McNAIR CHAMBERS
INTERNATIONAL COMMERCIAL LAWYERS

Bilateral Investment Treaties (BITs): The Essentials

Khawar Qureshi QC[1]

Summary of contents

1. Background

BIT disputes are a rapidly expanding and high profile area of international litigation. The UNCTAD Report (2006) shows that there were 7 known BIT cases in total as at 1996. By 2005 the total was 200. More than 70 states have faced BIT claims, Argentina having faced the most (the aftermath of its currency crisis)[2].

However, although rapidly expanding in numbers, Investment Treaty disputes still comprise less than 10% of the total number of international arbitrations. Publicly available information indicates that there are approximately 125 Investment Treaty cases pending before International Tribunals (there will be more disputes in existence because a further number are being considered before ad hoc tribunals and/or remain clothed with confidentiality).

Nevertheless, given the potential utility of BITs for Foreign Investors and the scope for claims against States, it is vital to be aware of the key features of Investment Treaties – whether from the perspective of advising on the negotiation of an inward investment agreement (and hence considering issues

[1] Khawar Qureshi QC specialises in International Arbitration/Litigation and Public International Law (kqqc@mcnairchambers.com) (www.mcnairchambers.com)

[2] See the UNCTAD Report (2006) "International Investment Arrangements: Trends and Emerging Issue" (2006 Report) at figure 6.

such as strategic use of jurisdictions which have Investment Treaty arrangements with the host state), or when considering a potential claim against a State.

Research tools

Good web sites:

UNCTAD - plenty of research data on trends in BIT negotiations/disputes and a very good database of Bi-lateral Investment Treaties ("BITs)
(www.unctad.org)

ICSID - case list, procedural orders, decisions on jurisdiction/merits and BIT list (of around 1100 BITs)
(www.icsid.org)

ECT - case list, information relating to Energy Charter Treaty 1994
(www.encharter.org)

2. Key Issues

I. What is a BIT?

1. These are Treaty arrangements to provide foreign investors with a "level playing field" and access to an international arbitral tribunal in the event the host State uses its sovereign power with detrimental effect to the foreign investor.

2. The First BIT was entered into in 1959 (in the wake of the Cold-War and nationalisations which exposed the lack of effective protection for foreign investors)[3]. There are now almost 3,000 BITs[4]. Most are bi-lateral, some

[3] The pre-cursors for BITs were Treaties of "Friendship, Commerce and Navigation" – the first one having been signed in 1788 between the US and France containing provisions regulating treatment of foreign investment.

[4] See the 2006 Report which indicates (at figure 4) that the Top 4 signatory States to BITs are:
1. Germany 2. China 3. Switzerland, and 4. UK. 40% of BITs are between Developed and Developing Countries. As the UNCTAD 2007 Report ("the 2007 Report") makes clear, since 2001 the number of BITs concluded annually has shown a downward trend. The 2007 Report makes an excellent comparison of key provisions in different BITs as well as commenting on their interpretation and effect.

are linked to multilateral treaty based systems such as the ICSID Convention (1965), and the Energy Charter Treaty (1994).

The contents of a typical BIT

3. Most BITs follow a similar approach vis-à-vis contents.

   i. **Preamble** – limited legal effect (provides context for interpretation)
   ii. **Definitions** – main ones being **Investor/Investment** - (increasing tendency in new BITs for States to require commercial presence/substantial business activities for nationality qualification qua investor[5])

   Scope of Protection – core provisions:

   iii. **Fair and equitable treatment** (including denial of justice)
   iv. **Expropriation**

   "Procedural (or substantive) bonuses"

   v. **Most-Favoured Nation Provisions ("MFN")**
   vi. "**Umbrella clauses"**

   These provisions (and their meaning/effect) are the subject of much debate.

   MFN provisions (depending on which ICSID decision you read, permit an investor to "cut and paste" more favourable provisions in any other BIT which the Host State has entered into[6]).

---

[5] See page 20 of the 2006 Report and see, for example, the 1998 BIT between Chile and Turkey (Article 1) which requires the corporate entity to have its "headquarters together with effective economic activities" in its "home State".

