The International Law on

Foreign Investment

Fifth Edition

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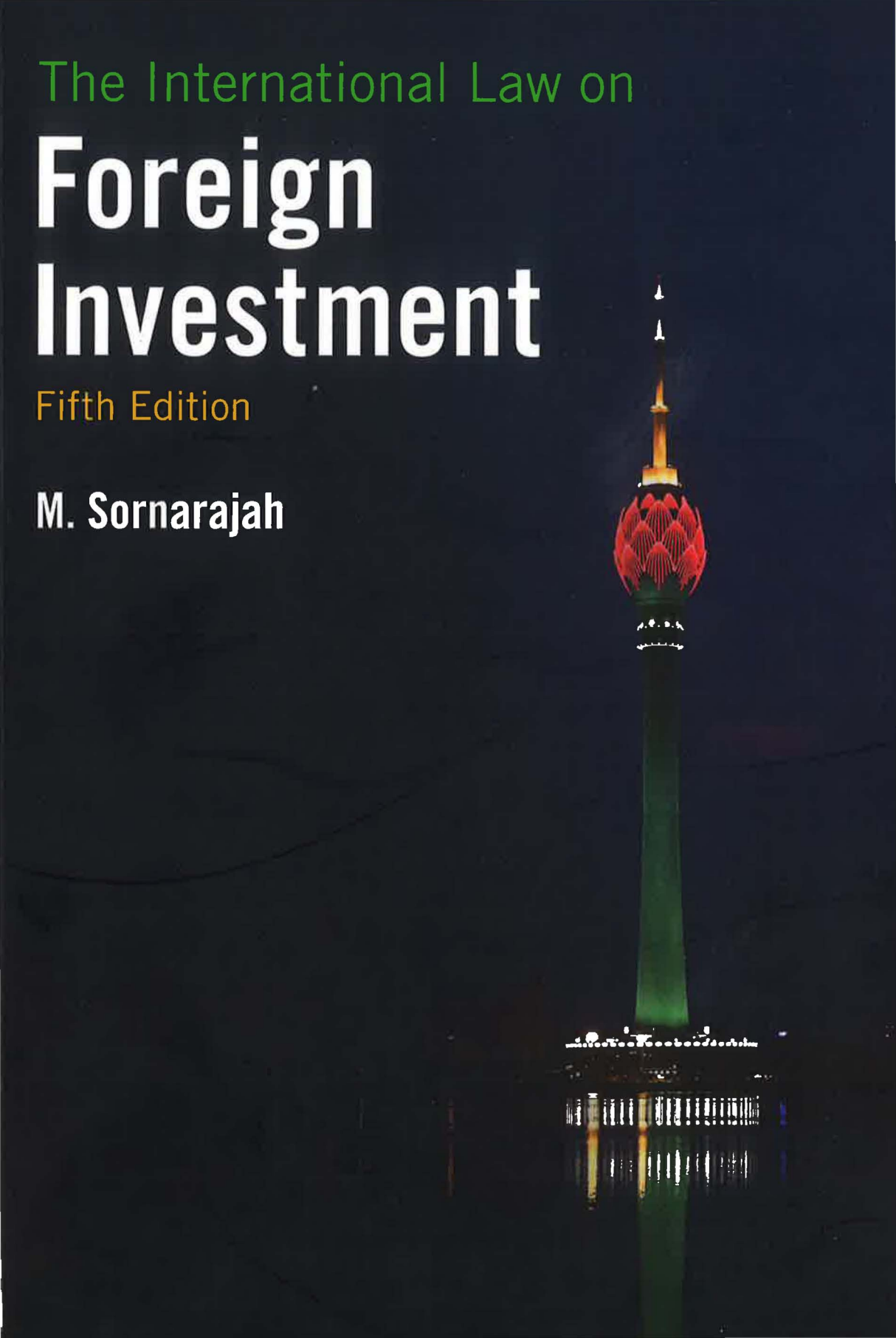

where the host state takes over control of the company without affecting the shareholding in the company, as where it intervenes to appoint a new management. The company cannot be protected simply because it is a corporate national of the host state and the shareholdings cannot be protected as they have not been affected.[140] A state could also take over management of a company, without affecting the company or its shareholdings.[141] In these circumstances, protection will depend on the manner in which the taking of property is defined in the treaty. But, increasingly, it is coming to be recognised that the shareholder is not dispossessed by the interference of the state, the expropriation provision cannot provide a remedy. These issues are considered later in the context of what amounts to a taking of property.[142]

