CHAPTER 15

Investment Treaty Arbitration: An Option Not to Be Overlooked

Barton Legum

"I have a huge mess in a really bad place," says Heidi Warren, general counsel of a longtime client of the firm. "We invested millions and millions of dollars in a brand new facility in a developing country. Things were going well—and then there was a coup d'état. The new government took over the facility and gave it to its cronies . . . but without paying us a cent."

Heidi anticipates your first instinct. "We thought about suing in local court," she interrupts, "but found out there is no real distinction between the government and the courts—it will take years and years and the end result is a foregone conclusion. Short of writing our congressperson, I just can't figure out what to do."

Twenty or 30 years ago, writing the local congressperson might well have been the best option. Today there may be a better option, although one that has not yet come to the attention of many practitioners. That option is arbitration under international investment treaties.

WHAT ARE INVESTMENT TREATIES?

Investment treaties are a particular kind of international agreement between states. These treaties provide basic protection for investments made by nationals of one state in the territory of the other state.

This type of treaty was originally conceived in the 1960s as a way to supplement public aid to developing countries by promoting private investment. A problem with attracting foreign investment to such countries was that local laws and legal institutions were not well established. Foreign investors would not risk their capital in a country that lacked basic legal protections.

Investment treaties provided a prepackaged solution to these issues. They stated a series of fundamental protections for foreign investment that, being embodied in a treaty rather than a national law, could not be changed at the whim of a country's government. To supply an alternative to inexperienced or inadequate local judicial institutions, the treaties provided for international arbitration of disputes about whether the state had lived up to its obligations under the treaty. And in a significant innovation, they allowed the foreign investor to initiate and control prosecution of the arbitration, without having to rely on its state to bring the treaty case for it.

There are over 2,200 investment treaties in force in the world today.[1] Most of these take the form of bilateral investment treaties (BITs), between just two countries. Some, however, are multilateral agreements involving three or more countries, such as the North American Free Trade Agreement and the Energy Charter Treaty, each of which includes an investment chapter. While the first investment treaties were agreed between developed and developing countries (so-called "North-South" agreements), it is relatively common today to find agreements between two developing countries as well ("South-South" agreements).

As might be imagined with a body of thousands of treaties entered into between many different countries over several decades, not all investment treaties have the same provisions. There are, however, a number of provisions that are commonly, but not always, found in such treaties. The general discussion that follows is based on those common provisions.

WHAT DO INVESTMENT TREATIES COVER?

In general, the treaties cover *investments* by an *investor of one country* in the territory of the other country. "Investment" is often broadly defined to include any kind of asset. Locally incorporated companies, shares of stock, bonds, contracts, and tangible and intangible property are often provided as examples of investments under the treaty definition.[2]

To be covered by the treaty, the investment in one country must be owned by an investor of the other country. Such an investor is typically defined to include nationals of the other country and companies organized under the laws of that country.[3]

Many investment treaties cover investments indirectly controlled by the investor of the other country. Example: A Delaware corporation holds a controlling interest in a Netherlands Antilles company that in turn holds all the shares of a Bolivian company. The Delaware corporation indirectly controls the shares of the Bolivian company. Those shares, the Bolivian company itself, and that company's assets are covered investments under the Bolivia-U.S. BIT.

WHAT PROTECTIONS DO INVESTMENT TREATIES PROVIDE?

As noted above, there is considerable variation in the terms of the BITs negotiated by different countries over the past 30 years. However, there are a handful of provisions that are sufficiently common that their absence in a given BIT is more remarkable than their presence. These provisions are briefly described below, though readers should note that the breadth and scope of any given provision will vary with the precise terms used in the treaty in question.

National Treatment

The obligation of national treatment is, quite intuitively, that the state should treat investments covered under the treaty no less favorably than comparable investments owned by nationals of the host state. The national treatment obligation is typically subject to a number of specific exceptions, as most states provide in certain sectors special treatment for nationals (e.g., national security, fisheries, political activities).

