

Yearbook on  
International Investment Law & Policy  
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Editor

Karl P. Sauvant

# Yearbook on International Investment Law and Policy

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The *Investment Yearbook* addresses legal and policy issues in the area of international investment—from national, regional, and international perspectives. The Editorial Committee invites for publication manuscripts that are of outstanding quality in terms of academic rigor, the quality of the argument, originality, and contribution to the field of international investment law and policy. The *Investment Yearbook* will not consider a manuscript that has been published previously. Every manuscript that is considered for publication will be assessed through an external double-blind peer-review process. The style of the manuscripts should follow the Vale Columbia Center's Style Sheet (available from the Editorial Committee).

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## Foreword

International investment law and policy are in flux. Investment law is a law in action. The flow of international arbitral awards treating issues of international investment remains strong. But at the same time, revisionist policy trends are manifest.

The United States, for 150 years a principal proponent of the protection of foreign investment, for the past ten years has advocated and adopted a defensive policy. Having, with the advent of NAFTA, discovered that bilateral and trilateral treaties run more than one way, it seems preoccupied with winning every case brought against it under NAFTA, even at the cost of the protection of massive American investments abroad. It has exchanged the enlightened provisions of standard bilateral investment treaties (as exemplified in its pre-2004 Model Bilateral Investment Treaty) for the minimum standard of customary international law, despite the fact that the majority of the United Nations General Assembly repeatedly has denied the existence, still less the content, of the minimum standard. Moreover, the United States interpretation of that standard seems to be rooted in the customary international law of the 1920s as articulated in a sentence of an arbitral award not on treatment of foreign investment, but on denial of justice.

The European Union, whose leading members are the fount of bilateral investment treaties (BITs), has brought into force the Lisbon Treaty, which incidentally moved foreign direct investment into the European Union domain. The Commission of the European Union has construed that dispensation as requiring it to neuter bilateral investment treaties between members of the European Union and to review—and possibly revise or void—such treaties of members with third States. A future place for ICSID in arbitrating disputes arising under European BITs may be uncertain, since the EU, not being a State, cannot adhere to the Washington Convention. Whether the Member States of the European Union will in fact accept such an aggressive—if not regressive—approach remains to be seen.

This edition of the *Investment Yearbook* is fully alive to such issues. Part One addresses recent trends and issues in foreign direct investment. Part Two addresses the fundamental developments in European Union policy toward bilateral investment treaties, and helpfully annexes the key official European Union documents. It then is comprised of a succession of articles on key discrete issues, among them the necessity defense and self-judging clauses. It concludes with a special section containing the winning memorials of the Foreign Direct Investment International Moot Competition, a recognition of the contribution that international moot courts make to the stimulation and seasoning of the new generation of international lawyers.

Stephen M. Schwebel

## Preface

Before the Western financial crisis and recession hit in 2008, foreign direct investment (FDI) flows had reached a record level of over US\$ 2 trillion in 2007. During the crisis, these flows declined to just over US\$1 trillion, a level at which they stayed until the end of 2010. Notably, developed countries bore the brunt of this decline in both inward and outward flows. There are, however, signs of recovery. In particular, outflows from the United States recovered strongly in 2010, cementing that country's position as the world's largest home country of, and host country to, FDI. Equally important, outflows from emerging markets (which had not declined as much during the crisis as those from developed countries) rose sharply in 2010, to US\$ 380 billion; Chinese firms alone invested some US\$ 68 billion abroad, making that country the world's third largest outward investor that year and by far the largest home (in addition to the largest host) country among emerging markets.<sup>1</sup> As Economou and Sauvant document in Chapter 1, the rise of emerging market multinational enterprises (MNEs) is in fact one of the distinguishing characteristics of the past decade, bringing about a change in the structure of world FDI. While the past few years have indeed seen a substantial decline of FDI flows, as long as they remain positive, the stock of FDI grows (at least in principle), signaling a further expansion of international production—and with it the importance of regulatory issues relating to this type of investment.

The further recovery of world investment flows will depend substantially on how the world economy will perform in 2011 and beyond. It will also depend on how MNEs perceive the risks of investing abroad and how the regulatory environment for foreign investment evolves.

Risks have become more important. Apart from the possibility of a faltering recovery, they include the prospects of further turmoil in the European Union due to the sovereign debt burdens of a number of its members; the downgrading of the debt of the United States and possibly that of other key developed countries; rising inflation; rising commodity prices; political upheavals in North Africa, the Middle East and potentially elsewhere; and the vulnerability of supply chains to natural disasters and other disruptions.

