign investment since it represents one of the core elements of economic development. In this regard, protection is an essential part of every international agreement on investment. However, access to investment is not guaranteed in all agreements; hence, most of such agreements are entitled *Agreements for the Promotion and Protection of Investments*.

Investment protection is determined by the concepts of “investment” and “investor”.

“Who” can invoke protection alludes directly to the concept of investor. Most investment agreements cover both nationals (sometimes including permanent residents) and legal persons who are generally requested to have their real or effective venue, or their effective economic activities in the territory of one of the Contracting Parties. For instance, an Spanish citizen submitted a claim under ICSID against Chile. At the time of the submission of the claim, this natural person was enjoying the Chilean nationality and residence. Later, because of the political events occurred in the country, such person denied the Chilean nationality, retaking the Spanish one. In accordance to the BIT between Chile and Spain, this citizen should not be protected by the Agreement; otherwise, a question could be arisen in the sense whether the protection is applied to a national from another country that has denied the nationality of the host country.

“What” is the subject of protection is dealt in the concept of investment. As in the case of the concept of investor, the higher or lower investment protection will depend on the kind of agreement. In most bilateral agreements that consider an asset-based definition on investment, the coverage is practically boundless. However, it could be limited when investment is restrained to the applicable legislation at the time the investment is admitted. In the case agreements assure access, they are usually accompanied by a restricted definition on investment that limits the coverage of the protection. Consequently, if in a certain sector the national law grants only to nationals the possibility of developing an economic activity, protection will not exist in that sector since it is not covered by the agreement.

Besides the concepts of investor and investment, it should be paid attention to the coverage of the investment protection that is determined by the temporary coverage of the

Agreement. This aspect is addressed, most of the time, in the section concerning the scope of application of the Agreement, and it can be analysed from two perspectives: from the investment perspective or from the measures that affect the investments. Regarding investments, it is possible to grant protection to all existing and future investments, or the protection coverage could be limited only to future investments by the time of the entry into force of the Agreement. Moreover, it is possible to exclude from the scope of application the disputes that could be arisen before the entry into force of the Agreement or that are directly related with events or measures arisen before its entry into force.

The practice followed by Chile is to include in the coverage the investments already carried out, but excluding the facts or actions occurred before the entry into force of the agreement - and that could be the base for a dispute. It allows the host country to have the certainty that the protection will be related to future actions or measures. If such a limit did not exist, measures or actions occurred since decolonisation times, civil wars or de facto governments could be challenged. In the Chilean case, after the military *coup d'état*, several measures concerning good confiscation were adopted. Later, the arrival of democracy and the subsequent signing of BITs impeded the guarantee of protection with a retroactive effect regarding facts or acts that were not part of the responsibility of the signing government.

II. Foreign Investment Protection.

In general, the protection of foreign investment in BITs could be mainly found in the following provisions:

- National treatment (NT) and most favoured nation treatment (MFN).
- Minimum level of treatment
- The prohibition to impose performance requirements; and,
- Expropriation measures.

These forms of investment protection are assured by a dispute settlement mechanism that can be initiated by an investor against a host country. This characteristic makes this mechanism unique since - with the exception of some countries in human rights aspects - natural persons do not hold the status of subject of international law that could allow them to initiate an international claim.

Chile has concluded 45 Bilateral Investment Agreements; three of its Free Trade Agreements include investment chapter.

In our BITs, we have included measures of NT and MFN for those investments carried out in accordance with current legislation. All these agreements consider the fair and equitable treatment principle and rules on expropriation, both guaranteed by an investor-State dispute settlement mechanism.

Those Free Trade Agreements signed with Canada and Mexico - instruments which follows the NAFTA model - include the provisions on protection described above: NT, MFN, fair and equitable treatment, the prohibition of imposing performance requirements and rules on

expropriation. Additionally, access to investment is guaranteed by a negative list liberalisation scheme. Include the prohibition to impose performance requirements.

Recently, we have concluded the negotiations of an Association Agreement with the European Union whose commercial section includes chapters on services, financial services (both containing commercial presence) and investment in goods. For the first two, we used a positive list liberalisation scheme for market access and NT, following GATS model. Regarding investment in manufactures we incorporated a provision on establishment that grant NT, following a posit list approach. The BITs between Chile and each European country are still applicable since they contain the rules on minimum standard of treatment, expropriation and investor-State dispute settlement.

(i) National Treatment and Most Favoured Nation Treatment

Almost all BITs establish that host countries grant to foreign investors a treatment that is not less favourable than the treatment granted to their investor or investor from third countries. In the NAFTA model agreements, the understanding of the wording “*in like circumstances*” is a constant cause of discussion and the level of the protection will depend on the meaning of this concept. This concept has a relation with the level of protection. Besides, in the WTO and specifically in the services sector, these rules are considered whether as a general obligation (MFN) or as a commitment for commercial presence applicable only to those sectors listed in the countries’ schedules (market access and NT).

(ii) Fair and equitable treatment

This provision obliges signatory countries of an investment agreement to grant foreign investors a treatment in harmony with the minimum international standards of treatment being part of the Public International Law’s Customary Law. This provision has been part of a discussion derived from NAFTA Chapter XI Metalclad Case. Such a debate has led the recent signature of an understanding on fair and equitable treatment by NAFTA members.

(iii) Performance Requirements

Those agreements that have followed the NAFTA or the US-BIT model contains a provision that impede the Parties to impose performance requirements to foreign investors. Such a measure has the objective to influence the behaviour of investors by imposing conditions that are not market-based.

Traditionally, two types of performance requirements have been identified: mandatory performance requirements and incentive-related performance requirements. Mandatory performance requirements are conditions or requirements that are imposed at the pre-and/or post-establishment phases, i.e. for the establishment and/or operation of an investment. Incentive-based performance requirements are conditions that an investor must meet to secure a government advantage (subsidy) or incentive.

The WTO Agreement on Trade-Related Investment Measures (TRIMs) establishes an illustrative list of prohibited performance requirements which affect trade in goods, those

contrary to the principle of national treatment (Article III of GATT 1994), such as local content and trade-balancing requirements, and those inconsistent with the general obligation of eliminating quantitative restrictions (Article XI of GATT 1994), such as trade and foreign exchange–balancing restrictions and domestic sales requirements. The TRIMs Agreement applies to both mandatory and incentive-based performance requirements. Developed countries have the obligation of eliminating these performance requirements within two years from the date of entry into force of the WTO agreement and developing countries in five years. Notwithstanding, the Council for Trade in Goods may extend the transition period for developing and least-developed countries. In this regard, a few developing countries have obtained such a waiver.

(iv) Rules on Expropriation.

Expropriation is the golden rule on investment protection. Through this provision, the host State guarantees that only under certain circumstances, the investor can be deprived of the property of his investment.

In the majority of international agreements, the conditions for expropriation are virtually the same. Besides, most domestic legislations consider rules on expropriation or nationalisation in their supreme laws. In the case of Chile, all of its investment agreements include expropriation rules. Even when differing in language, the conditions established on these agreements are the same. Likewise, the Chilean Constitution guarantees the right to private property which could only be expropriated by reason of public interest and by means of a previous compensation. The origin and amount of such a compensation can be contested before a Tribunal.

Definition

Traditionally, the term *expropriation* has been understood as “an administrative act derived from a law through which the State deprives a person of his or her property whether in its favour or in favour of a third person. Such an act should be made with the payment of a previous compensation and by reason of a public cause which can only be met – all or in part – by carrying out the expropriation.”

Scope in International Agreements

In most international agreements or organisations (in the case of Chile in all its investment agreements), both direct and indirect expropriation have been considered. The definition of direct expropriation matches up the traditional concept just above mentioned. Nevertheless, the definition of indirect expropriation or of a measure tantamount to expropriation generally tends to foresee a disguised expropriation if the main effect of the act carried out by the State is to deprive the investor of his/her investment. In such a case, the objective of the protection granted is to prevent the State from actions that arbitrarily deprived an investor of his or her assets.

In this regard, indirect expropriation or a measure equivalent to expropriation means:

«Any measure or act carried out by a host country that substantially undermines the value of an investment and that not necessarily implies the acquisition by the government of the property of such an investment».

Since the concept of indirect expropriation or a measure tantamount to expropriation was included in international agreements, some concerns have been raised regarding the relationship between foreign investment protection and the regulatory power of the host country. The question to elucidate is where the dividing line between the host country's right to regulate an economic activity or announce regulations aimed at the protection, for instance, of the human health or the environment, and the right granted to a foreign investor - such as the integrity and security of his investment - is found.

Ethyl was the first case showing what a country could face in the event it considers necessary to adopt regulations that could affect investments and whose consequences could be financially catastrophic for a developing country.¹

Some countries had try to resolve this problem by the conceptualisation of indirect expropriation or a measure tantamount to expropriation though a illustrative lists: i.a. the establishment of excessive taxes, the requirement of technological compulsory licenses, or provisions that enables host countries to appoint managers or directors of enterprises. In fact, this aspect was one of the most controversial during MAI negotiations, becoming a spearhead for civil society to criticise the process. It should be recalled how sensitive environmental issues were in the negotiations as well as the limitations governments could have to announce regulations on this matter.

For developing countries that have recently made incursions into the international regulation sphere, and that are even in the first stage of the implementation of the WTO TBT Agreement, it is relevant to assess the implications of facing claims that are worth millions of US dollars as a result of genuinely exercising the right to regulate certain economic activities or announce laws needed to protect health or the environment. However, it is also understandable that investors who carried out substantial investments in accordance to existing national laws and regulation, then at a latter stage are limited in their assets by national authorities, seek a fair compensation for losses. For example, an investor that has established a plant in a certain place, getting all municipal authorisations in accordance to existing national regulation, is suddenly prevented from continuing his economic activity by reason of environmental protection. In this case, it seems fair to grant him a compensation.

