Bilateral Investment Treaties

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Overview

- Movement of capital across borders
- Development of International Property Rules
- Challenges to foreign capital
- Emergence of Minimum Standard of Treatment
- Challenges to International Property Rules
- Signing of BITs
- Content of BITs

Investment before BIT era

Treaty practice can be traced back to European countries in the 17 C.

The historical links between the host state and the investor and the historical circumstances, especially the political circumstances that shaped the regulatory framework of foreign investment back then.

Investment before BIT era

With the advancement in transportation and communication, movement of capital across the border started taking place.

With the rise of industrial capitalism and the continued growth of the modern state, the expansion of capital across national boundaries became a common feature.

The capacity to organise production worldwide, manage events at a distance, and procure support from foreign governments became a characteristic feature of the world economy.

Initially, the companies focused only on trading- especially trading in fur, spices, precious metals etc.

But later these companies became international producers and were involved in activities like mining, manufacturing, farming etc.

Investment before BIT era

- There were vertical integration (For eg- companies that extracted oil started refining oil and started selling the final products) as well as horizontal integration where companies instead of exporting, started local production. This reduced transportation costs and the goods were tailored to the needs of the local market.
- Thus there was a development of international property rules.
- Some European countries' effort to protect the investment made abroad began in the 17th century.

Development of International Property Rules

- Initially, the merchants only relied on domestic laws for their protection but as economies developed, countries started taking interest in foreign commerce.
- European Countries concluded commercial treaties to protect each other's national's interests.
- These treaties were initially designed to protect the merchants and traders but eventually extended to protecting industrial and financial capital.
- Example of such treaty- The 1667 Treaty between Britain and Spain prohibited the mistreatment and seizure of ships and merchandise in each other's territory

Development of International Property Rules

- These treaties protected reciprocal interests among European countries as they had extensive ties with one another.
- Even during wartime, these treaties allowed setting up of mixed claims tribunals.
- The protection of foreigners and their property was secured by many European states and eventually even the United States did the same after its independence.
- But with increasing movement of capital, capital exporting countries devised other strategies to protect the capital invested in other countries by their nationals.

Strategies to protect foreign investment by their nationals

Friendship, Commerce and Navigation (FCN) treaties,

capitulation treaties (or unequal treaties),

diplomatic intervention backed by gunboats when necessary and

colonial annexation of territory.

Challenges to foreign investment

The expansion of production into foreign countries came with its own challenges.

General market risks were anyway there.

But the chances of political hostility to foreign investment may be high depending on the ideological inclination towards foreign investment.

Communist ideology was completely opposed to private capital and private means of production.

Challenges to foreign investment

- For instance, before the 1990s, in India, there was a combination of nationalism and socialism which were unfavourable to foreign investment.
- Another example- When President Sadat was heading Egypt, he wanted to improve tourism to Egypt and admitted foreign investment for building tourist complex near the pyramids.
- There were many oppositions to this project due to the proximity of this investment to the historic monument and this issue was raised many times in Parliament as well.
- After the assassination of President Sadat, President Mubarak halted the project even when the construction had begun.

Challenges to foreign investment

- Biggest threat to foreign investment- Nationalisation
- For instance- The decision of Mossadegh to nationalise oil companies in Iran is a good example in this context. Indigenisation in Africa can be cited as an example.

Emergence of International Minimum Standard of Treatment

The Minimum Standard of Treatment of aliens has its origin in the state’s responsibility for injuries to aliens.

The treatment extended to alien’s property as well.

The home state conferred diplomatic protection on its national and pursued a claim against the host state causing injury to its national.

Consequently many PCIJ and ICJ cases were filed.

Challenge to International Property Rules- by 19^{th} C

- With countries gaining independence, it aspired for economic independence along with political independence.
- Era of nationalization.
- One scholar, Friedrich Katz attributed this challenge to international property rules on foreign investment itself by stating that foreign investment generated sufficient revenues for Mexico to organise, and maintain a reinforced army, police and efficient bureaucracy.
- A serious challenge to international property rules came after the Soviet Revolution.

