Impact of Investment Treaties on FDI Flows

Making the Linkages between Policy Expectations and Treaty Variances

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Session 3: Drivers of FDI – International Investment Policy

2016 ADB Conference on Economic Development

The role of Foreign Direct Investment in Economic Development

Background materials

Journal of International Economic Law, 2015, 18, 79–115
doi: 10.1093/jiel/jgv008
Advance Access Publication Date: 2 March 2015

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Navigating the Expanding Universe of International Treaties on Foreign Investment

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The Geo. Wash. Int'l L. Rev. [Vol. 47

THE SHIFTING TECTONICS OF INTERNATIONAL INVESTMENT LAW—STRUCTURE AND DYNAMICS OF RULES AND ARBITRATION ON FOREIGN INVESTMENT IN THE ASIA-PACIFIC REGION

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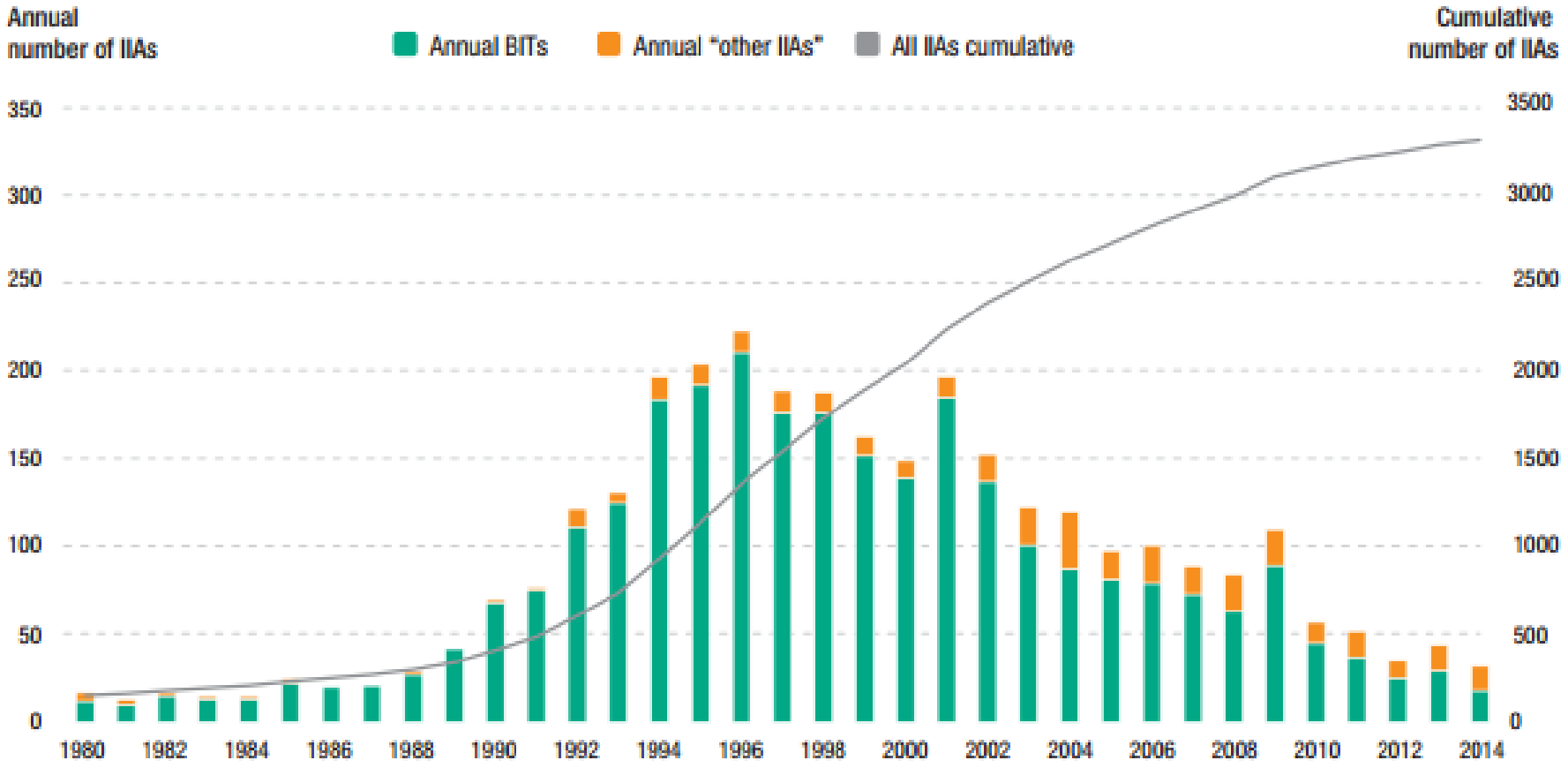
Impact of Investment Treaties on FDI Flows

Why is it an important question?