¹ Ethyl Corporation, a US based company, filed a notice of intent to submit a NAFTA Claim for US\$200 million against the Government of Canada by arguing a harm to its subsidiary Ethyl Canada. Ethyl, the manufacturer of a gasoline additive used in Canadian gasoline since 1977, filed a notice of intent to submit a claim to arbitration for breach of the government's obligations under NAFTA. Ethyl alleged that the Government of Canada breached its obligations under three NAFTA provisions: Art. 1110 (Expropriation and Compensation), Art. 1106 (Performance Requirements), and Art. 1102 (National Treatment). As part of the settlement, the Government of Canada removed the measure which unfairly banned the investor's product; issued a statement clarifying that it had no evidence of harm caused by the product issued by two government Ministers and paid the company approximately \$20 million (Canadian).

However, some conflicts could emerge among different international fora:

A first case could be raised in the WTO environment. When a Member State makes compatible its domestic regulation, it could announce measures that could be considered indirect expropriations. An example is the *Pisco Case* in which the European Community contested the Chilean taxation system by arguing discrimination between domestic and imported products. Since the taxation system of Chile was old dated, a foreign investor could have existed in the Pisco sector who, noticing that now they will have higher taxes and his products will have competition with the imported ones, considered this action an indirect expropriation since the value of his investment had decreased.

Another example could be when a host country announces a new tariff decree in telecom sector provoking objections by investors in WTO by arguing not to be in conformity with its commitments. In this case, an investor could question the measure considering it an indirect expropriation can go to ICSID too. Then, a WTO panel decides that the measure is compatible and legitimate with the host country commitments. Nevertheless, a Tribunal could decide that the measure is certainly an indirect expropriation.

All these issues should be clarified and discussed in order to avoid uncertainty in the investment and regulatory fields. Further, it is needed clear and transparent rules for both governments and investors.

Conditions for expropriation:

The measure should be adopted for a public reason or purpose.

The measure should not be discriminatory.

The measure should be in line with a compensation.

There should be a due process.

Public reason or purpose

It is pointed out in all agreements that any expropriation measure should be based on the public interest. In most cases, the contracting parties pretend to include those concepts already considered in their own legislations; hence, we can find concepts such as public interest, common good, public benefit, among others.

Not discriminatory

An investor cannot be differentiated by reason of his nationality or even, among investors of the same origin.

Compensation

On compensation, there is the traditional *Hull* rule. It means that compensation should be prompt, adequate and effective. In the majority of the investment agreements, assessment methods for investment are established.

Due process

Granting the possibility to challenge the measure adopted or the amount of compensation before local Tribunals is part of our investment agreements.

Application of Most Favoured Nation Treatment

With respect to the differences in methods of assessment or in any condition to expropriate, the investor – via the MFNT clause – is able to invoke the better of the treatment given by the host country.

III. Investment protection in current negotiations and perspectives.

1. FTAA

The negotiations of the Free Trade Area of the Americas consider a chapter on investment in which investment protection provisions such as national treatment, most-favoured nation treatment; fair and equitable treatment and expropriation are established.

2. WTO

Paragraph 20 of the Doha Ministerial Declaration points out that:

“Recognising the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade, and the need for enhanced technical assistance and capacity-building in this area as referred to in paragraph 21, we agree that negotiations will take place after the Fifth Session of the Ministerial Conference on the basis of a decision to be taken, by explicit consensus, at that Session on modalities of negotiations.”

Moreover, paragraph 22 indicates that further work in the Working Group on the Relationship Between Trade and Investment will focus on the clarification of: scope and definition; transparency; non-discrimination; modalities for pre-establishment commitments based on a GATS-type, positive list approach; development provisions; exceptions and balance-of-payments safeguards; consultation and the settlement of disputes between Members.

What should be understood by “modalities of negotiation” as mentioned in paragraph 20 is a question that will be clarified in the next Ministerial Conference. In the meantime, the Working Group is analysing and discussing the elements identified in the ministerial mandate.

As can be noticed in paragraph 22 of the Declaration, the subject of investment protection is not established, but since it seems to be an illustrative list, investment protection could be part of the future debate. It is clear that the investor-State dispute settlement mechanism will not be part of an eventual multilateral framework on investment, but this does not impede countries to agree on rules such as the conditions that domestic laws should include by the time of expropriation: public interest, non-discrimination, fair compensation and due process.

Taking into account current rules, an interpretation could be used to indicate that part of the protection is covered by GATS MFNT provision. Being a general obligation, GATS MFN provision prevents countries from granting to service providers under the third mode of supply (commercial presence) a treatment that is less favourable than that granted to service providers in accordance with bilateral investment agreements. It is important to recall that since BITs do not meet GATS art. V requirements, they do not represent an exception to the MFNT.

For instance, country “A” carries out an expropriation that affects service providers of the telecommunication sector who have a commercial presence in that country. Country “B” has signed an investment agreement with country “A” including provisions on investment assessment. On the contrary, Country “C” has not signed any BIT with “A”. An investor from country “B” appeals country “A” arguing that the provisions used generated an amount that is smaller than the one that could be resulted from applying the BITs rules. On consequence, “A” modifies the measure and applies the methodology established in the BIT. In this regard, Country “C” could argue that “A” has granted “B” a treatment that is more favourable, demanding the same treatment.

However, such an interpretation is not the only one. It is necessary to recall that GATS text refers to “any measure covered by this Agreement”. Since the subject of expropriation is not expressly regulated in the GATS, it could also be interpreted that the MFN provision does not apply to this kind of investment protection.

Because of all implications and relationships on protection, it is important to continue discussions on this matter in order to reach an understanding in fields that are very sensitive such as: the relationship between the regulatory powers of the States and the right to compensation of foreign investors because of indirect expropriations; the relationship between bilateral investment agreements and the diverse on-going disciplines, and the link with the civil society with the aim of destroy the myths surrounding some concepts still unknown.

Investor - State Settlement of International
Investment Disputes. Recent Cases and
Interpretations

Ricardo Ramírez

“Investor - State Settlement Of International Investment Disputes Under The Nafta: Recent Cases And *Misinterpretations*”

Ricardo Ramírez Hernández¹

I. Introduction.

The Investor-State settlement provisions established a mechanism for the settlement of investment disputes that aim at assuring both equal treatment among investors of the Parties, in accordance with the principle of international reciprocity and, due process before an impartial tribunal. Clearly, the Investor – State mechanism established under NAFTA Chapter XI is becoming an important reference in the discussion of these types of mechanisms, basically because it is enclosed in an agreement that not only includes disciplines for the protection of the investor and its investment (i.e. bilateral investment treaties), but also includes market access disciplines in goods and services, as well as obligations in the area of competition policy.

The importance could be easily illustrated by the fact that 91 cases have been submitted at the International Centre for Settlement of Investment Disputes (ICSID), according to their web site. Since the entry into force of the NAFTA, 19 disputes have been initiated under the NAFTA and 14 tribunals have been or were appointed. The problems that this mechanism faces are key elements in the development of these types of mechanisms, especially in the APEC area. Thus, I will try to give an overview of some of the problems that Tribunals have been facing in applying procedural and substantive rules under Chapter XI.

Our presentation will be divided in three parts. We will start by briefly explaining the main features of this mechanism. In the Second Part we will analyze the problems in the application of jurisdictional/procedural rules by making a reference to the Ethyl case. In the Third Part we will analyze the problems in the application of substantive rules using the Metalclad case.

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I. Chapter XI

To make it easier, I will address the main features of Chapter XI in a question form.

- *Who may have recourse to Chapter XI?*²
 - i. The investor national of a NAFTA Party; or
 - ii. The investor on behalf of an enterprise.

- *On what grounds?*³

An investor may initiate a Chapter XI proceeding for violation of:

 - i. Section A of the NAFTA Investment Chapter; or
 - ii. Article 1503(3) or 1502(3)(a), when a state enterprise or a monopoly of the state acts in a manner inconsistent with section A; and

In both cases, due to such a breach the investor has incurred loss or damage.

Section A of Chapter XI of the NAFTA includes disciplines with regard to:

- *Most Favored Nation*⁴

An investor and its investment shall receive the same treatment that a Party gives to any investor or its investment of a third Party.

- *National Treatment*⁵

An investor and its investment shall receive the same treatment that a Party gives to a national investor or its investment.

- *Minimum Standard of Treatment*⁶

An investor and its investment shall received treatment in accordance with international law from a Party. We will address this discipline in detail when we analyze the application of substantive law.

- *Senior Management and broad of directors*⁷

No Party may oblige an enterprise to appoint to senior management positions individual of any particular nationality.

- *Performance requirements*⁸

No Party may impose or enforce in connection with an investment a requirement to export a given percentage of goods and services; to give preference to goods or services of a Party or to achieve a percentage of domestic content; to relate

² Articles 1116 and 1117 of the NAFTA (any reference thereafter to an Article should be understood to be Chapter NAFTA)

³ Articles 1116 and 1117.

⁴ Article 1103.

⁵ Article 1102.

⁶ Article 1105.

⁷ Article 1106

⁸ Article 1107.

the volume or value of imports to the volume or value of exports; transfer of technology, among others.

- *Transfers*⁹
No Party may impose restrictions to the freely movement of capital.
- *Expropriation and compensation*¹⁰
In the case a Party expropriates or takes a measure tantamount to expropriation, it has to be for a public purpose and on a non discriminatory basis. In that case, the investor has the right to be paid with a compensation equivalent to the fair market value of its investment; without delay and in a G7 currency or its equivalent on the date of payment.
- *When can an investor initiate a Chapter XI proceeding*¹¹
No later than three years, but not before than 6 months after the investor acquire or should have acquired knowledge of the alleged breach or loss or damage.
- *How will an investor initiate a Chapter XI proceeding*¹²
By presenting a notice of intent to submit a claim to arbitration 90 days before the claim is submitted.
- *Are there any conditions to the submission of a claim*¹³
An investor submitting a claim must express its consent in writing to arbitration and waive, if any, its rights to initiate or continue internal proceedings with regard to the same measure that is being challenge before the NAFTA tribunal. Notwithstanding, an investor may not waive its right to initiate or continue injunctive, declaratory or extraordinary proceedings that provide for a relief other than the payment of damages.
- *Under what rules will the arbitration be carry?*¹⁴
Arbitration could be carried in accordance with the following rules:
 - i. The ICSID Convention
 - ii. The Additionally Facility Rules of the ICSID
 - iii. The UNCITRAL Arbitration RulesSince Mexico is not a Party to the ICSID Convention, when the Mexican government or a Mexican investor are involved the arbitration could only be carried under the Additionally Facility Rules or the UNCITRAL rules.

