Emerging Disciplines on Investments in Trade Agreements

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Summary

- *Investment agreements are increasingly being negotiated as part of Free Trade agreements thus allowing developing countries to trade off some of their objections on multilateralization of investments.*
- *In most cases, these agreements raise standards beyond what is agreed in the multilateral system and include mechanisms leading to substantial liberalization and erosion of regulatory space for signatories*
- *These restrictions effectively erode the policy space that developing country governments need in order to use foreign investments as tools for achieving economic growth or export diversification goals*
- *The TPP attempts to provide more predictable outcomes by defining and clarifying its provisions to remove ambiguities and ensure that arbitrators are bound by the intention of the parties in their interpretation of the terms of the treaty.*
- *In recent times, a number of developing countries have begun to have a rethink on the benefits of having ISDS in their BITs and other investments agreement and also modifying the investor protection clauses to remove ambiguities*

Context

In spite of the efforts by developing countries to resist the multilateralization of investment protection under the World Trade Organisations (WTO) rules, increasing number of these countries are signing regional and mega regional trade agreements which includes far reaching investment protection chapters amongst other emerging issues in the global trade policy rule making space. Mega-regionals are now part of trade policies of many developing countries and have an increasingly broad scope to include disciplines much beyond trade; amongst other things, these trade deals are aiming to define the rules in the global architecture of investment promotion and protection. In most cases, these agreements raise standards and include mechanisms leading to substantial liberalization and erosion of regulatory space. This new trend of mega trade agreements among developed nations and key emerging ones are

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strategic in nature, as they are not only a way to consolidate trade ties and deepen economic integration but are also expected to largely reshape global trade rules.

In recent times, the Trans Pacific Partnership (TPP) Agreement involving 12 countries across 3 continents and covering over 40% of world trade was signed by the parties in spite of oppositions to the agreement from Civil Society and other stakeholders. The agreement has an open membership provision which means that non-members are able to join in the agreement at a later date further expanding the global coverage and reach of the agreement. In the same vain, the USA and the EU are currently negotiating the Transatlantic Trade and Investment Partnership (TIPP). Taken together, these agreements have the capacity to further consolidate the rules being set on investment protection as models for future possible multilateral negotiations in the WTO or other forum.

In South East Asia, 16 countries are negotiating the Regional Comprehensive Economic Partnership (RCEP), a free trade agreement negotiations launched in 2012, which comprises the 10 member states of the Association of South East Asian Nations (ASEAN) and the six states with which ASEAN has existing free trade agreements. The RCEP will cover trade in goods, trade in services, investment, economic and technical co-operation, investments, intellectual property, competition, dispute settlement among other issues. In addition to this, the negotiation of a Free Trade Agreement of the Asia-Pacific (FTAAP), a potential association of 21 economies, including China, Russia, Japan, the US, Canada and South Korea are in the early stages.

On similar lines, 54 African Countries with a combined population of more than one billion are negotiating a Continental Free Trade Agreement (CFTA) people. The main objectives of the CFTA are to create a single continental market for goods and services, with free movement of business persons and investments, and thus pave the way for accelerating the establishment of a Customs Union.

Mega trade deals if successfully negotiated and ratified by parties will have an impact on trade flows, on the direction and intensity of investment, on the structure of regional and global value chains, and will redefine the 'rules of the game' This briefing note is part of a series examining emerging issues in regional and plurilateral agreements and their implications for the trade competitiveness of developing country member states.

International Investment Agreements

International investment agreements (IIAs) are treaties between states. They are agreements establishing the terms and conditions for private investment by nationals and companies of one state (home state) in the territory of another state (host state). It is estimated that there are over 3000 of these agreements currently in force. In the past, International Investment Agreements existed mostly as Bilateral Investment Treaties (BIT) or Regional Investment treaties signed by groups of states within a single regional territory. However, in more recent times, these agreements are signed as investment chapters in regional/mega regional trade agreements (RTAs).

The majority of IIAs are signed between developed and developing countries. Recent statistics[2] however shows an increase in FDI flows between developing countries and an increasing trend towards more BITs and regional treaties among developing countries exclusively. Most IIAs contain similar substantive provision on the protection of investments of nationals of contracting states on the territory of the other contracting states, including investor-to-state dispute settlement provisions (ISDS).

Chapter 9 of the TPP contains the provisions on investment protection and provides the basic investment protections found in IIAs and defines new rules for governing investment protection regimes. This paper examines some of the provisions of the agreement, the derogations made in the TPP in an attempt to make them more predictable in the light of recent arbitration decisions and their implications for developing countries if they become the new standard for multilateralization.

Definitions of Investments.