Trends in investment treaties signed, 1980–2015



UNCTAD, IIA database and World Investment Report 2015 p. 106.

IIL Expanding universe

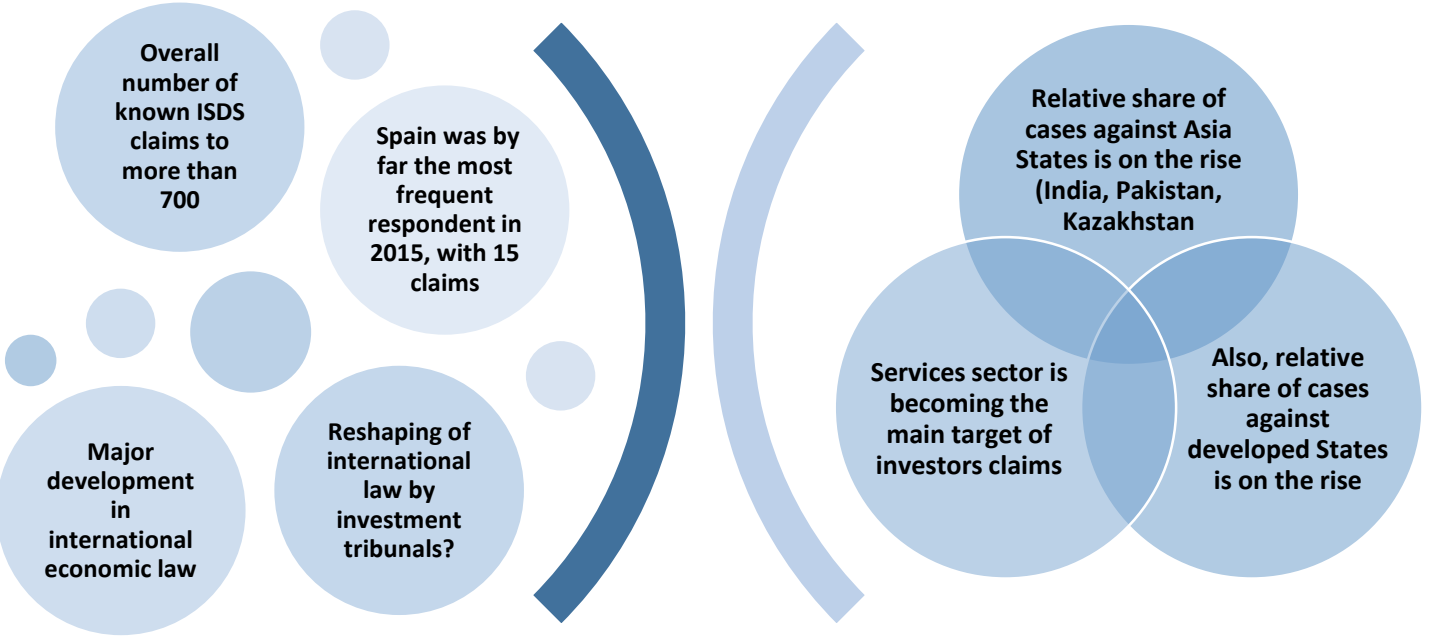
Quantitative expansion

- Number of BITs / Increasing use of PTAs
- Treaty-shopping as consequence (corporate structuring and restructuring)
- From North-South to South-South agreements (and even South-North)
- Proliferation of disputes (interpretation that broaden IIAs: FET, UC…)

Qualitative expansion

- IIAs as a cause and consequence of capitals flows
- Diversity of foreign investments (from tangible to intangible: next frontier servers and data)
- Improved drafting / clarification (FTC 2001, Canada-China 2012…)
- ISDS success but also inconsistent interpretations triggered more law– not less law

Current Trends in investment law (and arbitration)



As of January 1, 2016 / Source UNCTAD and ICSID

Current key negotiations

China – USA (started in July 2013)