⁹ Article 1109.

¹⁰ Article 1110.

¹¹ Paragraph 2 of Articles 1116, 1117 and 1120.

¹² Article 1119.

¹³ Article 1121.

¹⁴ Article 1120.

- *How is the tribunal comprised?*¹⁵
By three arbitrators. Each party to the proceeding selects an arbitrator and the third is agreed. If there is no agreement, the Secretary General of the ICSID will make the appointment from a NAFTA Roster and if it is not feasible from the ICSID Roster.
- *Where does the arbitration takes place?*¹⁶
Usually the place of arbitration is agreed by the Parties. If there is no agreement the place of arbitration must be a country member of the N.Y. Convention.
- *Do the other NAFTA Parties participate in the proceeding?*¹⁷
Under the NAFTA, the other Parties are entitled to receive all the documents submitted during the proceeding. Additionally, Parties may submit briefs regarding an interpretation of a NAFTA provision.
- *What is the Governing law?*¹⁸
The NAFTA and international law. Additionally, an interpretation made by the Free Trade Commission is binding for the Tribunal.¹⁹
- *What other powers does a tribunal have?*²⁰
An arbitral tribunal may appoint experts on any factual issue concerning environmental, health, safety or other scientific matters. Additionally, an arbitral tribunal may provide interim measures of protection which do not include the order attachment or enjoin of the measure reviewed.
- *What is the Content of the Final Award?*
An arbitral tribunal may:
 - i. award monetary damages and applicable interest;
 - ii. award the restitution of property (or pecuniary compensation in lieu of restitution); and
 - iii. not award for punitive damages.
- *How much time has a Party to comply with the award?*
Three months, in the case of a proceeding under the ICSID Additional Facility Rules or UNCITRAL Rules, and 120 days in the case of a proceeding carry under the ICSID rules.

¹⁵ Article 1123 y 1124.

¹⁶ Article 1130.

¹⁷ Articles 1127 y 1128.

¹⁸ Article 1131.

¹⁹ In accordance with Article 2001 of the NAFTA the Free Trade Commission is comprise by the three Ministers responsible for trade matters.

²⁰ Articles 1133 and 1134.

- *Is there recourse against an award?*
As in any arbitration proceeding, an annulment or revision proceeding may be initiated in accordance with the applicable law of the place where the arbitration took place.
- *What is the consequence of non-compliance of the award?*
If a Party does not comply with the award the investor may:
 - i. initiate enforcement proceedings in accordance with the applicable Convention; and/or
 - ii. ask its government to initiate dispute settlement proceedings under Chapter XX.

III. Compliance with Procedural Rules: the Ethyl Case

Ethyl Canada, a subsidiary of Ethyl U.S., brought this case. One of its principal activities was the production of a gasoline additive, which was made out of a mix of some substances, one of them called methylcyclopentadienyl manganese tricarbonyl (MMT). Ethyl imported MMT from its parent company. Canada banned the importation of MMT. Ethyl argued that the ban constituted a breach by Canada's of national treatment (1102), performance requirements (1106) and expropriation (1110) obligations. The banned was a violation on national treatment because there was not a banned for the production or sale of MMT in Canada. Additionally, Ethyl claimed that the banned constituted a "negative" performance requirement because it forced Ethyl to buy Canadian MMT instead of importing it. Finally, Ethyl claimed that the banned constituted a measure "tantamount to expropriation" because it will render Ethyl out of business in the production of this additive.

Since the case ended in a settlement between Ethyl and the Canadian Government, the tribunal did not render a decision on these issues. The only award rendered was with regard to the jurisdiction.

The Government of Canada's objected Ethyl's claim on the ground of jurisdiction. According to Canada, Ethyl failed to comply with the requirement of the NAFTA that six months had to elapsed before an investor may submit a claim to arbitration.

Articles 1119 and 1120 of the NAFTA provide that:

Article 1119

The disputing investor shall deliver to the disputing Party written notice of its intention to submit a claim to arbitration at **least 90 days before the claim is submitted**, which shall specify.....

Article 1120

Except as provided in Annex 1120.1, and provided that **six months have elapsed** since the events giving rise to a claim, a disputing investor may submit a claim to arbitration under...

The chronology of facts of the case was the following:

- The Notice of Intent was filed on September 10, 1996.
- Enactment of the Law which gave rise to the dispute, i.e. the banned of importing MMT was: April 25, 1997.
- Coming into force: June 24, 1997.
- The notice of arbitration was submitted on April 14, 1997.

The facts clearly show that Ethyl did not comply with the 6 months period require by the NAFTA. Based on this, Canada requested the nullity of Ethyl claim:

Because it had not adopted or maintained a measure with the meaning of Article 201 and because Ethyl failed to comply with Article 1119 through 1121 and 1137 of Chapter 11 of the NAFTA, the claim set out in the Statement of claim is null and void and this Tribunal is utterly without jurisdiction to entertain it.²¹

Conversely, Ethyl claimed that:

..Although the sixth month period referred to in Article 1120 was inapplicable in the circumstances it had elapsed.....and the fact that any of these requirements had not been fulfilled as of April 1997 has no jurisdictional significance.²²

The Tribunal clearly and correctly characterize the issue, namely, it had to determine whether the six months period was a jurisdictional or procedural requirement:

It is important to distinguish between jurisdictional provisions, i.e. the limits set to the authority of this Tribunal to act at all on the merits of the dispute, and procedural rules that must be satisfied by Claimant, but the failure to satisfy which results not in the absence of jurisdiction *ab initio*, but rather in a possible delay of proceedings followed ultimately, should such non-compliance persist, by dismissal of the claim. Canada argues that all of its objection fall into the first category, whereas Ethyl is of the view that such

²¹ *Ethyl Corporation v. The Government of Canada*. Award on Jurisdiction. 6/24/1998 (hereinafter referred as Ethyl award) at paragraph 45., Copy of these and other Chapter XI awards can be found at <http://www.state.gov/s/l/c3439.htm> or In their objection the Canadian Government also claimed that the act that established the ban was not enacted, and therefore, could not constitute a measure under challenge.

²² Ethyl Award at paragraph 46.

objections as may have been valid at once point fall into the second category and have since being obviated.²³

However, to address the issue the Tribunal went to the facts of the case to determine whether the delay of sixth months would serve for any purpose at all. First, it stated that no agreement would have been reached:

There also is an issue as to whether the six-month “cooling off period” should be applicable at all in this case, given the events discussed above. The Tribunal has been given no reason to believe that any “consultation or negotiation” pursuant to Article 1118, which Canada confirms the sixth-month provision in Article was designed to encourage, was even possible. It is argue, therefore, that no purpose would be serve by any further suspension of Claimant’s right to proceed. This rule is analogized to the international law requirement of exhaustion of remedies, which is disregarded when it is demonstrated that in fact no remedy was available and any attempt at exhaustion would have been futile.²⁴

Second, regarding the question whether to have waited the six months period would have any impact on the enactment of the measure at issue:

The Tribunal finds no need to address these arguments as to Articles 1119 and 1120 since the fact is that in any event six months and more have passed following Royal Assent to Bill C-29 and the coming into force of the MMT Act. It is doubted that today Claimant could resubmit the very claim advanced here (subject to any scope limitations). No disposition is evident on the part of Canada to repeal the MMT Act or amend it. Indeed, it could hardly be expected. Clearly a dismissal of the claim at this juncture would disserve, rather than serve, the object and purpose of the NAFTA.²⁵

In a nutshell, the Tribunal approached to the six-month rule as a procedural rule and concluded that because there was no purpose to resolve the issue and, the measure at issue would in any event have enter into force, there was no reason to dismiss the case on the grounds that a jurisdictional requirement was not fulfilled.²⁶

III. Compliance with Substantive rules: The Metalclad case.

In 1993, Metalclad a U.S. company purchased a Mexican waste management company (Coterin) to operate a waste transfer station. The Federal and State permits to operate were granted and Metalclad began to operate. The Municipality denied Metalclad’s application for a construction permit.

²³ Ethyl Award at paragraph 58.

²⁴ Ethyl Award at paragraph 84.

²⁵ Ethyl Award at paragraph 85.

²⁶ Notwithstanding its ruling the Tribunal punish the investor for “jumping the gun” and awarded Canada the costs of the proceedings on jurisdiction. Ethyl Award at paragraphs 86-88

Metalclad alleged that “Mexico, through its local government of SLP and Guadalupe interfered with and precluded its operation of the landfill.”²⁷

Such interference was, according to Metalclad, a violation of Article 1105 of the NAFTA.

Article 1105 of the NAFTA provides that:

Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

No other provision of the Chapter XI has been more invoked than Article 1105. The reason: its ambiguity. As opposed to MFN, national treatment or even expropriation obligation where a lot of doctrine and jurisprudence has been developed, in the case of Article 1105 there are very few references for its interpretation. Basically, there were two readings:

The question before the Tribunal was whether Article 1105 created a new standard, that is, whether the phrase “including” meant that a new standard was created in addition to the international law standard. Hence, in order to comply with Article 1105 the investor and its investment had to be treated in a *fair and equitable manner* and be given *full protection and security*. It would be in the discretion of the Tribunal to determine what would constitute a breach of these standards.