Consistent with most IIAs, Article 9 (1) has a wide definition of investment to include enterprises, shares, stock and other forms of equity participation in an enterprise; bonds, debentures, other debt instruments and loan, futures, options and other derivatives; turnkey, construction, management, production, concession, revenue-sharing and other similar contracts; intellectual property rights; licences, authorisations, permits and similar rights conferred pursuant to the Party's law and other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens and pledges, It excludes however Party to Party loans from the definition of investments and protects existing investments as well as those that are set up after the entry into force of the agreement

Scope and Coverage

Article 9 (2) provides that the agreement applies to measures adopted or maintained by a Party relating to: investors of another Party; covered investments; and with respect to Article 9. (9) (Performance Requirements) and Article 9 (15) (Investment and Environmental, Health and other Regulatory Objectives), all investments in the territory of that Party.

The provisions of the agreement applies to all measures adopted or maintained by all levels of Government in a member state and any person, state enterprise or any other body that exercises any governmental authority delegated to it by central, regional or local governments or authorities of that Party.

The implication of this is that any government institution official acting in any capacity who puts in place a measure deem to contravene the provision of the

[2] World Investment report 2015 UNCTAD

agreement can make the country liable for a claim by an injured investor under a dispute settlement claim.

National Treatment

Article 9 (4) on National Treatment provides that 'each Party shall accord to investors and investments of another Party treatment no less favourable than that it accords, in 'like circumstances', to its own investors with respect to the 'establishment', acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory'. The inclusion of the phrase 'like circumstances' should ensure that tribunals in deciding whether there has been a breach of the national treatment rule are limited to comparing 'oranges to oranges' This is relevant in an era where a previous decisions by a tribunal has found that a company exploring Oil is comparable to a company exporting agricultural produce.[3] The national treatment provision also covers pre-establishment rights. This implies that countries are mandated to treat foreign 'potential' investors in the same way as they do local investors and cannot reserve the policy space to restrict investments in certain sectors to local companies. The inclusion of pre-establishment rights in Investment agreements have severe consequences for developing countries. It creates rights for the investors and obligations for host states even before the Investor has made an 'investment'. Pre establishment rights limit the policy space of developing countries because in changing circumstances it might be necessary for host governments to place limitations on admission and establishment of investments. This becomes impossible once pre-establishment national treatment is granted in an investment agreement. Article 9:11 provides a list of non-conforming measure to which the provision of National treatment do not apply.

Most Favoured Nation

Article 9 (5) provides for the 'Most-Favoured-Nation' treatment and states that 'each Party shall accord to investors and covered investments of another Party treatment no less favourable than that it accords, in like circumstances, to investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory. An important point to note with this provision is that sub (3) explicitly excludes international dispute resolution procedures from MFN provisions in addition to the exception already contained in Article 9:11 on non-conforming measures. Given recent tribunal decisions[4] where parties have been allowed to import more favourable terms from other bilateral investment agreements to which their home states were not parties under the MFN rule, the deliberate exclusion of ISDS procedures from MFN in the TPP is an attempt by the

[3] Occidental Exploration and Production Co. v. Ecuador, LCIA Case No. UN3467, Award, July 1, 2004, paras. 167-179.
[4] MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile (ICSID Case No. ARB/01/7)

parties to ensure investors are not able to ‘treaty shop’ for better ISDS rules in bringing a case against host states. In the cited case of *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile*, a Malaysian investor successfully claimed that the MFN provision in the Malaysia-Chile BIT entitled it to invoke the FET provisions in Chile’s BITs with Denmark and Croatia, which contained more extensively worded obligations. In its consideration, the Tribunal concluded that, under the BIT, the fair and equitable standard of treatment has to be interpreted in the manner most conducive to fulfil the objective of the BIT to protect investments and create conditions favourable to investments and held that to include as part of the protections of the BIT those included in Article 3(1) of the Denmark BIT and Article 4(1)] of the Croatia BIT is in consonance with this purpose.

Minimum Standards of Treatment (Fair and equitable treatment)

One of the more controversial provisions of IIAs is the Minimum Standard of Treatment (or FET) rule. The FET obligation has emerged as a prominent feature in investors’ actions against host states and given them a right of action even when their claims do not meet the breach of non-discrimination or expropriation rules. In recent arbitration decisions, tribunals have interpreted this obligations with varying degree of latitude. While some have held states to a high standard of behaviour[5], others have held that the state only need **not** act in a manner that is outrageous or egregious[6]. The TPP in trying to limit the laxity that the interpretation of the standard is prone to, provide that ‘each Party shall accord to covered investments treatment in accordance with applicable ***customary international law*** principles, including fair and equitable treatment and full protection and security and prescribes customary international law as the ‘*minimum standard of treatment of aliens as the standard of treatment to be afforded to covered investments*’.