European Union – China (started in January 2014)

EU – USA (Transatlantic Partnership

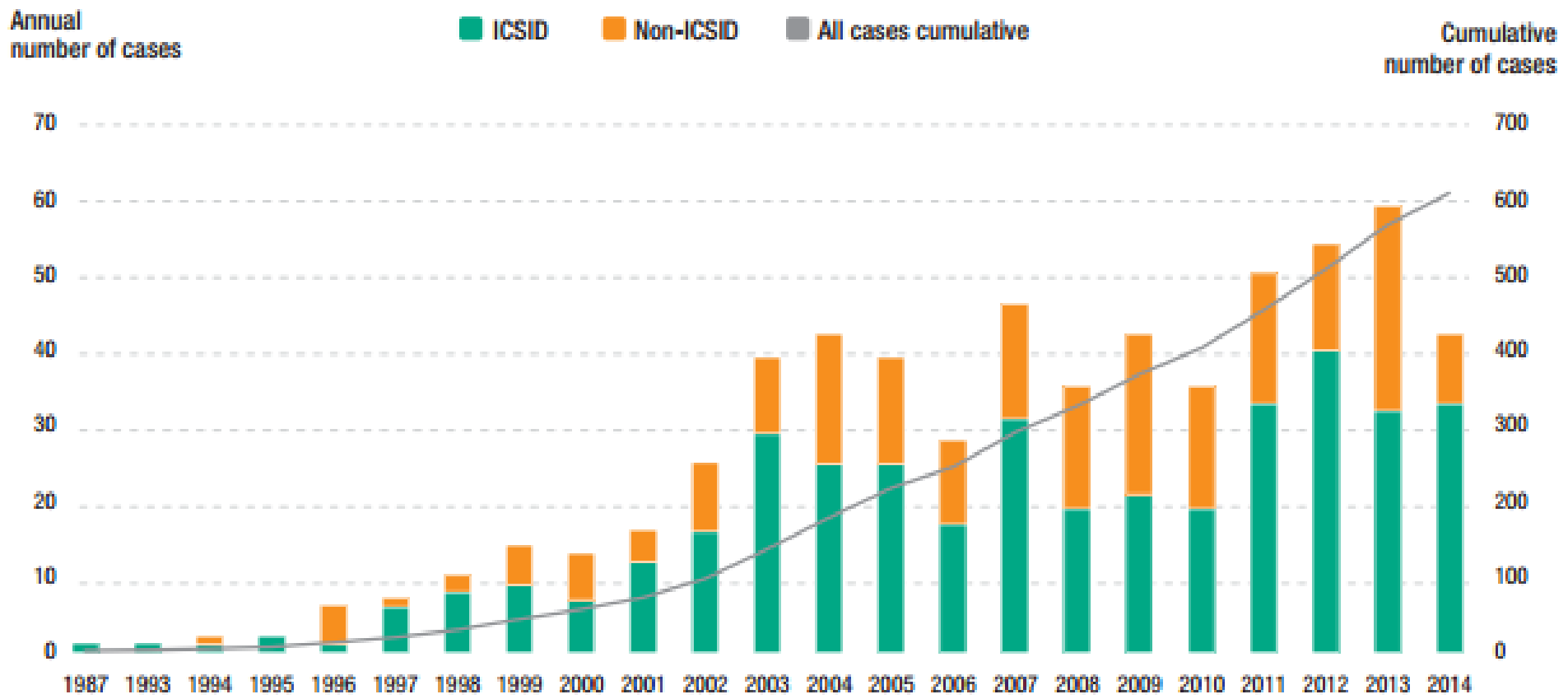
Trans Pacific Partnership (oct. 2015)

Watch: media reports on Blackboard

Are IIAs taken into account by investors?

Can we hypothesize the economic impact of IIAs (and try to measure it)?