Most-Favored-Nation Treatment

Most-favored-nation treatment (MFN) equally intuitively requires treatment of covered investments that is no less favorable than that provided to comparable investments owned by nationals of other countries. But there is another aspect to MFN that is less intuitive: The treatment encompassed by an MFN clause includes provisions in investment treaties with other countries. Depending on the language of the MFN clause, an investment covered by one BIT may be entitled to the benefit of a better deal that a third state struck in a different BIT with the host state. The MFN clause can therefore, in a sense, serve as a sort of choice-of-law clause that enables the investor to choose from the BITs of the host state the most favorable legal obligation covered by the clause.

Expropriation

BITs generally include a provision that recognizes the state's right to expropriate property for a public purpose, but only on payment of compensation. Such compensation is often defined as the fair market value of the investment just before the date the expropriation was announced. Significantly, indirect expropriations—those where the state's acts effectively remove any value of the investment to the investor but without a formal decree of expropriation—are generally explicitly encompassed by the obligation to pay compensation.

Transfers

Having a profitable investment in the host state does little good if those profits can never leave. BITs generally require the host state to allow the investor freely to transfer capital to and from the covered investment.

Fair and Equitable Treatment

BITs typically require the host state to accord "fair and equitable treatment" and "full protection and security" to covered investments. The precise content of fair and equitable treatment is the subject of debate. Some commentators and tribunals apply it as a subjective, "I know it when I see it" standard based on whether the treatment seems fair or unfair. Others consider the standard to refer to long-standing and evolving principles of customary international law. "Full protection and security" is often understood to refer to principles of international law requiring a minimum level of police protection for foreign property.

Other Protections

Many BITs also provide for a range of other protections, from prohibiting a disruptive form of trade restrictions known as "performance requirements" to coverage of contractual disputes between the state and the investor. Careful analysis of the particular BIT in question is essential to determine the protections available in any particular case.

HOW ARE INVESTMENT TREATY PROTECTIONS ENFORCED?

Investment treaties are part of a rare class of international agreements that grants private individuals and companies, as opposed to states or intergovernmental organizations, a direct right to enforce the treaty's terms in an international forum.[4] As already noted, the means of dispute resolution provided is arbitration. In many respects the process for resolving these disputes resembles that of international commercial arbitration. There are, however, certain important differences.

First, the applicable rules: The investor/claimant is often given a choice of arbitral rules to invoke to govern the dispute. The arbitration rules most often made available under investment treaties are those provided by the ICSID Convention,[5] the ICSID Additional Facility Rules,[6] and the UNCITRAL Arbitration Rules.[7] The two sets of ICSID rules are similar in many respects to international commercial arbitration rules, but also include elements of state-to-state dispute resolution procedures. The UNCITRAL rules were designed for commercial disputes, but are sufficiently flexible to adapt to this specific context.

From the investor's perspective, the most salient point is that the dispute will be heard by a panel of independent and impartial arbitrators, and not by a court of the host state. Typically each of the parties to the dispute names one arbitrator to the panel. The third and presiding arbitrator is chosen either by the two named arbitrators or by agreement of the parties. An arbitral institution names an arbitrator in the event that the methods just mentioned do not result in an appointment.

Second, the parties to the dispute are different from the typical international commercial arbitration. The parties consist of the foreign investor as claimant and the state itself as respondent.

Third, the applicable law is different. Most important from the investor's perspective, the applicable law for a treaty breach is *not* that of the host state, although the host state's law often forms an important part of the facts of the case. Rather, the applicable law for a breach of an obligation set out in the treaty is public international law. Public international law, however, is a specialized area, and one in which the sources of law are not easily accessible to general practitioners.

Finally, like international commercial arbitrations, successful investment treaty arbitrations generally result in an award that is enforceable under the terms of the New York Convention[8] and many result in awards that are enforceable under the ICSID Convention.

THE PROS AND CONS OF INVESTMENT TREATY ARBITRATION

As the previous discussion suggests, investment treaty arbitration is an option that should not be overlooked in counseling a client with a serious problem overseas. But what are its advantages and disadvantages, and what sorts of cases is it most appropriate for?

Advantages

The principal advantage of investment treaty arbitration is that it provides a level playing field for the dispute to be heard before impartial and independent decision makers. When the alternative is having a dispute against a government heard in courts that are not independent from that government, the benefit of this neutral forum is apparent.

Another advantage from the perspective of the investor is the comparative familiarity of the process for resolving the dispute. Most companies with significant operations overseas have engaged in international arbitration before. By contrast, most such companies will not have attempted to litigate a major dispute in the courts of many developing countries. The familiarity of the process tends to increase investors' confidence in investment treaty arbitration.