It also provides that the concepts of “fair and equitable treatment” and “full protection and security” does not create additional substantive right, thus restricting the ability of the tribunals to expand the scope of the provision beyond what is intended. More importantly, It further clarifies that ‘*the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result and the mere fact that a subsidy or grant has not been issued, renewed or maintained, or has been modified or reduced, by a Party, does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result*’

The inclusion of these proviso in the agreement is in a bid to again restrict the arbitrariness of tribunals who have held that the states can be liable to damages for

[5] Tecnicas Medoambientales Tecmed S.A. v. United Mexican States, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003
[6] Glamis Gold v. United States, Final Award, 8 June 2009.

acts that contravene an Investors 'legitimate expectations'. In a world where developing countries are 'racing to the bottom' to provide favourable conditions to attract FDIs and coupled with Investments treaties with pre-establishments rights, it is easy to envision a scenario where a country could be held liable for loss of 'envisaged' profits based on promises made by an overzealous government official hoping to attract investments into a particular sector of the economy. In the *Clayton and Bilcon of Delaware Inc. v. Government of Canada* case[7], the Investors pointed to promotional pamphlets made available by provincial entities to illustrate the government's encouragement of Investments and submitted that the Province of Nova Scotia had a publicly stated policy of encouraging investment in its mining industry and its political and technical officials when informed of the interest by Bilcon to develop the mining quarry and marine terminal welcomed Bilcon's interest and provided political and technical support thus creating a legitimate expectation of approvals for the project.

Performance Requirements

One of the driving forces for investment promotion by developing countries is the belief that FDIs lead to economic growth and development. Key objectives for seeking these investments may include; an interest in fostering technology transfer, employment creation, export expansion and local industry development through local content rules. However with the advent of performance requirements in Investments agreements, nations are restricted from placing any conditionalities that investors must meet in order to establish, operate, acquire, manage or sell off an investment. Article 9 (9)of the TPP provides among others that parties must refrain from imposing performance requirement on the investments of members:

(a) To export a given level or percentage of goods or services;

(b) To achieve a given level or percentage of domestic content;

(c) To purchase, use or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory;

(d) To relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with the investment;

(e) To restrict sales of goods or services in its territory that the investment produces or supplies by relating those sales in any way to the volume or value of its exports or foreign exchange earnings;

(f) To transfer a particular technology, a production process or other proprietary knowledge to a person in its territory;

(g) To supply exclusively from the territory of the Party the goods that the investment produces or the services that it supplies to a specific regional market or to the world market;

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[7] Clayton and Bilcon of Delaware Inc. v. Government of Canada (PCA Case No. 2009-04)

These restrictions effectively erode the policy space that developing country governments need to use foreign investments as tools for achieving economic growth or export diversification goals. These same policy tools have been used in the past by the developed countries to foster their industrialization. The WTO's Agreement on Trade-Related Investment Measures (TRIMs Agreement) is the first main international treaty that sought to restrict the freedom of governments to regulate FDIs using performance requirements. Investors could however not bring a direct dispute claim against a government under the TRIMS. Starting with the USA, Canada and Mexico NAFTA agreements however, performance requirements have become fairly common in IIA signed by these countries. The TPP goes beyond these regular provisions to include restrictions on requirements to use domestic technology and the ability to cap voluntary licence royalties. These restrictions further constricts the ability of states to develop local technology while not being allowed to mandate foreign technology transfer. Sub section 3 of Article 9:9 contains some limitations on these obligations for local training or obligations to safeguard health and environmental issues.

Investor State Dispute Settlement (ISDS)

Section B (Articles 17-29) of the TPP contains provisions on Investor State Dispute Settlement processes (ISDS)

Prior to the late 1990s, investment treaties were hardly a foreseeable threat to the sovereignty of nations as they have quickly become in the more recent past. Trade disputes were traditionally thought to be possible only between States and private entities could not take State governments to international arbitration without the knowledge or support of their Home states. All of these have changed with the advent of IIAs that allow investor- state arbitrations. The first investor – State dispute claim was brought in 1987 and as of 1997, there were only 19 known cases. By 2014 however there are 608 known cases involving 99 respondent states. It is interesting to know that 70% of these known cases were brought **against** developing and transition economies and 80% of the claims were brought by investors from **developed** countries[8]. In 2014, two developing countries Mozambique and Sudan faced their first ISDS cases. In *Oded Besserglik v. Republic of Mozambique*[9], a South African company is suing for alleged indirect expropriation of prawn-fishing quotas concerning a joint fishing operation in which the claimant had allegedly invested based on the 1997 BIT between Mozambique and South Africa. If this claim is successful, Mozambique, one of the poorest and most under developed countries in the world would be forced to pay huge sums to a private company that it could have otherwise spent on the delivery of social services for its citizens. In the case of Sudan, *Michael Dagher v. Republic of the Sudan*[10] the claimant is seeking for awards to the tune of 35 Million USD for the Government's alleged failure to grant

[8] World Investment Report 2015 UNCTAD
[9] ICSID Case No. ARB(AF)14/2)
[10] ICSID Case No. ARB/14/2

frequencies for a wireless internet network that was built by a company in which the claimant held shares.