Bearing this reading in mind, the Metalclad Tribunal found that, based on articles 102(1) and 1802 of the NAFTA²⁸, the failure of the Mexican government to ensure that the investor knew before investing in Mexico that a municipal permit was required to operate, was a violation to Article 1105:

Mexico failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that **it would be treated fairly and justly** in accordance with the NAFTA.²⁹

An interpretation of this award meant that a violation of any provision of the NAFTA will be a violation of Article 1105. This interpretation would have given a far greater outreach to Chapter XI.

²⁷ *Metalclad Corporation v. United Mexican States*. Award. ICSID Case No. ARB (AF)/97/1. 8/30/2000. (hereinafter referred as Metalclad Award), paragraph 72.

²⁸ Article 102 provides that: “The objectives of this Agreement [NAFTA], as elaborated more specifically through its principles and rules, including national treatment, most-favored nation treatment and **transparency**...”

On the other hand, Article 18- 02: “Each Party shall 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 Parties to become acquainted with them.”

²⁹ Metalclad Award at paragraph 99.

This interpretation did not prevail: the Government of Mexico successfully challenged this interpretation.³⁰

Concern about the Metalclad and other awards, which interpreted this provision, the NAFTA Parties, in accordance with the NAFTA, agreed to an interpretation of this provision:

Minimum standard of treatment in accordance with international law

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concept 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.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

Hopefully, problems with regard to the scope of Article 1105 will be solved, specially, since, as we mentioned, this interpretation is binding for Chapter XI tribunal.

Conclusion

Our presentation tried to highlight some problems in the interpretation of jurisdictional and substantive rules of the NAFTA. As we have seen it is essential to the proper operation of Chapter XI system that Tribunals applied strictly both jurisdictional and substantive rules of the NAFTA. Hopefully, we caught your attention in some issues that have to be considered as we developed this area in the APEC context. Thank you,

³⁰ The Mexican Government request the set aside of this award on the grounds that “the Tribunal used the NAFTA’s transparency provision as a basis for finding a breach of Article 1105” and “that the Tribunal went beyond the transparency provisions contained in the NAFTA and created new transparency obligations”. The Judge who reviewed the award found that “the tribunal made its decision on the basis of transparency. This matter was a matter beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11”. *United Mexican States v. Metalclad Corporation*. Supreme Court of British Columbia, Canada. Docket. L002904.

SESSION V

The Interrelation and Interaction of
Bilateral/Regional and Multilateral Investment
Rules

The Contribution of Uniform International
Investment Rules to a Predictable Investment
Environment

Raymundo E. Enriquez



The contribution of uniform international investment rules to a predictable investment environment

**Raymundo E. Enriquez
Baker & McKenzie, Mexico**

Mérida, Mexico, 17-18 May 2002

Introduction

According to UNCTAD, in the year 2000 developed countries remained the main destination of FDI flows:

- * Developed countries received 79% of FDI flows (1,005 US billion), 21% more than 1999.
- * Developing countries received 19% of FDI flows (240 US billion), 8% more than 1999.

Trends of FDI

- ✓ During 2000, FDI world-wide flows maintained their increasing trend, registering in that year a total amount of US\$1,270 billion (a growth of 18% with respect to 1999).
- ✓ However, for the first time in a decade, FDI flows declined in 2001 as a result of the slowdown in the world economy and the drop in the cross-border mergers and acquisitions. Notwithstanding, they are expected to recover.

Factors determining FDI flows' dynamism in 2000

- ⇒ In the context of economic globalisation, mergers and acquisitions (M&As) were the most important vehicles for the expansion of FDI flows.
- ⇒ Three factors have been determinant for such an expansion:
 - ▶ Liberalisation of trade and investment regimes.
 - ▶ Technological process.
 - ▶ Corporate strategies.

Benefits for the private sector of investment liberalisation

- ✧ Greater access to sectors previously closed.
- ✧ Full integration of the private sector in the global economy.
- ✧ It also implies benefits for consumers since there is a larger variety of goods, better prices and quality of the products.
- ✧ Forward and backward linkages with the local industry.
- ✧ Easier technology transfer.

Trade - Investment relationship

- ✦ International trade and FDI flows have an important relationship.
- ✦ According to the WTO, one third of international trade in goods and services is carried out among related enterprises (i.e. among subsidiaries located in different countries and among subsidiaries and their parent companies).

- ✎ Countries involved in the globalisation process have recognised that a commercial liberalisation will be successful only if it is accompanied by a capital liberalisation.
- ✎ Understanding this feature, nations have acted in consequence in their commercial and investment negotiation strategies.

Investment in the multilateral context

- ✓ There is an important number of international instruments that regulate investment flows. However, there is no a comprehensive instrument addressing world investment flows.
- ✓ As a consequence, nations have tended to negotiate bilateral or regional agreements to promote and protect FDI.

✓ Even if the existence of a large quantity of instruments provides evidence of the levels of convergence, it also introduces elements of confusion, inefficiency and uncertainty since it enhances the fragmentation and overlapping of different regimes applicable to FDI in a world in which investments are global or regional.

✓ Two efforts have been made to reach a multilateral understanding:

- ▶ OECD Multilateral Agreement on Investment (MAI).
- ▶ WTO Doha Declaration.

The MAI

- ✳ In 1995, OECD member countries plus the European Commission, initiated negotiations for a multilateral agreement on investment.
- ✳ The Agreement was originally supposed to cover the highest disciplines on liberalisation and protection of investment.

MAI provisions

- ✓ Scope of application
- ✓ Treatment and protection of investment
- ✓ Exceptions and safeguards
- ✓ Financial services
- ✓ Taxation
- ✓ Reservations
- ✓ Relation to other international agreements
- ✓ Dispute settlement

* However, because of the quantity and complexity of the topics covered, after long negotiations and internal consultations, the MAI was suspended.

* Among the topics considered beyond the MAI concept were:

- ✓ Extraterritorial application of laws.
- ✓ Labour and environment.
- ✓ Specific reservations.
- ✓ Cultural exceptions.

WTO Doha Declaration

There are two main areas of work in the WTO on trade and investment:

- ☞ The Agreement on Trade-Related Investment Measures (TRIM).
- ☞ The General Agreement on Trade in Services (GATS).

There are also other instruments related to investment in the WTO:

- ⇒ The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPs).
- ⇒ The WTO Agreement on Subsidies and Countervailing Measures (ASCM).

☆ However, there is still an structural unbalance in the multilateral system.

☆ While WTO Agreements establish rules applicable to trade and services - and investment in services - there is not an applicable provision to investment in the goods sector.

- Initial efforts were carried out in order to make up for this unbalance after the MAI suspension. However, a concrete outcome came from the Fourth Session of the Ministerial Conference held in Doha, Qatar on 9-14 November 2001.
- At that meeting, Ministers recognised the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade.

- Ministers agreed that negotiations will take place after the Fifth Session of the Ministerial Conference, on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations.
- In the meantime, further work in the Working Group on the Relationship between Trade and Investment will focus on the clarification of the following issues:

- ➔ Scope of definition
- ➔ Transparency
- ➔ Non-discrimination
- ➔ Modalities for pre-establishment commitments based on GATS-type, positive list approach.
- ➔ Developing provisions
- ➔ Exceptions and balance of payments safeguards
- ➔ Consultation and the settlement of disputes between members.

The private sector perspective

The implementation of a Multilateral Investment Agreement will be beneficial for the private sector because:

- ✓ It will give juridical certainty to the sectors that are open to foreign investment.
- ✓ It will also contribute to transparency with respect to the applicable laws related to the admission of investment.

- ⇒ However, any framework should reflect, in a balanced manner, the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest.
- ⇒ Besides, it should be coherent with the investment provisions already established under GATS.

- ☆ Notwithstanding, investment has been one of the most controversial issues in the international scene; hence, it is necessary to be realistic with respect to the scope of an eventual multilateral instrument.
- ☆ It is important to understand that seeking a broad scope could inhibit consensus.

- ☆ Therefore. it would be convenient to start negotiations from the consensus already reached.
- ☆ In this regard, the logic starting point would be Foreign Direct Investment since it is a common element in all international investment agreements. Otherwise, an asset-based definition could generate a never-ending discussion.

Conclusions

- ✓ Right now there is a patchwork of regional and bilateral investment instruments regulating FDI.
- ✓ It is difficult to predict the outcome in the WTO.
- ✓ It is necessary to settle international standards on investment as it has been done in trade but being realistic.
- ✓ This would create legal certainty and stability.

Beyond Bilateral Investment Treaties

Julio Faundez

Beyond Bilateral Investment Treaties

Julio Faundez

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INTRODUCTION

The organizers of this Workshop have requested me to assess the benefits and challenges of a multilateral framework on investment. This is, undoubtedly, an important and controversial topic. Its importance is underscored by the fact that after Doha the WTO is exploring the possibility of bringing investment rules within its sphere of activity. This topic is also controversial, as evidenced by the heated and well-publicized debate surrounding the collapse of the OECD sponsored negotiations on the draft Multilateral Agreement on Investment (hereafter, MAI). Indeed, proposals for a multilateral framework on investment generate such passion that many, albeit wrongly, tend to assume that anyone even mildly sceptical of such a framework is necessarily a radical opponent of the current process of globalisation.

I will not repeat the interesting debate that took place during the frustrated MAI negotiations as I do not think that I can add much to it. What attracts me to this topic, however, is that the answer to the question whether a multilateral framework for investment is feasible, is, on the surface, simple and straightforward. After all, bilateral investment treaties (hereafter BITs) are today widely accepted and regarded as an unqualified success. Insofar as a multilateral framework for investment involves codifying state practice under BITs, the task should be easy and not controversial. In practice, however, attempts to codify this practice are strongly resisted, even by those who are otherwise staunch advocates of BITs. I am of course aware that one of the main problems in this debate is that the proposed codification involves a little more than just bringing in existing practice within the framework of a multilateral treaty. And it is this 'little more' that seems to be main source of the controversy. Yet, as I explain in this paper, even this limited enterprise is resisted by many, including some that otherwise are firm supporters of BITs. Thus, one of the questions underlying proposals to establish a multilateral investment framework is why the transition from bilateral to multilateral investment rules is proving so difficult. This paper attempts to answer this question.