[6] In the case of *Maffezini v. Spain* (ICSID) (25/1/00), the Argentine Investor in Spain was allowed to use a more beneficial time requirement in the arbitration process found in the Chile-Spain BIT on the basis that (subject to public policy considerations of the parties to the negotiations of the respective BITs), this reflected the rationale of MFN provisions. However, since then, various cases (most recently *Telenor.v. Hungary* [13/906] (ICSID)) have evidenced a more restrictive approach, focussing on the intention of the parties to the BITs to evaluate the effect of the MFN provision.

Umbrella clauses (again depending on which ICSID case you read and the exact wording of the provision, "elevate" a contractual obligation to the realm of Treaty obligation[7]).

Jurisdictional provisions.

vii. Settlement of disputes between the Host State and an investor
viii. Entry into force of the BIT
ix. Duration of the BIT

4. As BITs are treaties, the obligations undertaken by States are governed by Public International Law. There was very little development by way of International Law jurisprudence on key concepts such as the meaning of expropriation for decades, due to ideological differences as to the role of investors.

5. Hence, anyone coming to this area will find that most of the "learning" is recent (within the past 10 years) and essentially comes from decisions of International Arbitral Tribunals such as the ICSID Tribunal.

6. ICSID and ECT decisions are publicly available and, (in addition to the very recent admission of "amicus" briefs – see the Procedural Order in the case of *Suez v. Argentina* [ICSID] (12/2/07)), there is a move to make pleadings in these cases publicly available also. Two reasons may explain the stark contrast (vis-à-vis the apparent openness of the process) with most international arbitrations which are controlled by strict confidentiality requirements:

- There is a perceived strong public interest in the "investor community" and citizens of a "Host State" being informed as to the existence and nature of investor disputes
- There is a very real problem with regards to the lack of any system of precedent vis-à-vis arbitral decisions in this area (see the observations of the ICSID Tribunal in the case of *AES Corp v. Argentina* [13/7/05] at paras. 30-32 thereof). Conflicting decisions are common (often reflecting the quality of the arbitrators and/or the desire of the tribunal to "push" a certain argument)

[7] *SGS v. Pakistan* (6/8/03) ICSID Tribunal said the BIT clause in question did not do this, whereas the ICDIS Tribunal in *SGS v. Phillipines* (29/1/04) said it did vis the BIT clause it considered (differently worded). The emerging consensus is that a clause requiring the State to "honour all of its obligations/commitments" does in fact "elevate" a contract breach to the realm of a BIT obligation for the State IF it, (as opposed to a sub-state entity), has entered into the contract in question – see the cases of *Salini v. Jordan (ICSID) (Jurisdiction) [12/11/04]* (at paragraphs 120 to 130), and *LG&E v. Argentina* [3/10/06] (ICSID – Liability) (at paragraphs 164 to 175).

7. Many States that were hitherto blissfully ignorant as to the significance of BITs have been taken by surprise as to their meaning and effect. Indeed, there have been an increasing number of threats by States to seek re-negotiation of BITs and/or their termination.

8. On 2nd May 2007, the World Bank received a written notice of denunciation of the ICSID Convention from the Republic of Bolivia. In accordance with Article 71 of the ICSID Convention, the denunciation will take effect six months after the receipt of Bolivia's notice (on 3rd November 2007).

II. How to spot a BIT claim.

9. Is there a claim involving a State entity where it might be argued that an investment has been detrimentally affected by the use of State authority?

3. BIT Claim Checklist

Assuming you have located an applicable BIT, when advising on a BIT matter, always ask the following questions to evaluate whether the BIT provisions are engaged, and the nature/extent of any potential claim thereunder:

(i). When did the BIT enter into force?

(ii). Was the alleged BIT breach by the State after its entry into force or is it a continuing breach?

(iii). Is there an Investor?

Very broad definition – so long as a national of a BIT State party (natural or legal entity) can claim to have made an investment in the Host State party to the same BIT, the fact that a locally incorporated entity is used to conduct business is no bar to a BIT based claim.