Added to this are uncertainties in the regulatory framework for FDI. At the national level, the percentage of policy changes that make the investment climate less welcoming has risen to over 30 percent of all regulatory changes in 2009, compared to around 6 percent during the period 1992–2000—the highest during the past 20 years. This change in the attitude toward FDI (and hence in the investment climate) reflects a certain reevaluation of the cost and benefits of certain types of FDI (especially mergers and acquisitions, particularly in sensitive industries), the rise of FDI by state-controlled entities (especially from emerging markets), and a certain resurgence of resource nationalism. All this makes for a more uncertain economic, political, and regulatory environment for foreign investment.

At the same time, these developments underline the importance of a stable and predictable international investment law and policy regime. Indeed, investment treaty making has continued unabated in 2009 and 2010 (with over 100 international investment agreements concluded in 2009, and 19 bilateral investment agreements renegotiated, as

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<sup>1</sup> Not including Hong Kong (China), which registered US\$76 billion in outflows that year.

shown by Kehoe and Maslo in Chapter 2). Some of it took the form of the renegotiation of bilateral investment treaties, with certain provisions becoming more favorable for investors (e.g., strengthening intellectual property rights), while most reflect more host country policy objectives (e.g., the narrowing of investor protections).

At the same time, too, a record number of 57 international investment arbitral decisions were issued in 2010, underlining the vitality of the regime. A review of their salient features by Laird, Sabahi, Sourgens, and Birch in Chapter 3 suggests that the question of what constitutes a qualifying investment (under a specific international investment agreement, the ICSID Convention or both) was a key issue of contention in 2010, that the fair and equitable treatment protection standard played a prominent role in tribunals' decisions and that, in the NAFTA context, the distinction between the fair and equitable treatment standard and the customary international law minimum standard of treatment of aliens continues to be discussed.

These are just some indicators that the international investment regime itself is in flux. Further changes can be expected as new actors enter the picture and established actors seek to shape the investment regime in light of their own expectations.

The European Union is of course the most important new actor in the international investment field, having received—toward the end of 2009 through the Lisbon Treaty—exclusive competence in the area of foreign direct investment. Given this important development, this edition of the *Investment Yearbook* devotes a Symposium (Chapters 4–7) to this topic (and also reproduces the principal official European Union documents pertaining to this new development). At the time of the closure of this edition of the *Investment Yearbook*, the discussions and negotiations concerning the exact scope and nature of this new competence and the manner in which it should be exercised were still ongoing among the European Parliament, the Commission, and the Member States. The chapters in this volume examine some of the principal issues that shed light on this matter, beginning, in Chapter 4 by Brown and Alcover-Llubia, with a review of the Commission's response to three main challenges facing the European Union and its Member States: the dense network of Member State agreements and their relationship with the European Union; the possibility that Member States may need to conclude future agreements or to amend existing agreements; and the creation of an European Union investment policy and its integration in the broader EU Common Commercial Policy.

Bearing on some of these issues is the question of the scope of the new competence of the European Union. De Luca argues in Chapter 5 that the existing bilateral investment treaties of Member States, insofar as they do not include market access commitments, do not seem (at least in principle) to be incompatible with European Union law as a result of the new allocation of competence between the European Union and Member States. Hindelang, however, looking beyond issues of competence, makes the case in Chapter 6 that there are incompatibilities between these bilateral investment treaties and European Union law unrelated to competence issues, and that it is politically unlikely that the existing bilateral treaties will or can be altered in a way that fully conforms with European Union law. Of course, these challenges are not new. They had to be tackled at the beginning of the European integration enterprise, namely in the transition from bilateral agreements on trade in goods to the Common Commercial Policy. The lessons that Dimopoulos draws from this transition in Chapter 7 are that, in moving toward a common investment policy, one should avoid the gradual development of a European Union investment policy, and one should avoid authorizing the conclusion of new investment agreements by its Member States.

With European Union members having signed around 1,700 bilateral investment treaties, the extent, manner, and precise scope of the transfer of competence from the Member States to the supra-national level might profoundly affect the further development of the international investment regime.

The renegotiation of existing investment treaties offers established actors an opportunity further to refine the international investment law and policy regime, an authority they often exercise to bring their treaty obligations in line with model treaties that were revised in line with their prior experience. Even more important, the negotiation of new treaties, especially among key actors, may well change the future direction of the regime. Particularly worth watching are the negotiations of a bilateral investment treaty between China (and perhaps India) and the United States (and Canada and China), as well as the negotiations of a Trans-Pacific Partnership. The negotiations between the United States and China are especially important as they involve, with the United States, the world's largest FDI home and host country. It is a country that has traditionally been very supportive of investors, but having "discovered" that it is also an important host country (increasingly also to investment from emerging markets and from state-controlled entities headquartered abroad) and an occasional respondent in international investment disputes, has become less supportive of expansive investor protections and more respectful of the right to regulate in the public interest. China, the largest home and host country among emerging markets, in turn, has moved in its international investment agreements toward being more supportive of investors.