I will approach this question from a dual perspective: the perspective of an international lawyer who participates and is interested in practical matters; and the perspective of a legal academic who has a strong interest in institution building and governance. As an international lawyer I am interested in the process through which international legal rules come into being and evolve. The proposal to develop a multilateral framework for investment illustrates this process as it involves, partly at least, a move from bilateral to multilateral rules, within the misty background of international customary law. As a legal

academic I am interested in governance and institution building. From this perspective, I understand that the underlying concern of proposals to establish a multilateral investment framework is to improve the quality of governance in the world economy within the rapidly evolving process of globalization. This is a valid and urgent concern reflected also in the current debates about the role of the World Bank, the IMF and the WTO. Thus, any assessment of the advantages or disadvantages of a multilateral investment framework must necessarily take into account wider issues such as the link between globalization and state sovereignty and the nature and scope of state regulation in the world today.

Seasoned investment practitioners will probably regard my approach as too academic, a bit naïve, or perhaps both. From the perspective of the development of international law, however, my approach is neither academic nor simplistic. Many international legal rules in force today developed slowly through well-defined stages. The best example of such a rule is the rule concerning the enclosure of the oceans by coastal states through claims of territorial sea. At the beginning, there were conflicting unilateral claims, later on there were some bilateral agreements or plurilateral agreements establishing general rules among contracting parties. Eventually, and after a long process of claims, counter-claims and negotiation there emerged a few general rules regarding the nature and breadth of the territorial sea and other areas of the sea under the jurisdiction of coastal states. Thus, the regulation of this particular area of international concern went through a clearly defined evolution from unilateral claims to generally accepted rules embodied in a multilateral treaty. The experience of the law of the sea is replicated in many other areas of international practice, such as air law, international criminal law and human rights law. If this is the way many international legal rules have come into being and have evolved, why is it so difficult to codify the practice of states under bilateral investment treaties within a single multilateral framework?

Institution building within the context of globalization offers another useful perspective to examine the seemingly difficult transition from a bilateral to a multilateral investment regime. It is generally accepted that one of the consequences of globalization has been to increase the number of issues that fall within the scope of international law. One only has to compare the rules and practices of the old GATT with those of the new WTO to gauge the impact that globalization has had and continues to have in international law. Within this perspective, the proposal to establish a multilateral framework on investment appears as a natural step in the process of building suitable institutions to manage the challenges of globalization. Yet, although there is general agreement on the urgent need to reform old institutions and to create new mechanisms to govern the world economy, in the area of international investment there are, however, fundamental disagreements as to whether such an institution is necessary. While some believe that a new mechanism in this area is necessary to enhance the security and predictability of investments, many disagree. Even those who accept that a multilateral investment framework is desirable have profound differences regarding its form and shape. Given the prevailing consensus about the need to improve the quality of governance in the world economy, it is of fundamental practical importance to explore from a legal perspective, why this area of international practice is so controversial.

So, why is the transition from bilateral to multilateral investment rules so difficult? I will answer this question in three stages. Firstly, I will focus on aspects of the practice of states under BITs in order to explain why it is difficult to transplant this practice into multilateral treaty rules. Secondly, I will consider some aspects of NAFTA's experience under Chapter 11, since this is the most comprehensive attempt at transforming BIT rules into rules that bind more than two states; and finally, I will briefly look at aspects of the process that led to the collapse of the draft MAI Agreement as they offer interesting lessons that contemporary proponents of a new multilateral investment regime would be wise to take into account.

BILATERAL INVESTMENT TREATIES

Most observers regard the proliferation of BITs since their inception in the late 1970s as one of the few positive cases of proliferation in the international arena. Indeed, there are some 2,000 bilateral investment treaties in force today and their number grows by the day. Most of the BITs are treaties between capital exporting and capital importing countries, but there is also a growing number between developing countries. The proliferation of BITs and their acceptance even by countries that do not openly embrace the market system, such as Cuba and China, suggests that states regard them as useful tools of economic policy.

Most academic observers regard BITs as one of the most successful instruments in modern international economic law. This positive assessment is justified. BITs have contributed to consolidating changes in legal approaches to the regulation of foreign investment. In the 1960s and early 1970s there were sharp divisions between capital exporting and capital importing countries about issues such as the standard of treatment of foreign investment, the rules that apply to compensation in the event of nationalization and the type of remedies available to foreign investors. Today, largely as a consequence of the emergence of BITs, these issues are no longer controversial. The principles of national treatment and most favoured nation are widely accepted; the notion that international legal rules should govern the standards of treatment of foreign owned property is also accepted and the principle that investors who feel aggrieved by the behaviour of host governments can resort to international arbitration is no longer regarded as offensive to state sovereignty. Within this wide area of agreement there is plenty of room for disagreement and conflict. Yet, there is nonetheless a remarkable consensus on basic principles. Such a consensus would have been unthinkable in the late 1960s or early 1970s when developing countries using their voting power within the United Nations approved several resolutions that purported to establish ground rules for what was then called the new economic order. These resolutions underscored the importance of host state regulation and were generally seen as hostile to foreign direct investment and multinational companies. Yet, while officials from developing countries were voting in favour of these seemingly radical UN resolutions, they were, at the same time, quietly negotiating bilateral investment treaties that contradicted them. These negotiations resulted in the vast network of BITs that has brought about a major shift in the international legal framework governing foreign investment.

BITs and International Law

There is little doubt today that international rules are friendly to foreign investment. Yet, it is necessary to ask whether they have become part of international customary law. If the answer to this question were yes, then it would seem that conditions are ripe to move to the next stage and codify BIT rules within a multilateral treaty framework. If on the other hand, the answer were that these rules have not yet acquired such a status, then any attempt to incorporate them into a multilateral agreement would require a process of bargaining and negotiation. In the jargon of international lawyers, this process would involve progressive development of international law.

The question as to whether BIT rules have become part of international customary law has to be answered in two stages. First, it is necessary to ascertain what role, if any, customary international law played in bringing about this shift in the rules governing the protection of foreign investment. Second, it is necessary to determine whether, as a consequence of BITs, the rules of international customary law have changed.

Under traditional international legal doctrine there are two requirements for the emergence of a rule of international customary law: one objective and the other subjective. The objective requirement refers to a consistent practice by states over a relatively long period of time. In general terms, the objective requirement could well be said to have been fulfilled since, for nearly three decades, a large number of states have accepted virtually the same rules for the protection of foreign direct investment. The subjective requirement refers to the belief that such practice is required by international law. This requirement, however, is more difficult to satisfy. Have states entered into commitments under BITs because they believed the rules were already binding under general international law or because they believe that it was expedient to do so? In other words, is the acceptance of BITs by developing countries merely a strategic decision prompted by the changing international economic and political context, or is it a decision prompted by a profound belief that that such behaviour is required by international law. Those who are not familiar with the reasoning of international tribunals will find this discussion a bit metaphysical. Yet, these are the questions that international tribunals ask, or should ask, when they have to decide whether a particular rule is part of general international law.

The nature of the subjective requirement in international customary law has generated an interminable debate among international lawyers. International tribunals have also wrestled with this problem and have not succeeded in clarifying it, largely because international law operates within a political framework where decisions are generally prompted by expediency rather than principles or conviction. In the case of the development of BITs, it is apposite to remember that when the first BITs were adopted, developing countries were at the same time, but in a different forum, demanding that host states should play a paramount role in the regulation of foreign investment. BITs, however, contradicted this demand and introduced rules that established an international regime for the protection of foreign investment. This contradictory behaviour illustrates a well-known fact of international power politics; mainly, that what states do in practice does not always coincide with what they believe.

While it is safe to assume that when BITs were first adopted capital-importing states accepted them more out of convenience than conviction, the situation may not be the same today. It is arguable that the cumulative effect of the 2,000 or so BITs in force today has had an impact on the content of the rules of customary international law governing the protection of foreign direct investment. So, do states today enter into BITs because they believe that its rules are required by international law? This is still an open question. In the meantime, I would note that even though some BIT rules could well be regarded as required by international customary law –such as no expropriation without prompt and adequate compensation – there is still plenty of room for disagreement about how and when these rules should be applied. Thus, any attempt to codify BIT rules within a multilateral framework would open up controversial issues. It is likely that the outcome of such a process would result in a multilateral treaty, better in many respects than the existing network of BITs. This outcome, however, is uncertain and the process is not free of risks.

BITs and Globalization

Whether or not BIT rules have become part of international customary law, there is a further question that remains. If, for the sake of argument we were to assume that codification of BIT rules is possible, would the outcome of this process improve the quality of world economic governance? There is little doubt that the proposal of moving from a bilateral to a multilateral investment regime satisfies lawyers' love for consistency and symmetry. After all a similar process took place in the area of international trade when in 1947 a multilateral legal framework, the GATT, replaced a complex, unworkable and largely defunct network of bilateral trade treaties. On the basis of this experience, many advocates of a multilateral investment framework appear to assume that if GATT proved useful as a device to place international trade relations on a multilateral footing, then why shouldn't a similar mechanism be used in the area of investment – a sort of GATT for investment? In order to answer this question it is necessary to place BITs in their proper context.

If one asks the question what the proper context of BITs is, one soon discovers that although BITs now perform a useful role, it is likely that with the deepening of globalization they will become less important and even obsolete. BITs are mainly designed to ensure that capital importing countries accept certain ground rules to protect investments from investors based in capital exporting. In practice, there is no *quid pro quo* in these treaties since investment tends to flow only in one direction – from developed to developing countries. Judging by the number of BITs and the absence of major conflicts, BITs have performed their function extremely well and will probably continue to do so in the future. BITs, with a few exceptions, of course, were not meant to liberalize foreign investment or to achieve other objectives. Most BITs are based on the fundamental assumption that nation states continue to have the power to regulate foreign direct investment flows, especially with regard to the right of establishment. After the investment is allowed into a country, then the provisions of the relevant BIT are there to ensure that the investor of the contracting party is treated fairly and is not discriminated against - hence the emphasis placed on national treatment and the most favoured nation principles.