However, see the recent (and likely to be criticised) majority decision in the case of an ICSID Tribunal *Waguih Siag v. Egypt* [11/4/07]. The Claimant was an Egyptian national at all materials times when the investment was made, and then allegedly lost his Egyptian nationality, acquired Lebanese nationality and also Italian nationality – he claimed under an Italy/Egypt BIT.

The majority held that the ICSID nationality requirement (Article 25 ICSID Convention) was satisfied and that the Claimant had lost Egyptian nationality, despite the fact that his acquisition of Lebanese/Italy nationality appeared to be a device. The minority view was that Egyptian nationality had not been lost and was the real and effective nationality (which meant that as a national of the Host State the Claimant's claim was barred).

Also remember that the ICSID Convention contains its own (undefined) requirement of Investor/Investment (Article 25 ICSID Convention) which can sometimes act as a second hurdle vis local corporate entities where the issue of effective "investor" control is raised – see the ICSID case of *Suez v. Argentina* [16/5/06] (at paragraphs 38 to 40 thereof).

The fact that the "foreign" investor (company) is 99% owned by nationals of the Host State, and that there is no evidence to show "inflow of capital" might appear to disqualify a party from claiming to be an "investor" – not so - (see the case of *Tokios v. Ukraine* [29/4/04] and the dissenting opinion of Professor Prosper Weil who argued that the "real investor" in this case was a Ukraine national and not a Lithuanian company, and that *"investments made in a State by its own citizens with domestic capital* through *the channel of a foreign entity"* did not fall within the object and purpose of BIT protection).

(iv). Is there an Investment?

"Every kind of asset" – again a very broad concept.

However, it has limits – see the very recent decision of the sole arbitrator in the ICSID case of *Malaysian Salvors v. Malaysia* [17/5/07] – which is apparently being challenged via the ICSID annulment process.

In that case (which helpfully summarises all recent ICSID cases dealing with the meaning of "investment") the requirements of an "investment" and "approved project" (under the UK/Malaysia BIT) were not satisfied by a claim relating to a contract for the salvage of an old maritime vessel.

To qualify as an investment, the Tribunal observed that the activity should, inter alia, "promote some form of positive economic development for the host State" (paragraph 68 of the Award).

In the case of *Bayindir v. Pakistan* [ICSID] (14/11/05) (Jurisdiction decision), the Pakistani Government's eminent legal team provided a good opportunity for the Tribunal to rule on a very expansive challenge to knock out the claim on jurisdictional grounds.

The claim against Pakistan had been brought by a Turkish contractor whose agreement to build a motorway in Pakistan had been affected (allegedly) by, inter alia, the imposition of additional taxes, favouritism to local contractors and corruption.

The ICSID Tribunal rejected all of Pakistan's contentions. On the issue of the nature of an investment, the Tribunal stated (at paragraph 116) that it could not be ***"****seriously disputed that Bayindir's contribution in terms of know how, equipment and personnel clearly has an economic value and falls within the meaning of "every kind of asset*".

For another recent example of an expansive (and unsuccessful) "wholesale" jurisdiction challenge see the case of S*aipem v. Bangladesh* [21/3/07] (Jurisdiction stage – held by the ICSID Tribunal, inter alia, that alleged frustration of enforcement of ICC Award by Bangladeshi Courts could constitute expropriation of an investment).

(v). Has there been an absence of Fair and Equitable Treatment?

- What does this mean in practice?
- How do you recognise unfair and inequitable treatment when you see it?

The meaning of fair and equitable treatment

- No "standard" definition
- Generally requires States "to maintain stable and predictable investment environments consistent with reasonable investor expectations"
- However, there is substantial room for exercise of discretion by the arbitral tribunal in each particular case

See for example:

CME v. The Czech Republic **[13/9/01]**
Ronald S. Lauder v. The Czech Republic **[3/9/01]**

Essentially the same facts (nominally different parties and different BITs) (alleged interference with TV broadcast licence), yet:

- **CME**: The Tribunal found that there had been a breach of the requirement for fair and equitable treatment, "by evisceration of the arrangements in reliance upon which the foreign investor was induced to invest".