Finally, investors can rely on international law firms to represent them in the case if it is submitted to treaty arbitration. By contrast, they must rely on local counsel if the dispute is pursued in the courts of the host state. Many companies prefer to have a major litigation handled by a recognized international firm.

Disadvantages

There are three principal disadvantages to investment treaty arbitration: cost, governmental relations chill, and adverse effect on prospects for settlement.

First, these are expensive cases to litigate, particularly when compared to the cost of pursuing a claim in a developing country's courts. Unlike a court, one must hire the adjudicator (the arbitrators) and pay separately for the facilities necessary to adjudication (hearing room, travel expenses of arbitrators, etc.). Moreover, these are complex cases. Most mix the factual complexities of a significant commercial enterprise with the particularities of the local legal order and relevant measures, then engraft onto this mix the complexity of the international law that supplies the rule of decision. Counsel fees accordingly tend to be quite significant.

Second, suing a government before an international tribunal does not generate good will. While government officials do not enjoy having their actions scrutinized in local courts, claims against the government in local court are common occurrence in most legal systems. In part because the local courts are part of the same government, the prospect of an adverse award by the local courts tends to generate less local controversy and attention. By contrast, no government likes being brought before an international tribunal with respect to acts within its own territory.

Moreover, an investment treaty claim, because of its international nature, generally involves several government ministries—typically the ministries of justice, economic affairs, and foreign affairs in addition to the ministry that was the source of the dispute in the first place. The unfavorable attention generated by bringing a claim may therefore be widely shared in the government. An investor with significant ongoing operations in a country should carefully consider if the potential recovery in the case outweighs the governmental ill will that will be generated by its bringing a treaty claim.

Finally, because of the involvement of multiple ministries, investment treaty claims are more difficult to resolve by agreement. Depending on the internal organization of the government in question, the approval of two or three ministries for a settlement may be required for an investment treaty claim, while only one ministry's approval is required when the claim is treated as a domestic one. These complications make it harder for treaty claims to be resolved consensually.

Conclusion

It follows from the above assessment of pros and cons that investment treaty arbitration should seriously be considered in cases in which three elements are present: first, where the amount in controversy is substantial enough to justify the significant expense of such cases; second, where consensual resolution of the claim is unlikely; and finally, where the negative impact on governmental relations of bringing such a case is less important to the client.

As this discussion shows, today there may be a better alternative to writing the local congressperson when a client loses a major investment overseas. Investment treaty arbitration, in the right case, is an option not to be overlooked.

NOTES

1. *See, e.g.,* UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, WORLD INVESTMENT REPORT 2004: THE SHIFT TOWARDS SERVICES 221 (2004) ("At the bilateral level, the number of BITs . . . reached 2,265 by the end of 2003, and involved 175 countries.").
2. For example, the definition set out in art. 1 of the 2004 United States Model Bilateral Investment Treaty [hereinafter 2004 U.S. Model BIT] provides as follows: " '**investment**' means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an

investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include: (a) an enterprise; (b) shares, stock, and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges." (Footnotes omitted; *available at* **http://www.state.gov/documents/organization/38710.pdf**.)

3. *See, e.g.,* 2004 U.S. Model BIT art. 1 ("'**investor of a Party**' means a Party or state enterprise thereof, or a national or an enterprise of a Party, that attempts to make, is making, or has made an investment in the territory of the other Party; provided, however, that a natural person who is a dual national shall be deemed to be exclusively a national of the State of his or her dominant and effective nationality.").
4. For a general comparison of investment treaty arbitration to other forms of public international dispute resolution, *see* Barton Legum, *The Innovation of NAFTA Investor-State Arbitration*, 43 HARV. INT'L L.J. 531, 534–38 (2002).
5. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 575 U.N.T.S. 160 (*available at* **http://www.worldbank.org/icsid**).
6. Additional Facility Rules of the International Centre for Settlement of Investment Disputes (*available at* **http://www.worldbank.org/icsid**).
7. United Nations Commission on International Trade Law Arbitration Rules (*available at* **http://www.uncitral.org/english/texts/arbitration/arb-rules.htm**).
8. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 2.