Known ISDS cases, annual and cumulative, 1987–2015

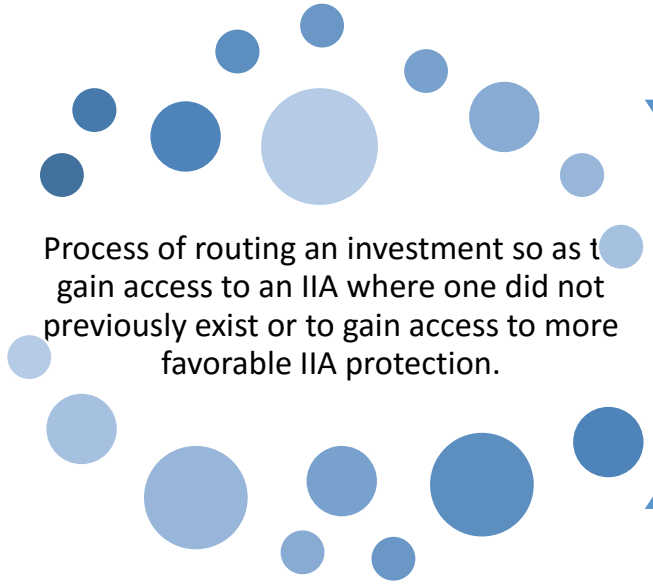


UNCTAD, ISDS database and World Investment Report 2015 p. 114.

"*As a rule* States comply with investment awards. Yet, in *some cases*, the *enforcement* of such awards has proved to be *difficult*".*

*Viñuales, J. E. and D. Bentolila, 'The use of alternative (non-judicial) means to enforce investment awards', in Boisson de Chazournes, L., M. Kohen and J. E. Viñuales (eds.), *Diplomatic and Judicial Means of Dispute Settlement : Assessing their Interactions* (The Hague: Brill 2012).

Treaty-shopping



Process of routing an investment so as t gain access to an IIA where one did not previously exist or to gain access to more favorable IIA protection.

In addition, treaty shopping can further be narrowed by introducing a temporal element and by focusing the definition on restructuring by the transfer of shares or otherwise at the time when the investment is already under some threat, such as in the case of revocation of a license or termination of a contract.

In essence, treaty shopping refers to the practice of structuring (and restructuring) investments to gain access to international jurisdiction

Philipp Morris v. Australia saga

April 2010	**Australia announces plans for plain packaging; consultation papers, draft legislation**
June 22, 2011	PMI serves Notice of Claim to Australia to initiate negotiations before arbitration
November 21, 2011	Tobacco Plain Packaging Act 2011 and Trademarks Amendment (Tobacco Plain Packaging) bill receive final legislative approval; PMI announces it will pursue remedies via the Hong Kong, China-Australia BIT and domestically in the Australian courts
December 20, 2011	PMI files writ against the Australian government
March 2012	Ukraine complains to WTO
July 1, 2012	Tobacco legislation in force
October 2012	Australian High Court rejects PMI's claim
February 2013, July 2013, March 2013, October 2014	Main arbitration hearings. Award rendered in December 2015

Treaty-shopping in the case law

Award	References	Contribution	Legal basis for arbitral jurisdiction
Maffezini v. SpainDecision on Objections to Jurisdiction	Emilio Agustín Maffezini v. The Kingdom of Spain, ICSID Case No. ARB/97/7	Distinction has to be made between the legitimate extension of rights and benefits by means of the operation of the clause, and disruptive treaty shopping that would play havoc with the policy objectives of underlying specific treaty provisions	Argentina-Spain BIT
Yaung Chi Oo Trading v. MyanmarFinal Award	Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar, ASEAN I.D. Case No. ARB/01/1	Requirement of effective management of the investing company in the place of incorporation was primarily included in the 1987 ASEAN Agreement to avoid what has been referred to as "protection shopping"; i.e., the adoption of a local corporate form without any real economic connection in order to bring a foreign entity or investment within the scope of treaty protection	ASEAN Agreement for the Promotion and Protection of Investments
CME v. Czech RepublicPartial Award	CMECzech RepublicB.V. v. The Czech Republic, UNCITRAL	Initiation of parallel treaty proceedings (under a different BIT offering similar protections) by a claimant's shareholder is not an abuse	Czech Republic-Netherlands BIT
Tokios v. UkraineDecision on Jurisdiction	Tokios Tokelés v. Ukraine, ICSIDCase No. ARB/02/18	Distinguishes between the creation of foreign legal personality for legitimate commercial planning purposes and the kind of conduct which the ICJ noted (in Barcelona Traction) can lead to the piercing of the veil in municipal legal system	Lithuania-Ukraine BIT
Aguas del Tunari v. BoliviaDecision on Objections to Jurisdiction	Aguas del Tunari, S.A. v. Republic of Bolivia, ICSID Case No. ARB/02/3	It is not uncommon in practice, and in the absence of a particular limitation not illegal, to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT	Bolivia-Netherlands BIT
Telenor v. HungaryAward	Telenor Mobile Communications A.S. v. The Republic of Hungary, ICSID Case No. ARB/04/15	The effect of the wide interpretation of the MFN clause is to expose the host state to treaty shopping by the investor among an indeterminate number of treaties to find a dispute resolution clause wide enough to cover a dispute that would fall outside the dispute resolution clause in the base treaty	Hungary-Norway BIT
Phoenix Action v. Czech RepublicAward	Phoenix Action, Ltd. v. The Czech Republic,ICSIDCase No.ARB/06/5	When a party makes an investment, not for the purpose of engaging in commercial activity, but for the sole purpose of gaining access to international jurisdiction, it does not engage in a bona fide transaction	Czech Republic-Israel BIT
Cementownia v. TurkeyAward	Cementownia "Nowa Huta" S.A. v. Republic of Turkey, ICSID Case No. ARB(AF)/06/2	Treaty shopping per se is not in principle to be disapproved of, but in some instances it has been found to be a mere artifice employed to manufacture an international dispute out of a purely domestic dispute	Energy Charter Treaty (ECT)