Challenge to International Property Rules

When Mexico began its land reforms and when the reforms' pace quickened in the 1930s, it threatened US investors' property rights.

US oil industries were affected. If US took action against Mexico, that would affect US silver investors in Mexico.

The US, instead of imposing swift economic sanctions, engaged in prolonged negotiations with Mexico and settled the issue.

Latin American countries opposed the idea that foreign investors were entitled to any greater protection than that accorded to their own nationals.

Calvo Doctrine

Two essential principles of Calvo doctrine on the exercise of diplomatic protection to investors are-

(i) the doctrine of state sovereignty precludes states from intervening in the affairs of another, both diplomatically and by force and

(ii) aliens should be afforded no more than the same treatment as nationals and must limit themselves to filing claims in the local judicial system

International Conferences

A collective of developing countries identified as “Group of 77” used the United Nations as a platform to advance their propositions relating to foreign investment.

The developing countries realised that the international property rules are designed in a way to protect the interests of the investors.

Accordingly, Uruguay and Bolivia introduced a resolution in the UN General Assembly in 1962-Declaration on Permanent Sovereignty over Natural Resources.

In 1972, a Resolution was passed in the General Assembly which reiterated the rights of states to nationalise and that it was the expression of sovereign power.

International Conferences

A Resolution was passed in Security Council, Resolution 330 (1973) on 21 March 1973 which states that home states cannot exercise economic, political or other sanctions to threaten host states from exercising their sovereign right.

New International Economic Order (NIEO) was established through Resolution no. 3201 in 1974.

Resolution 3281 of December 1974 on the Charter of Economic Rights and Duties of States (CERDS).

Hypocrisy of developing countries

- At the international level, developing countries were fighting against the tenets of international property rules.
- But at the same time, they needed capital for development.
- With foreign aids drying up and conditional loans from international financial institutions, developing countries sought foreign investment in their territory.
- So, developing countries started concluding bilateral treaties with capital exporting countries and offered protections to foreign investments and investors.

Signing of Bilateral Investment Treaties

- The first BIT was signed by Germany with Pakistan.
- Germany actively signed many BITs.
- Soon, other European countries followed this.
- US and Japan were late to this trend.
- India started signing BITs after liberalisation in 1990s.

Theories relating to Foreign Investment

Classical Theory

Dependency Theory

Middle Path Theory

Content of BITs

- One country will have multiple BITs with different contents.
- Each BIT is signed after negotiation with that country.
- Every country has a Model BIT.
- So the final BIT will have provisions from model BITs of both countries.
- Provisions of the BIT are broadly the same categories even if the wording of the provisions differ.
- Brief idea- ICSID and UNCITRAL Arbitration Rules
- International Centre for Settlement of Investment Disputes

Preamble

Earlier BITs

- preamble- only economic terms

Modern BITs

- preamble- sustainable development

Definition clause

- Investment
  - Asset based definition- broad
  - Enterprise based definition- narrow
  - ICSID cases- certain criteria- risk, substantial capital, substantial duration, development to host state (Salini criteria)

Definition clause

- Investor
  - Natural person and legal person
  - Incorporation test, economic substance test, seat of business
  - It can be broad or narrow
  - Nationality Planning

Scope

- FDI or portfolio investment
- Exclusion from scope- pre establishment or post establishment
- For instance- India excludes taxation measures from scope

Substantive Protections

Expropriation

Expropriation and nationalization

Legal expropriation or direct expropriation

Illegal expropriation or indirect expropriation

Creeping expropriation

Disputes- legitimate regulatory measure or indirect expropriation

Right to regulate

Modern treaties

Sole effect approach v police powers doctrine

Weighing and balancing approach

Anti-discrimination provisions

- National Treatment
  - Like circumstances
- Most-favoured nation treatment
  - Treaty shopping
  - Procedural provisions
  - Substantive provisions
  - Absent in Model India BIT
  - White Industries case