Judged in terms of their limited objective, BITs are an unqualified success and have undoubtedly contributed to consolidating investor friendly regimes throughout the world. In this respect, BITs play a key role in support of economic globalization. Globalization, however, is not just about greater openness to foreign direct investment. It is a much wider processes which includes, among many other things, trade liberalization, deregulation, privatisation, financial liberalization, tax reform, fiscal discipline, reorientation of public expenditure, tax reform, labour market flexibility, compliance with a large number of WTO codes and comprehensive legal and institutional reform. Indeed, so comprehensive is the process of globalization that some may even argue that insofar as BITs establish a special regime of protection for foreign investors in the not so distant future these treaties may in fact become a barrier against further liberalization and healthy economic competition. This argument is based on the assumption that economic globalization is leading to an increasing process of integration where the distinction between national and international markets is becoming meaningless and where new forms of regulation are required. It is perhaps premature to regard BITs as obsolete. The process of economic integration at a global level is in fact only just beginning. It is undeniable, however, that BITs are not capable of performing all the tasks required to support the expanding process of globalization. They were simply not designed for that purpose.

The foregoing analysis leads to the following conclusion. First, although the global economy is rapidly changing, BITs continue to perform a crucially useful function – affording protection to foreign investors within a framework of rules that are generally accepted. Second, although BITs are successful they are by no means immune from the consequences of globalization and thus, attention should focus on ways to adapt them towards contemporary challenges. Third, any attempt to codify within a multilateral framework the practice of BITs is bound to open up a complex set of issues on which there is little agreement, even among the most advanced countries within the OECD. And fourth, despite the difficulties involved in shifting from a bilateral to a multilateral investment framework, this shift is necessary given the continuously expanding process of globalization.

A BIT FOR THREE: NAFTA'S CHAPTER 11

Any discussion about the feasibility of a multilateral framework for investment cannot ignore the experience of NAFTA under Chapter 11. Although Chapter 11 is not the only instrument of its kind, it is perhaps the most comprehensive and most often invoked plurilateral investment framework in force today. It is based largely on the US model of bilateral investment treaties. One of its distinctive features is that it gives investors from each party the right of establishment in the territory of the other parties - subject, of course, to some limitations. In almost every other respect, however, it is similar to most bilateral investment treaties. Thus, the experience of NAFTA parties under Chapter 11 should be of great interest to proponents and critics of a comprehensive multilateral framework for investment and, more immediately, to the governments currently negotiating the Free Trade Area of the Americas (FTAA).

Although NAFTA is a relatively new institution, its experience under Chapter 11 illustrates how difficult it is to transplant legal rules. What is happening is that rules and procedures designed to protect foreign investment are now giving rise to an endless number of claims. The irony is that while it is safe to assume that Chapter 11 was included in NAFTA to ensure that Mexico would adhere strictly to the rules protecting foreign investors, the majority of these claims have been brought against the United States and Canada, not Mexico. Under these claims, phrases commonly used in bilateral investment treaties, such as ‘indirect expropriation’, ‘fair and equitable treatment’ and ‘full protection and security’, have, suddenly, become a source of controversy. So far, only a handful of these claims have been decided and on some crucial points the interpretation put forward by investors has prevailed (S.D. Myers, Pope & Talbot and Metalclad). Whatever the outcome of the cases still pending, the experience of NAFTA under Chapter 11 is bound to have a major impact on the law governing the protection of foreign investment. It is perhaps early to predict the nature of this impact, but there are signs that the experience under Chapter 11 may have destabilizing effects on the network of bilateral investment treaties.

Problems have arisen mainly in relation to a variety of regulatory measures and even judicial decisions, taken by the officials or courts from NAFTA parties. The aggrieved investors claim that these measures are in breach of the rules of Chapter 11. Environmental regulations are one of the favourite targets of these claims. Two US companies (Ethyl Corporation and S.D. Myers) have already successfully challenged Canada’s implementation of this type of measure, while a Canadian company (Methanex) is currently demanding 1 billion dollars in compensation from the United States, claiming that a decision by the state of California to ban the use of a gasoline additive for reasons of public health is inconsistent with Chapter 11. Mexico has also been a target. A US firm (Metalclad) has successfully challenged a decision by a local authority in Mexico that refused a construction permit to build a toxic waste dump. Two other claims against Mexico (Azinian and Waste Management) have also focused on environmental matters. Two claims by Canadian companies operating in the United States (Loewen and Mondev) are challenging the legality under Chapter 11 of decisions taken by state courts. Two US companies (Pope & Talbot and Ketcham) have challenged in separate claims Canada’s implementation of the 1996 US - Canada Softwood Agreement. A Canadian construction group (ADF) is currently challenging the ‘Buy American’ law, while a US company (UPS) is claiming that the way Canada runs its postal services is inconsistent with the rules of Chapter 11.

Reviving an Old Argument

The flood of claims by investors has taken NAFTA governments by surprise since in different ways they all seek to obtain a review by NAFTA Panels of decisions that under their domestic laws are otherwise legal and legitimate. It has also astounded some environmental NGOs and civil society groups that have characterised these claims as attempts by greedy multinationals to use NAFTA as a shield to evade and undermine the legitimate use of regulatory powers.

The large number of claims under Chapter 11 filed since NAFTA's inception is striking particularly when compared to the number of claims filed under the 2,000 or so BITs during the last three decades. The available figures suggest that in a few years there will be more NAFTA claims under Chapter 11 than the total amount of claims filed under BITs. The subject matter of NAFTA claims, however, is not entirely surprising. What makes the propensity of NAFTA investors to litigate so remarkable, however, is that two of the host states accused of breaching Chapter 11 rules are developed, not developing countries.

At first glance, it seems surprising that most of these claims have been brought against Canada and the United States. After all, these two countries have a long history of intense economic relations and there has never been a suggestion that either country treats investors from the other country unfairly. The trust existing between Canada and the US is evidenced by the fact that the agreement that preceded NAFTA, the Canada – US Free Trade Agreement, did not include rules to protect investors. It was taken for granted that domestic legal rules and processes afforded ample protection to foreign investors. By contrast, Chapter 11 rules, based as they are on the text of bilateral investment treaties, reflect a fundamental distrust of the fairness and, often the integrity of legal and political processes in capital importing countries. Two of the main devices used by BITs illustrate this distrust. One removes investor/state disputes from the jurisdiction of host states, while the other provides that the standard of treatment is to be determined by international law, not domestic law. These two devices also serve another important and complementary purpose: they depoliticise state/investor disputes, thus underscoring their commercial and private law nature.

Those familiar with the history of this area of international law will remember that for a long time capital-importing countries, especially in Latin America and most notably Mexico, strongly resisted attempts by capital exporting countries to remove investment dispute out of their jurisdiction. Eventually, however, they gave in. Moreover, because there were relatively few international judicial decisions in this area of international practice before the establishment of NAFTA, legal doctrine, largely reflecting the views of capital exporting countries, played a major role in developing the contours of the law governing the protection of foreign investment. As a consequence, these doctrinal interpretations extended the scope of protection that these rules afforded foreign investors. Two concepts that stemmed from these doctrinal developments are included in Article 1110 of NAFTA: 'indirect expropriation' and 'measures tantamount to nationalization or expropriation'. Together with this expansive interpretation of the notion of expropriation, legal doctrine also raised the status of the international concept of minimum standard, from a floor below which treatment could not fall, to one which included full protection and security. This doctrinal elaboration found its way into the bilateral treaty network and is reflected in Article 1105 of the NAFTA Agreement.

Initially, these doctrinal developments were strongly criticized by capital-importing countries. These countries pointed out that such an expansive concept of expropriation would tie their hands since virtually any measure that even remotely affected the interests and expectations of foreign investors could be seen to fall within the concept of indirect expropriation, creeping expropriation or measures tantamount to expropriation. This criticism, however, became dormant as the bilateral investment treaty framework began to

expand. It also became somewhat academic since during the last 25 years the behaviour of developing countries towards foreign investors, though not always above reproach, has been quite amicable.

Which rules? What meaning?

Ironically, however, as today Canada and the United States defend themselves against multimillion claims, their arguments are reviving the critique of investment rules that developing countries abandoned only a few years ago. Both countries are finding that a broad interpretation of the international rules protecting foreign investment is undermining their capacity to formulate and implement public policy. Thus, for example, Methanex, a Canadian company, claims that a decision by the state of California to phase out the use of a particular chemical component in fuels has the effect of removing an entire market that was otherwise available to the company and as a consequence is a form of expropriation prohibited under Chapter 11. The United States, for its part, argues that Methanex's claim is based on a mere expectation of profit and, as such, is not protected by the rules of Chapter 11. It could well be that Methanex's claim is based on an over expansive interpretation of Article 1110 of NAFTA. Yet, its claim is in many respects consistent with an objective widely shared among foreign investors: to ensure that host states do not take measures that in any way interfere with their business activities, including measures that even indirectly may affect intangible assets regarded by investors as essential components of their property in the host country. In the case of agreements for the exploitation of natural resources, this objective is achieved through the so-called stabilisation clause. In the BIT context, this objective is embodied in the minimum standard of treatment provision that requires host states to afford investors full protection and security.