In a nutshell

- IIAs are proliferating
- Important IIAs under negotiations- Governments have expectations
- IIAs are used by corporations to structure their investment (not the main driver but increasingly important)
- The latter element suggest that not all IIAs are equal– that’s why there is treaty-shopping

Variances in rule-making

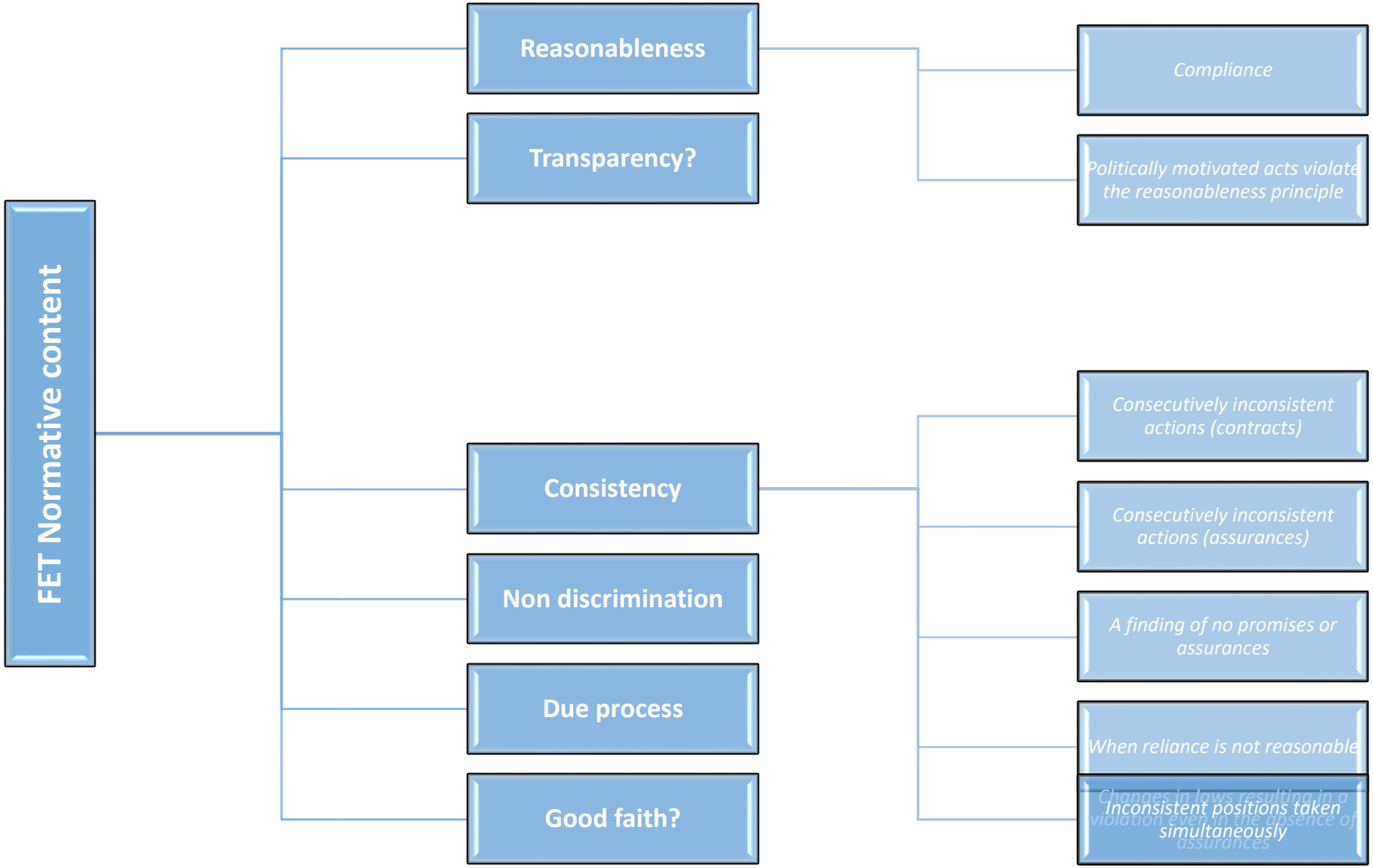
Basic provisions

Breadth of investment agreements	Definition of foreign investment, temporal scope of application, umbrella clause.
Liberalization of cross-border investment flows	Market access: Admission vs. establishment. Guarantee of free transfer of payments, of capital and returns, related to foreign investment, often qualified by exceptions in case of balance of payments problems.
Non-discrimination principle	Principle of national treatment for foreign investors, but often subject to qualifications and exceptions. MFN treatment, subject to standardized exceptions.
Regulatory constraint and investment protection	Fair and equitable treatment of foreign investors. Right of the host country to expropriate foreign investors, subject to the condition that expropriation is non-discriminatory and accompanied by adequate compensation.
Access to international dispute settlement (Arbitration)	State-to-state dispute settlement provisions, and increasingly also investor-to-state dispute settlement.

Example: fair and equitable treatment (FET)

Hong Kong – Thailand BIT 2005

- Article 2.2: "Contracting Party shall at all times be accorded *fair and equitable treatment* and shall enjoy full protection and security in the area of the other Contracting Party."



Inconsistent Positions Taken Simultaneously

- Consistency principle also may be violated not by changes in the law over time, but by taking inconsistent positions simultaneously.