Investment treaties typically creates obligations for Host states and benefits for investors without counterbalancing obligations for the Investors. In the TPP, claimants can bring a claim for a breach of any of the protections afforded investors under the terms of the agreement. However, the TPP contains a new addition in Sub 2 of Article 9:18 by providing that the respondent (Host State) '*may make a counterclaim in connection with the factual and legal basis of the claim or rely on a claim for the purpose of a set off against the claimant'*. This new rule allows countries to counterclaim against an investor for breach of any obligations under an investment agreement.

ISDS has been criticized by various stakeholders because of the overreaching powers it gives to investors to challenge otherwise altruistic goals of a government for the social development of its country. Examples abound where countries have been held liable for breaches of investor interest for taking actions aimed at controlling 'waste management'[11] measures imposing and attempting to collect taxes; bans on harmful chemicals; bans on mining; environmental restrictions on the manner in which mining can take place; requirements for environmental impact assessments; regulations regarding transport and disposal of hazardous waste; regulations governing health insurance; measures aiming to reduce smoking; measures affecting the price and delivery of water; regulations aiming to improve the economic situation of minority populations; and measures aiming to increase revenues gained from production and export of natural resources.

ISDS restricts national judicial power because it allows large (and often Western) multinationals to bring claims against developing countries outside their judicial system and before private arbitrators with little understanding or consideration for its judicial systems. Because treaties supersede national laws, It also restrict state powers by creating a 'chilling' effect on government bodies causing such institutions to refrain from introducing new laws or regulations or modifying existing laws and regulations, including those whose sole purpose is to promote public health, security and environmental protection for fear of being taken to arbitration.

One of the most damming criticism of the system is the impartiality of arbitrators in investment treaty arbitration, arbitrators are chosen by the parties, are not scrutinised and are immune from liability. Some arbitrators represent major companies as Counsel and yet sit as arbitrators in certain situations, reflecting a potential bias in favour of these investors. In the TPP, parties reserved the right to provide guidance on the application of other relevant rules or guidelines on conflicts of interest in international arbitration' and states that Arbitrators shall *comply with that guidance in addition to the applicable arbitral rules regarding independence and impartiality of arbitrators*. The TPP also requires that arbitration proceedings

[11] Metalclad v Mexico

be made open to the public in contrast with previous processes where proceedings were not publicised.

In general, investment treaties afford protections to foreign investors that are not available to domestic investors and although there have been discussions about the possibility of setting up appellate bodies to reconsider arbitral awards, this is still in the realms of talk. Given the arbitrariness in the interpretations by arbitrators of the meaning and scope of the protection afforded by IIAs to investors and the lack of judicial precedent principles where arbitrators are bound by previous rulings, the uncertainty that pervades the ISDS is not likely to be resolved in the distant future.

Conclusions

The TPP attempts to provide more predictable outcomes by defining and clarifying its provisions to remove ambiguities and ensure that arbitrators are bound by the intention of the parties in their interpretation of the terms of the treaty. Whether this would be sufficient protection for member states is yet to be seen.

The TPP has been touted as the new model FTA for the 21st century attempting to define trade rules going forward. If the agreement is eventually rectified by all parties and comes into force, it can be expected to become a model draft for future negotiations on investment by the parties and extended to their trading partners.

In recent times, a number of developing countries have begun to have a rethink on the benefits of having ISDS in their BITs and other investments agreement and also modifying the investor protection clauses to remove ambiguities. Case in point is Brazil who in their recent investment cooperation agreements signed with Mexico and Mozambique, create investor obligations and have State to State dispute settlement procedures in place of ISDS. India, Indonesia and South Africa are taking the lead in proposing Investment models that are more balanced and preserves the right, autonomy and policy space of Host states to ensure that the investments they attract into their countries are geared towards meeting the sustainable development objectives of the States.

The Trade Competitiveness Section

The Trade Competitiveness Section provides technical assistance to Commonwealth member countries in four areas, namely market access; export development; export of services; and trade facilitation, in order to exploit opportunities offered by international trade. The Section works with government ministries, agencies, regulators and their stakeholders to provide assistance to develop their trade competitiveness. Areas of recent intervention include national trade policy formulation, export strategies, aid for trade strategies, competitiveness implications of trade agreements, trade facilitation and gendering trade policy.

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