It will be interesting to watch how these various negotiations (including those pertaining to the competency of the European Commission) evolve and how they will influence the nature of the international investment law and policy regime. The outcome may well be a new template of how the rights and responsibilities between countries and investors should be defined - in other words, a new regime may emerge in which the protection of investors and the facilitation of their operations is balanced, at least to a certain degree, by more respect for the right of host countries to regulate in the interest of legitimate public policy objectives.

One important aspect of this rebalancing is the increased attention that the essential security clause (or similar clauses) receives in international investment agreements and arbitral proceedings. This issue is examined in a number of chapters (Chapters 8–12), with the Argentinean cases, not surprisingly, remaining at the forefront of this discussion. One of the questions that has arisen in this respect is whether the Tribunal in *Continental Casualty v. Argentina* was right in letting itself be guided by the approach of the World Trade Organization to "necessity" under GATT Article XX when interpreting the "essential security clause" in the underlying United States-Argentina bilateral investment treaty. Alvarez and Brink argue in Chapter 8 that the textual discrepancies between the rules of the World Trade Organization and those of bilateral investment treaties, as well as the different object and purpose of each instrument, make this a flawed approach.

The essential security clause (and similar clauses) can provide host States with flexibility to pursue legitimate public policy objectives. But the so-called "self-judging" version of an essential security clause—now included in United States investment treaties and also those of other countries—is potentially problematic, as it could make an offending State the judge in its own case. The argument of Nolan and Sourgens in Chapter 9, however, is that too much has been made of the term "self-judging", and that the use of this term cannot substitute a rigorous textual analysis of the treaty in which it is included. They find that, in many instances, arbitral tribunals would nonetheless be required to review a respondent State's invocation of a "self-judging" clause. In accordance with the text,

other provisions and objectives of many treaties containing such clauses, they submit, “self-judgment” has to be exercised in good faith, i.e., it must be honest in fact and reasonable within the scope of the treaty as a whole.

Alvarez-Jimenez further suggests, in Chapter 10, that the interpretation of such clauses needs to lead to a more balanced result in terms of risk allocation (letting the necessity justification be temporary and offering, in principle, no compensation during the crisis) by proposing that certain requirements be met successfully to invoke necessity clauses in bilateral investment treaties. This rebalancing also takes place at the national level, not only as regards less welcoming investment laws and regulations but also by, for example, limiting the extent to which a country can yield its sovereignty in international investment agreements, as examined by Fach, in Chapter 11, for Ecuador. Schill and Kim add to this debate, in Chapter 12, by analyzing a German Constitutional Court decision from 2007 that deals with Argentina’s necessity defense. They hold that the Court’s thesis that international and domestic law pertain to strictly separated legal spheres is antiquated and that, instead, a State’s reaction to financial and economic crises, including in the context of sovereign debt, should be analyzed primarily in connection with a State’s police and emergency powers that international law and jurisprudence recognize as a general principle of law, independent from the necessity defense under customary international law.

Finding the proper balance between protecting the rights of investors and the need for governments to have sufficient policy space to pursue their legitimate public policy objectives is a difficult task and, most likely, will receive increased attention. Non-conforming measures of various kinds have a role to play in this process. However, the challenge posed by the growing importance of (especially self-judging) non-precluded measure clauses of all kinds needs to be watched carefully, as their spread can undermine the very transparency, predictability, and stability of the international investment law and policy regime.

While these developments unfold, the demands on the international investment regime increase as new issues are put on the agenda (Chapters 13–16). A prominent new issue relates to the intersection of climate change policy and international investment law, where emerging trends in both regimes are creating new opportunities for coordination, as opposed to conflict. As Firger and Gerrard suggest in Chapter 13, developed and developing countries alike are reevaluating the general policy objectives of their international investment agreements, while at the same time developing new climate policies that seek to incentivize transnational investments in low-carbon projects. Although they recognize that the systematic integration between climate regulations and treaty obligations on an international law level is still weak—as many elements of the “regime complex” for climate are not subject to international treaties but are taken bilaterally, regionally, or nationally (or even sub-nationally)—the trend is toward “bottom up” integration across regimes and instruments.

The growing role of FDI in the acquisition of land and the development of large-scale, highly specialized plantations – a recent trend that has attracted considerable attention – entails various risks for the local communities that are affected. While a number of proposals have been made to ensure that these risks are mitigated, De Schutter and Rosenblum observe, in chapter 14, that there remains a considerable gap between the existing institutional and governance conditions in host States and the framework that should be established in order for large-scale investments in land truly to benefit local communities. Experiences from the extractive industries can help bridging that gap by exploring alternative investment models that do not require altering the basis of local land

rights.