The ambiguity regarding the meaning of the notions indirect expropriation and measure tantamount to nationalization is further complicated in the context of NAFTA by the confusion regarding the meaning of one of the rules that provides for minimum standard of treatment. This rule, found in Article 1105 (1), has proved to be one of the most disputed provisions of Chapter 11. It reads as follows:

Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

Investors interpret this provision broadly while Canada, the United States and Mexico favour a narrow interpretation. According to the broad interpretation this provision protects investors against any breach of international law, whether customary or conventional law. It also regards the phrases 'fair and equitable' and 'full protection and security' as an addition to the international minimum standard. NAFTA parties, on the other hand, interpret the reference to international law in this provision as including only customary international law and not treaty law. They also regard the requirements of fair and equitable treatment and full protection and security as requirements that are already contained within the notion of international customary law and not as a supplement to the standard requirements of international customary law. Faced with these two alternatives NAFTA panels have so far tended to take sides with the investors (Metalclad, Pope & Talbot and S.D. Myers). As a

consequence, on 31 July 2001, the NAFTA parties issued an interpretation of Chapter 11 that authoritatively reaffirms that Article 1105 (1) only prescribes the customary international law standard of treatment and that the two disputed phrases ‘fair and equitable treatment’ and ‘full protection and security’ do not require treatment in addition or beyond what is required by the international customary law standard of treatment of aliens. It is unlikely that this interpretation will restrain other investors from bringing new claims since the minimum standard of treatment under customary international law is itself complex and ambiguous. The interpretative statement has thus not significantly altered the terms of this debate.

NAFTA’s experience under Chapter 11 offers valuable lessons for those interested in developing a multilateral framework for investment. I would highlight the following three points. First, that the application of bilateral investment treaty rules between capital exporting countries is bringing about a flood of litigation as regulatory structures in those countries is extensive and highly complex, thus offering innumerable opportunities for investors to challenge them. Second, that the scale of the claims and their potential impact

on public policy is bound to bring into question the wisdom of relying on ad-hoc commercial arbitration for the resolution of disputes that raise sensitive matters of public policy. And third, that this flood of litigation is reopening old arguments and thus destabilising the relatively tranquil atmosphere prevailing within the BITs network.

A BIT FOR ALL - THE MAI NEGOTIATIONS

Any discussion about a multilateral framework for investment necessarily evokes the experience of the OECD sponsored negotiations on the draft a Multilateral Agreement on Investment. This inevitable association is unfortunate because the OECD’s approach to the MAI negotiations was fundamentally flawed. Thus, today any proposal to go beyond the bilateral treaty framework is viewed by many with great suspicion. There are, however, positive signs that suggest that the MAI fiasco taught OECD countries an important lesson.

A Flawed Strategy

In order to understand and criticize the process that led to the collapse of the MAI, it is necessary to understand the objectives sought by the MAI draft. At one level the MAI seemed to be merely an attempt to codify existing practice under bilateral investment treaties. Yet, insofar as it also sought to create a universal right of establishment, it sought to move beyond the structure of the majority of BITs. In this respect, the draft MAI was innovative as it purported to transfer to the international sphere regulatory powers hitherto vested within nation states. Yet, although original in this respect, the MAI did not go far enough. It made no attempt to tackle other investment related issues – such as competition, taxation, transfer of technology, the environment, movement of labour and investment incentives.

If the MAI is seen merely as an attempt by OECD countries to codify state practice under BITs – with the addition of the right of establishment - the futility of the enterprise becomes

apparent. After all, foreign investment among developed market economies has been going on for years without having to resort to the type of rules contained in BITs. Foreign investment in OECD countries is adequately protected by domestic legal rules and institutions with the complement of a few voluntary codes of practice prepared by the OECD. It is interesting, however, that even among OECD countries, whose favourable attitude to foreign investment is beyond doubt, the attempt to codify BIT rules should have generated such concern that negotiators were forced to use several devices to restrict the reach of the proposed agreement. Some of these devices were described as 'carve outs', 'standstill' and 'rollback'. 'Carve outs' referred to areas exempted from the Agreement, while 'rollback' required the eventual elimination of 'carve out' laws and 'standstill' was meant to prevent the introduction of new measures that purported to introduce new areas of 'carve out'. This incomprehensible jargon offers an insight into the difficulties involved in making formal binding commitments at a multilateral level in areas perceived by states as economically or politically sensitive.

But the main problem with the MAI process was its not so hidden agenda. MAI negotiators were, of course, aware that OECD countries did not urgently need a formal legal framework to increase levels of foreign investment or to enhance the security of investments. Their objective was to establish a binding multilateral framework among OECD countries, which after a few years would be accepted by the rest of the world. The MAI was thus meant to serve as a model regulatory framework, but because it was the only one on offer it was also a compulsory model. Although in hindsight the expectation that the rest of the world would accept the MAI without any debate seems unrealistic and somewhat arrogant, it is worth noting that this expectation is not entirely alien to the way some international legal rules are developed. Indeed, there are several areas of international law where practices, initiated by a small group of states slowly influence other states and eventually become rules that are generally accepted and are often embodied in multilateral treaties. As ever, the law of the sea offers several examples in areas such as maritime spaces and boundary delimitation. Likewise, most of the international rules governing explorations in outer space also stem from the practice of a small number of states. If we go a bit further back, we find that the rules on the acquisition of territory also stem from the practice of a few states, mostly European, involved in territorial conquest and expansion. The problem with this approach, however, is that the area of practice covered by the draft MAI Agreement is not restricted to a few states. Indeed, this is an area of international practice in which all states have a major interest and in which all states are involved. It is also an area of international practice where there are still sharp divisions and conflicts of interest between capital importing and capital exporting countries, as well as within capital exporting countries, as evidenced by debates that preceded the collapse of the MAI negotiations.

It could be argued that the example of the so-called Washington consensus shows that the approach of the OECD to the MAI agreement was not altogether misguided. After all, when the Washington consensus first emerged, only a handful of countries adhered to it and yet, in a few years, it became widely accepted as the new paradigm for development. The widespread acceptance of the Washington consensus is, of course, undeniable. But the Washington consensus is not the same as a multilateral framework of binding rules. It is a set of principles, not a detailed code of legal regulation. Countries implement the principles

of the Washington consensus in different ways and in accordance with their own policy priorities and preferences. A multilateral investment framework, however, is not merely a set of principles, but a long and complex set of rules that have binding force.

The Lesson

There are many lessons that can be drawn from the MAI experience. In my view, however, the most important is that it was unrealistic to expect that a multilateral framework drafted by a few, who largely have the same interests, would be accepted by a majority who was excluded from the drafting process and does not necessarily have the same interests. Fortunately, it appears that this lesson has been learned as evidenced by the Doha commitment to open negotiations within the framework of the WTO and by the current negotiation under the framework of the proposed FTAA.

CONCLUDING COMMENTS

I share the concern of those who advocate the establishment of a multilateral investment framework. Such a framework would do much to improve the quality of governance in the world economy. It would also help to spread more evenly the benefits of growth and development. Yet, as this paper shows, this task, though necessary is complex and controversial. It is complex because even if it were limited to a codification of BIT rules, the process of incorporating them into a multilateral treaty would expose the numerous gaps, contradictions and deficiencies of existing rules. As the NAFTA experience shows, when BIT rules are applied between developed countries, the potential for conflict and litigation sharply increases so that the rules may become unstable and less predictable. But, as I have explained in this paper, the task of developing a multilateral investment framework requires more than merely transplanting BIT rules into a new document. Since the first wave of BITs was launched, globalization has deepened. Today, investment issues, not unlike trade issues, are related to a variety of other issues. If the object of the exercise is to improve the quality of international governance, these issues cannot be ignored. This is why the task of developing a multilateral investment framework is both daunting and urgent.

*In order to ease the reading of this document I have not included the normally copious footnotes found in legal articles. I would of course be delighted to share my sources with any interested reader. Please contact me through my email address (julio.faundez@warwick.ac.uk).

The Doha Mandate on Trade and Investment

Martha Lara



The Doha Mandate on Trade and Investment

Martha Lara

Trade and Finance Division, WTO

APEC Workshop on Regional and Bilateral Investment Rules/Agreements

Mérida, México, 17-18 May 2002



The Doha Declaration

* **Recognized** the case for a multilateral framework:

"to secure transparent, stable and predictable conditions for long-term investment flows, particularly FDI, that will contribute to the expansion of trade"

* **Agreed** that negotiations will start after the Fifth Ministerial (Mexico 2003) on the basis of explicit consensus on the modalities of negotiation

* **Stressed** the need for technical assistance and capacity building for developing countries



WGTI to focus on key issues

Up to Fifth Ministerial: Focus on Clarifying key issues of a possible multilateral framework

- scope and definition
- transparency
- non-discrimination
- pre-establishment commitments based on GATS- type, positive list approach
- development provisions
- exceptions and balance-of payments
- consultation and dispute settlement among Members



Other elements of the Doha mandate

Any multilateral framework on investment should take into account:

- balance of interests of home and host countries
- development policies and objectives of host countries
- right to regulate in the public interest
- development, trade and financial needs of developing and LDC countries: obligations commensurate with needs
- other relevant WTO provisions
- existing bilateral/regional arrangements on investment



Scope and Definition

- Options for defining “investment”:
 - Narrow, enterprise-based: limited to FDI
 - Broad, asset-based: FDI + portfolio investment + other
- Fundamental questions:
 - whether or not to include portfolio investment
 - how to distinguish FDI from other types of investment
 - treatment of speculative, short-term capital flows
- Scope: also determined by substantive provisions and specific commitments



Transparency

- Clear, predictable rules + ensure compliance
- Key goal in an eventual agreement
- What level of obligation?
 - Publication
 - Notification
 - Prior comment ?
 - Procedural transparency (uniform, impartial, review)?
- Balance costs vs. benefits (avoid extra burdens)
- Technical assistance for developing/LDC Members



Non-discrimination

- MFN and NT: ensure non-discrimination of foreign investors and their investments
- Their application raises some key questions:
 - NT: pre and post-establishment?
 - Strike a balance: disciplines and policy flexibility
 - What type of limitations and exceptions?
 - Implications of a MFN clause for existing IIAs