Substantive Protections

Fair and Equitable Treatment

- Unqualified FET clause
- Qualified FET Clause
  - In accordance with international law or customary international law
  - Defined FET clause

Content of FET clause

- Denial of justice
- Lack of Transparency
- Lack of stability, consistency and predictability
- Legitimate expectations
- Procedural propriety and due process
- Good faith

Full protection and security

- FPS clause
- Physical protection
- Legal protection
- Czech Republic cases- broad interpretation
- Some treaties explicitly limit it to physical protection

Umbrella Clause

- "Each contracting party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other contracting party."
- Elevates contractual disputes as treaty disputes
- Very broad provision to protect the interests of foreign investor

Transfer of Money

“Subject to its law, each Party shall permit all funds of an investor of the other Party related to an investment in its territory to be freely transferred and on a non-discriminatory basis. Such funds may include: \

(i) contributions to capital;

(ii) profits, dividends, capital gains and proceeds from the sale of all or any part of the investment or from the partial or complete liquidation of the investment;

(iii) interest, royalty payments, management fees, and technical

assistance and other fees;

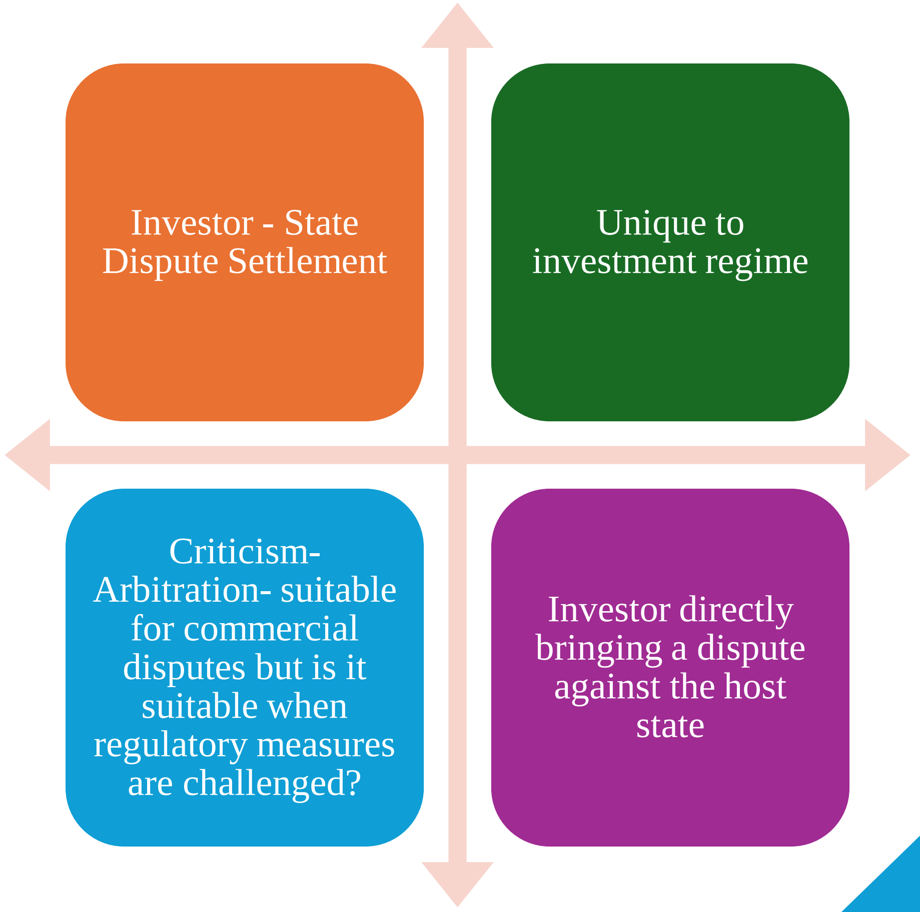
(iv)payments made under a contract, including a loan agreement;

(v) payments made pursuant to Article 5 [Expropriation], Article 7[Compensation for losses]”

Entry and Sojourn of Personnel

"Subject to its law relating to the entry and sojourn of non-citizens and on the basis of reciprocity, each Party shall permit natural persons of the other Party employed by the investor or the locally established enterprise to enter and remain in its territory for the purpose of engaging in activities connected with the investment."