- In *MTD Equity v. Chile*, a case arising under the Malaysia-Chile BIT, Chile had induced a Malaysian company to invest in building a planned community.
  - Subsequently, the Malaysian company learned that construction of the community would violate local zoning laws and thus the work could not be performed.
- The tribunal held that
  - *"approval of an investment by the [Chilean Foreign Investment Commission] for a project that is against the urban policy of the Government is a breach of the obligation to treat an investor fairly and equitably."*
- As the tribunal explained, Chile has
  - "an obligation to act coherently and apply its policies consistently."
- Chile had adopted two inconsistent policies simultaneously
  - *(1) encouraging an investment at the national level (2)* that it simultaneously *forbade at the local level!*

MTD Equity Sdn. Bhd. v. Republic of Chile, ICSID Case No. ARB/ 01/7, Award, (May 25, 2004) 165-166

Politically Motivated Acts Violate the Reasonableness Principle

- In *Vivendi v. Argentina*, a case arising under the France-Argentina BIT,
  - Claimants' investment had obtained a concession to operate a water distribution system undergoing privatization.
- Tribunal found that
  - after sharp rate increases and a temporary but harmless discoloration of the water had stirred local opposition,
  - local officials engaged in a campaign to force the investment to accept new terms,
  - such as by encouraging customers not to pay their bills.
- Further, after the investment sought to terminate the agreement and to institute arbitration under the BIT, Argentina enacted legislation to prevent the investment from pursuing collection lawsuits or enforcing debts, measures that the tribunal found to constitute
  - "a vindictive exercise of sovereign power aimed at punishing . . . [the investment that] cannot plausibly be justified."
- The enactment of these unjustified measures violated the FET standard.