- **Lauder**: The Tribunal found that there had been no breach of the requirement for fair and equitable treatment.

CMS Gas v. Republic of Argentina [2005]

Claim by an US investor following the massive currency devaluation and "pesification" by Argentina in the late 1990s

- Held that Argentina had breached the requirement for fair and equitable treatment, by breaching the legitimate expectations of the investor

(vi). Has there been expropriation of the investment?

- Various treaty based restrictions on expropriation (Art. 1110 NAFTA, Art. 13 Energy Charter Treaty, BITs, S.712(g) American Restatement 3rd of the Foreign Relations Law)
- General rule: Investment shall not be expropriated or nationalised or subjected to measures having the effect equivalent to expropriation or nationalisation except:
    - for a public purpose
    - in a non-discriminatory manner
    - in accordance with due process
    - against prompt, adequate and effective compensation

What sort of state conduct constitutes an Expropriation?

- **Key Test**: Whether action of a state deprives investor of the whole or significant part of investment (substantial deprivation test)

- However, deprivation is not the determinative factor for expropriation

- Bona fide acts of state: such as general taxation, regulation for public health and other exercise of state police powers if not discriminatory do not constitute expropriation
- Key Question: When does conduct of state cross the line that separates valid regulatory activity from expropriation?

Note:

(a) The form and intent of government measure will always be important but not always decisive

(b) There is no need to show obvious benefit to the Host State

- Outright expropriation is relatively easy to recognise – State takes over a business or nationalises an entire industry (fairly uncommon)

- What amounts to expropriation is largely fact driven
- "creeping"/"regulatory" expropriation is more likely to be seen where the investor's ability to conduct business is effectively undermined by regulations/State acts or omissions.

(1). Direct Expropriation

- Seizure of a factory or machinery (Case Concerning certain German Interests in Polish Upper Silesia)

- Appointment of state managers and supervisors (Various Iran – US Claim Tribunal Cases)

- Forceable seizure of two hotels by Egyptian State (Wena Hotels Ltd, ICSID 2000)

(2). Indirect/Regulatory Expropriation

- Azihian v. Mexico, 1999 (NAFTA)

- Metalclad v. Mexico, 2000 (NAFTA)

- CME v. Czech Republic, 2001 (BIT)

- SD Myers v. Canada, 2000 (NAFTA)

- Waste Management v. Mexico, 2004 (NAFTA)

- Pope & Talbot v. Canada, 2000 (NAFTA)
- CMS Gas Transmissions Co. v. Argentina, 2005 (BIT)

Some of the expropriation cases.

(1). Azinian v. Mexico (1999)

Facts: Concession granted for waste management. Misrepresentation by US company as to experience. Evidence of lack of capacity to perform concession. State government terminated contract.

Decision: Termination of contract upheld by Mexican courts based on relevant standards for annulling concessions under Mexican law. No evidence that the finding by the Mexican Courts was so insubstantial, bereft of basis in law so as to be arbitrary or malicious (and thus constitute a denial of justice).

(2). Metalclad v. Mexico (2000)

Facts: Investor obtained necessary federal permit to operate landfill. Local municipality subsequently denied construction permit forcing facility to close. Later, the State Governor issued an ecological decree (ostensibly for the preservation of cactus in the area) which had the effect of barring operation of facility.

Decision: Measure tantamount to Expropriation:

(a) By tolerating and acquiescing in actions of municipal authorities which prevented operation of landfill despite approval of federal authorities; and

(b) Passing of ecological decree.

NB: Judicial Review in Supreme Court of Canada held expropriation as a result of decree was not patently unreasonable.

(3). CME v. Czech Republic (2001)

Facts: Lauder (US investor) invested in CME (Dutch Co), which in turn invested in Czech Co which was to hold broadcasting licence and operate television station. Public outcry at foreign ownership of television broadcast after award of licence. New business agreement agreed as a result of involvement of Czech Media Council whereby ČNTS (a joint venture) was set up to hold broadcasting license.

Decision: Indirect expropriation on 2 grounds:

(a) Media Council's deprived ČNTS of exclusive use of broadcasting licence; and

(b) Media Council forced changes in relationship between ČNTS and joint-venture partner benefiting the local JV partner.