Dispute Resolution clauses



Dispute Resolution clauses

Two kinds of dispute resolution-

- State to State dispute resolution
- ISDS

Various forums for ISDS

- ICSID
- ICSID AF
- UNCITRAL

Dispute Resolution clauses

- Notice of dispute
- Amicable settlement period or cooling off period
- Notice of arbitration
- Arbitration

Appeal Mechanism

BITs may provide for bilateral appeal mechanism.

ICSID Convention provides for Annulment proceedings on limited ground.

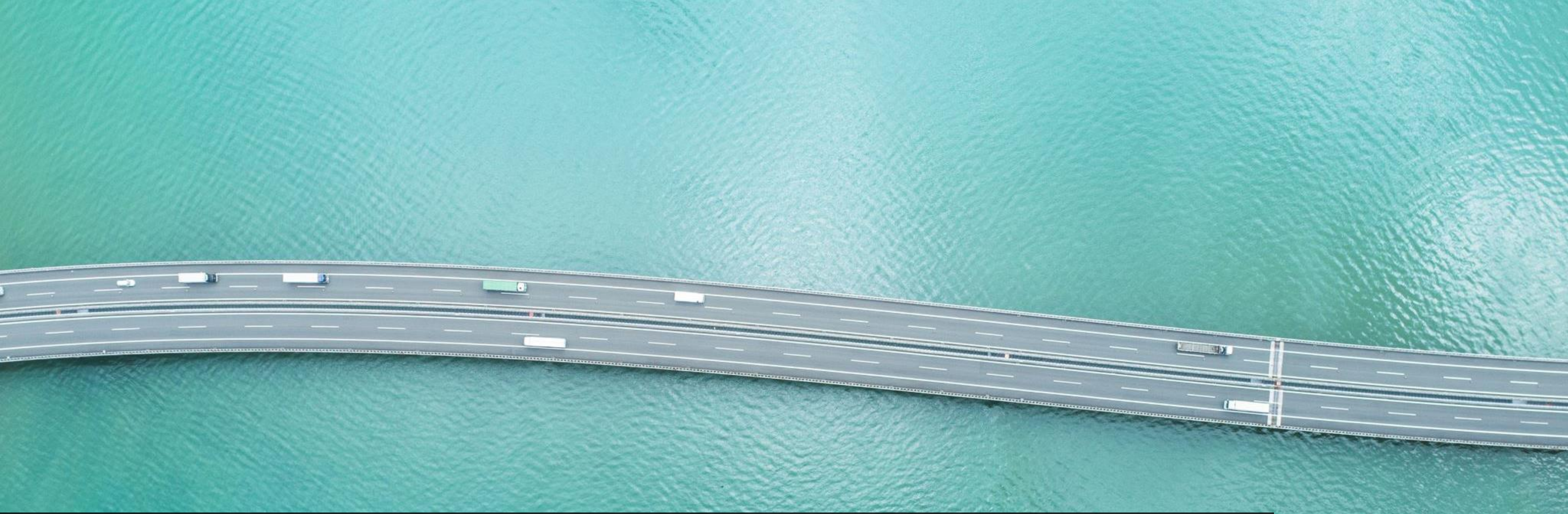
Investor and home state obligations

Modern treaties impose obligations on investors.

Draft Model India BIT contained obligations imposed on home state but the final version of Model India BIT did not contain such obligations.

Termination and Sunset clause

- Few months of notice is required to terminate the BIT at the instance of any one party.
- The number of months differ from treaty to treaty but ordinarily 6 months.
- Sunset clause- mentions a specific period where the provisions of the terminated treaty will still be applicable.
- For instance, Indian BITs before had 10 years in sunset clause but the latest Model India BIT mentions 5 years.



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