Compagnia de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Arg. Republic, ICSID Case No. ARB/97/3, Award (Aug. 20, 2007) para 7.4.45

Deviations from standard FET

TPP 2016

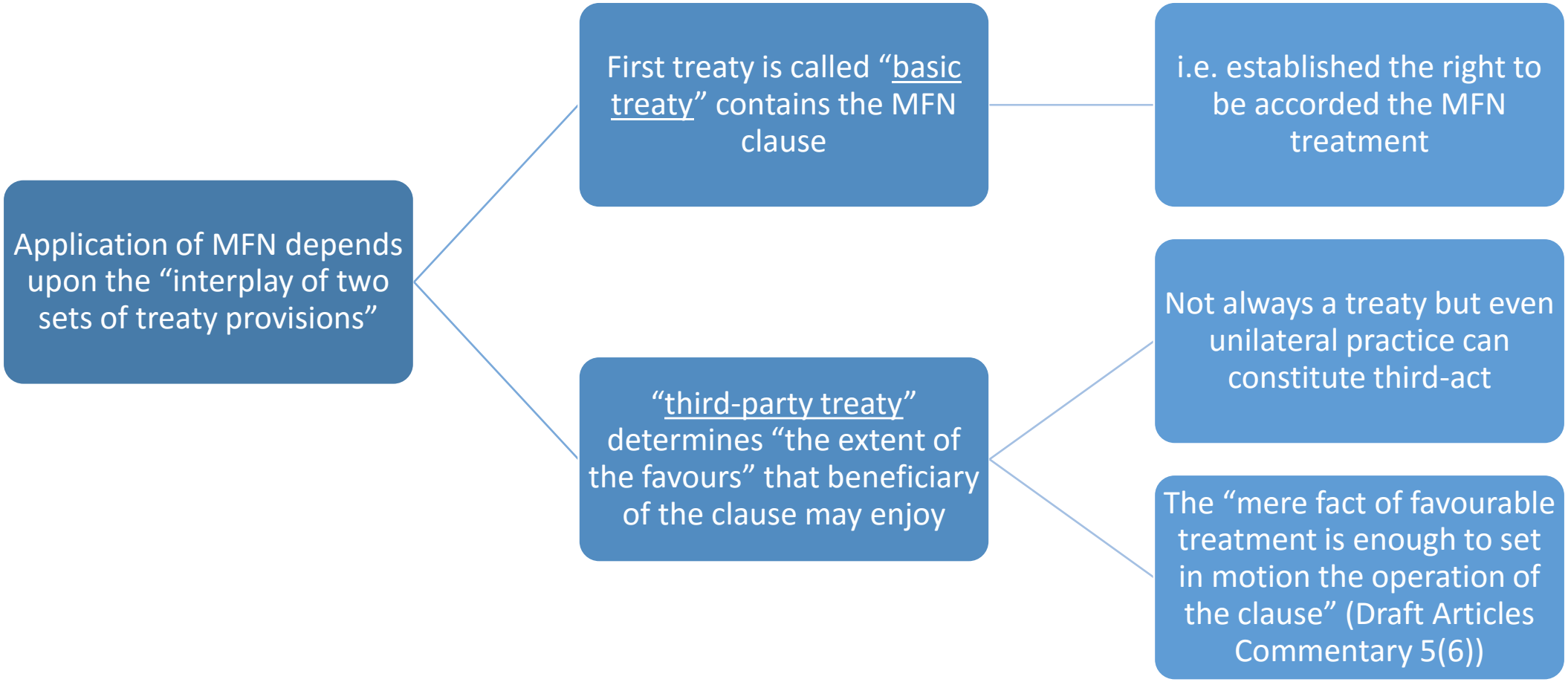
- Article 9.6.1: “Each Party shall accord to covered investments treatment in accordance with applicable customary international law principles, including fair and equitable treatment and full protection and security.”