Two other new issues are addressed in this volume. As mentioned at the beginning of this Preface, FDI from emerging markets has grown rapidly during the past decade. A good part of this investment is being undertaken by State-controlled entities, especially State-owned enterprises and sovereign wealth funds. In the case of China, for example, State-controlled entities account for 80–90 percent of the country’s FDI outflows (although China is an outlier in this respect). While there have been some disputes involving State-controlled entities in the past (and for that reason this is not strictly speaking a new issue), the rapid growth of FDI by State-controlled entities can be expected to lead, sooner or later, to disputes between such investors and their host States, in part because it seems that some national regulatory developments appear to discriminate against State-controlled entities in certain circumstances (e.g., when they seek to enter a foreign market through mergers and acquisitions). The question of whether a State-owned entity qualifies as a “national” under Article 25(1) of the ICSID Convention becomes therefore all the more urgent. As Feldman advocates in Chapter 15, when seeking an answer to this question, tribunals should weigh not only the commercial or governmental *nature* of the entity, but also the commercial or governmental *purpose* of the entity’s activities, which would help maintain the legal distinction between investor-State and State-to-State disputes, as well as complement, rather than undermine, recent developments in international investment policy.

While State-controlled entities are likely not to have major financial limitations when contemplating complicated, lengthy, and expensive international arbitration, this is not necessarily the case when it comes to the many private investors that may feel aggrieved by actions of a host State: For them, financing international investment disputes can involve important opportunity costs or might simply be prohibitive, especially if the investor is one of the tens of thousands of small or medium-sized MNEs. In response to this situation, a litigation financing industry has sprung up, with a growing number of firms providing third-party funding to potential claimants. This development raises a number of issues, not least among them the question of whether litigation financing of this kind has an impact on the nationality of the claimant. Pinsolle holds, in Chapter 16, that third-party funding has no impact on the nationality of the claimant if not so specified in the investment treaty. He considers, however, that a change in nationality may occur if a funding agreement amounts to an assignment of a claim to the funding firm. Systematic disclosure of funding arrangements at the earliest possible time is therefore important.

While new issues are beginning to attract attention, many important and fascinating aspects of the international investment law and policy regime continue to attract examination (Chapters 17–20). The *Investment Yearbook* reflects this, beginning with a broad canvas review by Johnson and Gimblett in Chapter 17 of the evolution of modern investment law that argues that the central achievement of bilateral investment treaties lies in the removal of investment disputes from the immediate bilateral diplomatic agendas of the treaty Parties. This view is however disputed by Schneiderman in Chapter 18: While the investor-State dispute settlement mechanism is an achievement of some significance, one cannot describe the dispute settlement system as depoliticized; rather, it is more accurate to describe it as decentralized, with power being in the hands of investors and arbitrators and government involvement taking place right up to the point at which a tribunal is being constituted. In the case of Japanese overseas investors, Wells and Tsuchiya show, in Chapter 19, that disputes have almost never reached international arbitration because Japanese firms’ aversion to litigious approaches and their lack of experience with arbitration at home lead them to negotiate settlements of conflicts with

their host country governments. This set of chapters is rounded out with a thorough comparative analysis by Parvanov and Kantor in Chapter 20 of United States domestic law and recent United States investment agreements and NAFTA awards, concluding that investment law protections for foreign investors under recent United States investment agreements and NAFTA awards are in general not more favorable than U.S. domestic law protections.

Quantitative methods have been used extensively in many of the social sciences for some time. While they have their limitations, they can certainly add a useful dimension to the debate of specific phenomena. These methods are also increasingly being employed in the international investment law and policy area—for example, when examining the impact of bilateral investment treaties on FDI flows and, more specifically, the impact that different types of dispute-settlement clauses have on investment flows, as done by Peinhardt and Allee in Chapter 21. They find that some elements of bilateral investment treaties appear to lead more directly to increases in FDI flows between treaty signatories than others. Surprisingly, it is not those with advance consent to international arbitration, but instead treaties that delegate dispute resolution exclusively to international arbitration, as well as those that constrain the choice of arbitration forums, that seem more directly to stimulate investment flows.

But the use of empirical methodologies, like other methodological approaches to the study of social phenomena, has difficulties and limitations. The debate between van Harten and Franck, Garbin and Perkins in Chapter 22 and its sub-sections shows this regarding the possibility of bias in the outcomes of investment arbitration cases, and what these outcomes signify. The debate suggests that empirical legal scholarship has its merits and should be pursued, with care and diligence, including in the international investment arbitration field. We hope that this particular interchange of ideas highlights some of the challenges involved and how to address them.

The *Investment Yearbook* is pleased to provide a forum for the discussion of these and other issues. Part of this function is also to bring the winning claimant and respondent memorials of the 2010 Foreign Direct Investment International Moot Competition (FDI Moot) to the attention (in the special section of this volume) of a wider audience and, in this manner, encourage the next generation of international investment specialists. As the investment law and policy regime evolves further, more issues will come to the forefront and will require careful examination and discussion. We are looking forward to your contribution!

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