NB: Lauder Tribunal (US/Czech BIT case) on same facts held no expropriation.

(4). Pope & Talbot v. Canada (2000)

Facts: Canada imposed a lumber export control regime.

Decision: Test: Is the interference sufficiently restrictive to support a conclusion that property was taken? The Investor was able to continue to export and to earn profit from those exports; remained in control of the investment including day-to-day operations. Therefore, no substantial deprivation of right.

(5). S.D. Myers v. Canada (2000)

Facts: Canadian government closed border to transportation of PCB hazardous waste to detriment of S.D. Myers whose Canadian operation engaged in sale of such waste to USA based entities.

Decision: Canada not acted for legitimate environmental purpose and was motivated by a protectionist desire to favour Canadian firms engaged in waste remediation. Creeping expropriation defined as "a lasting removal of ability of owner to make use of its economic rights".

Held: Temporary closure of border to PCB transport not expropriation (but held a breach of minimum standard of treatment).

(6). CMS Gas Transmission v. Argentina (2005)

Facts: License to a gas transportation company provided tariff to be calculated in USD, converted into pesos and indexed to US PPI. In 1999 Argentina temporarily suspended PPI adjustment, subsequently suspended permanently (not for exports). In 2000 a court injunction suspended license pending challenge to legality of PPI adjustment. In 2001 Emergency Law set exchange rate 1 peso to 1 dollar.

Decision: No indirect expropriation as per the substantial deprivation test. Applying Pope & Talbot and Metalclad, tribunal held that investor in control of investment, day-to-day management of business, and was able to export.

Note: Argentina commenced ICSID annulment proceedings, and was granted a stay of execution of the Award in the interim.

(vii). Is there sufficient evidence to make out a prima facie case of a breach of the BIT?

See the (somewhat scathing) criticism of the Claimant's pleading in the ICSID Tribunal's decision in the case of *Telenor v. Hungary* (13/9/06), where the Claimant had failed to establish (at the threshold level of jurisdiction) a prima facie case of expropriation in relation to provision of telecommunication services.

(viii). Is there evidence of a "knock out" point such as the payment of a bribe?

See the decision of the ICSID Tribunal in the case of *World Duty Free v. Kenya* (4/10/06), where the Claimant (alleging, inter alia, that its investment in construction of duty free complexes in Kenya had been expropriated) deployed evidence to the effect that senior

Kenyan officials had been bribed in 1989 by its personnel, to obtain the contract pursuant to which its investment had been made.

Perhaps unsurprisingly, (because it is extremely rare for a party to advance facts relating to payment of a bribe - unless it is seeking to avoid contractual responsibilities/legal claims), the Tribunal dismissed the claim.

(ix). What is the claim worth - what are "just and equitable" damages?

See the recent decision of the ICSID Tribunal in the case of PSEG v. Turkey (19/1/07) (at pages 72 to 87) for the approach to fair market value and loss of profits.

4. Concluding Observations

11. Once you have read a few BIT cases (unwieldy as they are) and represented clients in them, a familiar pattern emerges: filing of a claim, delay in appointing the Tribunal, a procedural order which is inevitably violated. Thereafter, a hearing on jurisdiction which mostly results in the Tribunal finding jurisdiction. After 4 years or so, if and when a Merits award is produced, the claim is very often dismissed or an award is made for a sum significantly less than sought[8].

13. Nevertheless, there are very real signs (in recent decisions) that Arbitral Tribunals are now recognising the need to produce expeditious, clear, coherent and consistent decisions. This is a very important and welcome development.

25th June 2007

[8] Yukos BIT related claims total USD$ 33billion (ongoing). Metaclad's claim of USD$ 43 million yielded a USD$ 17 million award. S.D. Myer's claim of USD$ 80 million yielded a USD$ 6 million award. In the *Telenor* case (13/9/06) , the Tribunal appears to have been heavily influenced by the fact that the Claimant was unable to show any real damage or loss to support its claim of expropriation – even at the jurisdiction stage.