Pakistan – Turkey BIT 1995

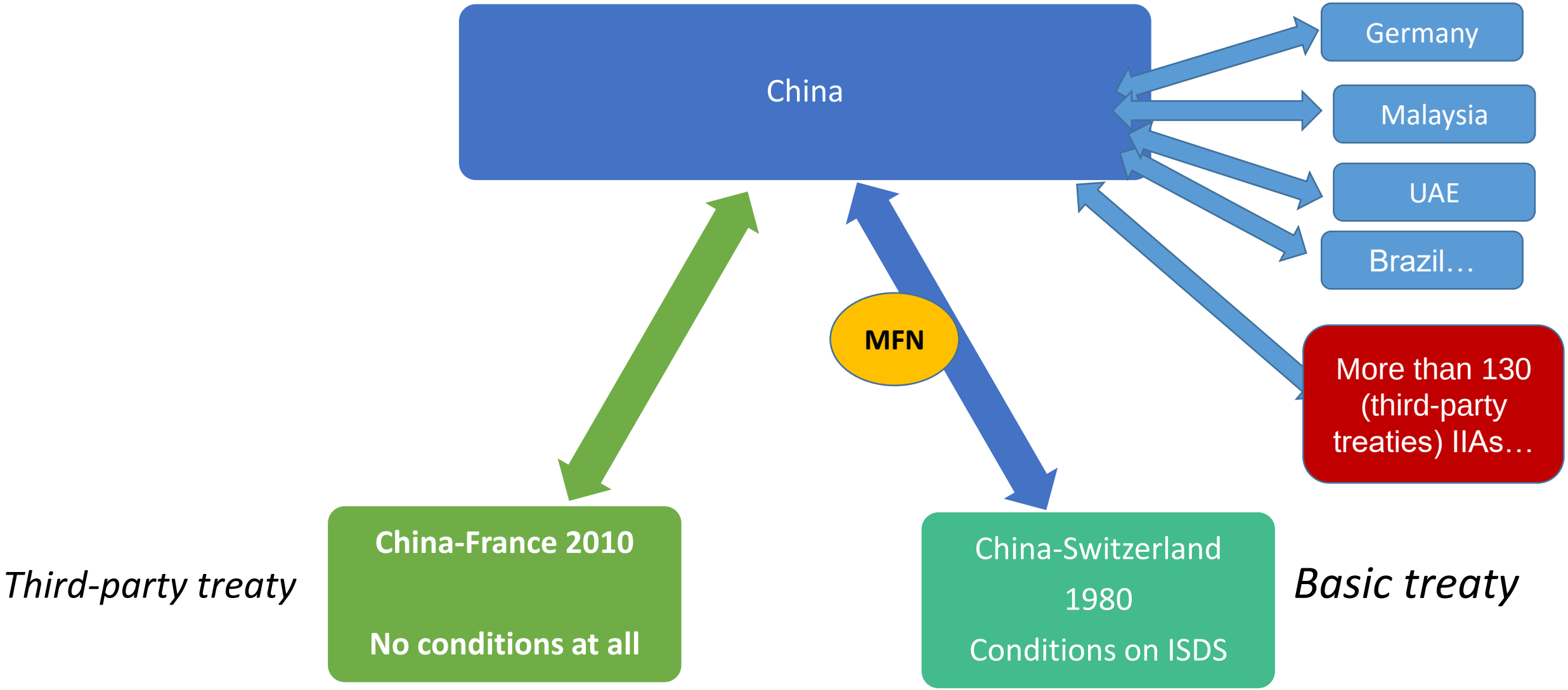
- No FET clause

MFN as endogenous variable

MFN application is “double” in nature



(Simple) Example



MFN and Fair and Equitable Treatment (FET)

- Bayindir v Pakistan (2005) found that FET could be read into the base treaty, the Pakistan-Turkey BIT even though there was no FET clause therein.
  - Because wording of the MFN clause + all other Pakistanese BIT incorporate FET!
  - because the Preamble referred to the fair and equitable standard as well
- Tribunal concluded "prima facie Pakistan was bound to treat investments of Turkish nationals fairly and equitably".
- It should be the Pakistan-Switzerland treaty **on the ground that it was the later in time**
  - NB: It should be noted that this was a decision on jurisdiction and that the finding was only a *prima facie finding*

Bayindir Insaat Turizm Ticaret Ve Sanayi AS v. Islamic Republic of Pakistan, ICSID Case No. ARB/03/29, Decision on Jurisdiction of November 14, 2005, para. 227-235.

MFN: Promises and shortcomings

Conclusion

- IIAs specific provisions must be taken into account to correlate FDI flows
- In addition, the context in which a given IIA exists must also be factored in:
  - Tax treaty, quality of governance; stage of development…
- Implications for empirical studies:
  - best countries, region or period to conduct empirical studies
  - Probably that a country with significant capital export and large number of IIAs could be the best pick
  - Malaysia? 70+ IIAs (including FTAs), diverse set of partner countries, political stability, rule of law…
  - Conversely a number of countries (e.g. Pakistan) can be suggested not being good samples: few BITs, no FDI import/export…

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