Pre-establishment commitments GATS-type, positive list

- *Top down vs. Bottom up*
- GATS' positive list: market access and NT obligations apply only to specific commitments
- Flexibility to select sectors; keep control over what and how fast they liberalize. Attach conditions.
- Extent of liberalization may be limited
- Need for transparency on NT limitations
- Hybrid approach: positive and negative lists



Development provisions

- Core element of any eventual agreement
- No single conception of development dimension
- Investment-friendly to attract FDI flows
- Flexibility to pursue development objectives:
 - admission and regulation,
 - promotion of industrial and technological capabilities
- Integral part of objectives, structure and substantive obligations of an agreement
- Transitional periods not enough



Exceptions and balance-of-payments safeguards

- Exceptions
 - General: national security, public order, health
 - Systemic: exempt from obligations certain sectors or measures (eg taxation, IPRs, GP)
 - Specific: negative list or positive list
- Balance-of-payments safeguards
 - BOP clauses: GATT Arts. XII, XVIII:B and GATS Arts. XII
 - The broader the definition, the greater the need for BOP clause (address affects of short-term capital flows)



Dispute Settlement

- Impartial dispute resolution; avoid disruption of FDI flows
- Two models of dispute settlement:
 - State-to-State** (eg. WTO)
 - Investor-State** (eg. NAFTA)
- Concerns about Investor-State: investors can take host government to international arbitration, not the reverse
- Doha mandate only seeks clarification of dispute settlement **"among Members"**
- FDI-related WTO rules already subject to DSU
- Costs and resources involved in using the system



Technical assistance

- Recognition of needs of developing countries and LDC for technical assistance and capacity building
- Work in cooperation with other international organizations, including UNCTAD, and through bilateral and regional channels
- WTO/UNCTAD programmed for technical assistance:
 - workshops, regional and national seminars
 - training courses for negotiators
 - activities with other organizations



Run up to the Fifth Ministerial

- Focused work and technical assistance will help developing countries:
 - **evaluate** the implications of closer multilateral cooperation on investment for their development policies and objectives
 - **take informed decisions** required at the Fifth Ministerial in Mexico



APEC'S contribution to the Doha Mandate

- APEC's goal: liberalize trade and investment in the region
- APEC Non-Binding Investment Principles
- Osaka Action Agenda: guidelines/collective actions
- Individual Action Plans: Menu of options for Investment Liberalization
- Technical cooperation and training activities in the region
- Promoting the understanding of the Doha mandate
- Dialogue process with international fora, including WTO

Comments on Session Five

Miguel Flores Bernés

Comments

Miguel Flores Bernes

Deputy Director General for International Affairs
Ministry of Economy, Mexico

Introduction.

I really appreciate the opportunity to make some comments on the final session of this workshop particularly because I know how relevant this subject is for the future work of APEC economies. In this regard, I wish to thank Raymundo Enriquez, Julio Faundez and Marta Lara for the important contributions they have made on the main connections between bilateral and regional initiatives and multilateral rules on investment.

General Comments.

Please let me try to make a brief summary of what I consider have been the main ideas arisen from this important session:

During the presentations, I could observe a broad convergence on the need of encouraging the development of a multilateral framework on investment. Many reasons have been expressed: on the one hand, the suggested structural imbalance partly provoked by the diversity of initiatives that have introduced elements of confusion, inefficiency and uncertainty to the extent it enhances fragmentation and overlapping of different regimes applicable to FDI. On the other, the benefits a multilateral understanding could bring for the many sectors of our economies as we have heard from the business sector.

Nevertheless, building a multilateral understanding entails many challenges. Perhaps, the most important is revealing the real interrelation and the possibility of a transition from bilateral/regional to multilateral investment rules. In this regard, it has been suggested that proponents of a new multilateral investment regime take into account the lessons that can be drawn from the experiences of NAFTA and the OCDE MAI.

The Doha Declaration represents an opportunity to create the right conditions for a comprehensive framework that secure transparent, stable and predictable environment for investment flows. However, the Doha mandate also implies many challenges. One of them is the answer to many questions, as we saw in Marta Lara's presentation; the other is related to consensus-building. It has been recognised that investment has traditionally been a sensitive issue; hence the importance to be realistic. Realistic could mean, from the perspective of the business sector, use as an starting point consensus already reached multilaterally.

Finally, it was highlighted the contributions APEC can make to post-Doha work, in particular, the role of the APEC investment instruments such as the Non-binding Investment Principles, the Osaka Action Agenda and the Individual Action Plans. Likewise, special mention was said to the technical co-operation and training activities that can be made among APEC economies.

Conclusions

Conclusions

The *Workshop on Regional and Bilateral Investment Rules/Agreements* was launched on 17 May in Merida, Mexico by the Vice-Minister of Regulations and Services to Industry and Foreign Trade, Juan Antonio García Villa.

The objective of this event was to provide a plural forum in which participants from the private, public and academic sectors had informal discussions with the aim of getting a broader understanding of issues relevant to investment agreements.

FDI is still a core element of countries' development strategies...

The growth of international private financial flows in recent years has been exceptional. However, for the first time in a decade, FDI flows declined in 2001 as a result of the slowdown in the world economy and the drop in the cross-border mergers and acquisitions.

Thus, countries have reconsidered their domestic strategies not only to attract FDI but also to maximise its benefits since they still regard FDI as a powerful engine for achieving their development goals. For host countries, FDI plays a key role in the formation of capital, expansion and diversification of exports, access to state-of-the-art technology and managerial systems, and creation of employment. It also stimulates technological capacity building for production, innovation and entrepreneurship within the larger domestic economy through catalysing backward and forward linkages.

Notwithstanding the decrease of FDI flows last year, there are positive expectations, especially now that the recovery of the global economy is on the way.

APEC at the forefront on investment matters...

The spirit of APEC toward a sound investment environment has come to fruition through a number of initiatives seeking to reduce investment barriers and promote the free flow of capitals among member economies. The Bogor Declaration, the Non-Binding Investment Principles and the Osaka Action Agenda have all largely contributed not only to set the stage for an increasing open regionalism but to outline the current international framework for FDI as well. Moreover, in line with the principle of transparency, concrete actions have been undertaken by APEC economies as it is demonstrated in the Individual Action Plans, in which efforts of liberalisation are annually recorded.

APEC investment instruments, even if not legally binding in nature, have certainly considerable legal and political authority since they represent the most widely expectations of the APEC economies. In this regard, the Investment Experts Group (IEG) has played a

key role in building an open dialogue and consensus among members, and in creating a coherent perspective and voice on global investment issues.

Trade and investment rules supplement each other at the regional level...

Economies have widely recognised the positive correlation between trade and investment; hence, they have tended to create international instruments to promote and protect investment flows in line with an international legal framework to promote the export and import of goods and services. NAFTA and the Andean Community constitute vivid examples of the efforts to reflect such correlation as it is not only limited to goods and services but also covers FDI. Further, empirical evidence shows an exponential growth in both trade and investment among NAFTA countries, reflecting the benefits of the trade and investment parallelism.

Special mention deserves the efforts of the OECD in developing international rules relating to capital movements, international investment and trade in services. In the framework of this organisation, governments have set rules of the game for themselves and for multinational enterprises established in their economies by means of legal instruments to which all Members must adhere.

However, at the multilateral level it has not been possible to reap the full benefits of a commercial liberalisation since that openness has not been effectively accompanied by a liberalisation of productive capital flows. But, it seems that policy-makers may have given themselves another opportunity for making up the structural imbalance currently existing in the multilateral context. The consensus reached in Doha on trade and investment could reflect such a will.

Seeking an international understanding on BITs provisions...

Investment is one of the fields in which international agreements are more frequently negotiated. However, contrary to the common perception, their provisions differ significantly among each other, depending on the spirit of the instrument. For example, the definition of investment varies according to the specific objective of the agreement, whether it seeks protection or liberalisation. But notwithstanding the scope of the agreement, foreign direct investment tends to be included in both cases.

Concerning substantial provisions to be incorporated in international investment agreements, economies must exercise caution by taking into account the interpretation of investment principles and concepts that is taking place through arbitral tribunal decisions. The concept of “fair and equitable treatment” was referred as a particularly critical example of how tribunals have gone beyond the original intent of the parties to an international agreement.

Another provision that has raised some concerns is that of expropriation. It has proved to be very complex as there are many aspects which are still under consideration to the extent the agreements are implemented. Actually, one of the main difficulties has been the lack of defined criteria to distinguish between direct and indirect expropriation.

Regional and bilateral investment rules are interrelated, and interact with multilateral investment rule-making...

In view of the possibility of eventually having a multilateral understanding on investment, it has been important to evaluate the impact that bilateral and regional rules on investment could have on the multilateral sphere. First, it has been noticed that these three categories are not exclusive but complementary. Second, their interaction is so closed that what happens in one sphere could have important implications on the two others.

Today, international investment faces a patchwork of regional and bilateral instruments that regulates FDI flows. This is particularly important in relation to the liberalisation of investment rules. On one hand, the existence of such a quantity of instruments definitely makes evidence of the levels of convergence that have been reached on investment, as well as the interest of the countries to guarantee more stability in the investment rules. On the other hand, it also introduces elements of confusion, inefficiency and uncertainty since it enhances the fragmentation and overlapping of different regimes applicable to FDI in a world in which investments are global or regional.

In this regard, we heard from the business sector a demand for multilateral rules on investment. Nevertheless, building a multilateral framework for investment entails many challenges. Perhaps the most important is revealing the real interrelation and possibility of transition from bilateral/regional rules to multilateral rules. It is also recognised that investment has always been a controversial issue; hence, it is important to take realistic steps in order to reach pragmatic consensus and avoid falling in a never ending discussion regarding sensitive elements that could hamper the negotiating process in the WTO.

Finally it is important to highlight the contributions that APEC can make to post-Doha work, in particular, the role APEC investment instruments such as the Non-binding Investment Principles, the Osaka Action Agenda and the Individual Action Plans. Likewise, special mention must be made to the technical co-operation and training activities that can be made among APEC economies.

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