5.4.3 Standard of Treatment

There are a variety of standards of treatment provided for in bilateral investment treaties. They would usually contain one article on treatment standards but that article would identify several different standards of treatment. These include national treatment, a fair and equitable standard of treatment, an international minimum standard of treatment and full protection and security. There would be references to the most-favoured-nation standard of treatment, but the operation of this standard is not internal to the treaty as it depends on the identification of standards of treatment in other treaties so that the best standard offered could be determined. It is this best standard that flows through the most-favoured-nation clause to the foreign investor. Unlike the other treatment standards, the most-favoured-nation standard has significance to jurisdiction as well. Chapter 9 deals with the violation of these different standards of treatment. It is sufficient at this stage to describe the issues which arise in connection with each of these treatment standards.

5.4.3.1 International Minimum Standard

In the history of the subject, the international minimum standard owes its origin to the stance that the United States took in arguing that disputes concerning foreign investment are external, governed by a supranational system and should be arbitrated outside the host state. It has already been seen that this standard, originally formulated in the context of disputes with Latin American states, was resisted through the Calvo doctrine which required the settlement of such disputes by domestic tribunals applying domestic law. The insistence of the United States on the doctrine and its espousal by other capital-exporting states is the basis of the claim that it is customary international law. It is as such that it has passed into

[140] Mann made the point as follows: 'The shares in a company incorporated in a host country are not usually affected by any measures taken there. It is the company itself that is the victim.' F. A. Mann, 'Foreign Investment in the International Court of Justice: The ELSI Case' (1992) 86 *AJIL* 92 at 100. Technical arguments may be made that such interventions are takings in that they lead to depreciation in the value of shares. But, such arguments contemplate the existence of sophisticated stock markets in the state.

[141] Interference with management of a company is regarded as a taking as it affects the property rights of the foreign investor. This view has been accepted in many arbitral awards. *Revere Copper & Brass Inc.* v. *OPIC* (1980) 56 *ILR* 258 at 290–3 and 295. There are many awards of the Iran-US Claims Tribunal which considered the issue. These are dealt with in Chapter 8.

[142] See Chapter 10.

modern investment treaties as an 'umbrella concept'[143] encapsulating other standards. It is regarded as 'the floor below which the treatment of investors must not fall'.

The US memorials in several cases fairly admit that the practice has 'crystallized to establish a minimum standard only in a few areas'. It identifies the fair and equitable treatment standard as the example of the minimum standard treatment. It includes within the fair and equitable standard the notion of denial of justice, which is identified as one of a 'few areas'.[144] After all the debate on the subject, the only item that is identified is the notion of denial of justice as a component of the minimum standard. But, whether it should be stated as a part of the fair and equitable standard, a dormant provision in investment treaties until it was woken into life in arbitral awards at the start of this millennium, is contentious. The term 'fair and equitable treatment' came into use after the claims as to the existence of an international minimum standard.[145] Denial of justice precedes reference to the fair and equitable treatment in international law. The memorials specifically disavow the legitimate expectations doctrine, that is the most repeated basis of liability in the awards as a part of the fair and equitable treatment. The memorandum rightly defines customary international law as constituted by practice of states with an *opinio juris*. There has been no support for the fair and equitable treatment standard until recently; it remained a phrase without meaning. It is hardly mentioned in the classic American texts on investment protection by Borchard, Roth or even Lillich. The much-repeated American statement on the scope of the international minimum standard needs to be rethought. The need for the inclusion of the fair and equitable treatment standard, an interloper into the equation, is without sufficient basis.

Whether the international minimum standard is customary law is contentious; its development was resisted by the Latin American states and then by the states of Africa and Asia. It is the practice of the capital-exporting states, which is essentially practice initiated by the United States, which finds its way into the bilateral investment treaties. The treatment standard is rooted in the practice of the United States, later espoused by the European states. This practice consists of two principal areas: denial of justice and failure to give protection and security to investment when it is under physical threat. The second area is separately stated in investment treaties. State responsibility arose only after the exhaustion of local remedies. This meant that the foreign investor had to have recourse to local courts. It is only if the local courts denied justice in an egregious manner that state responsibility could arise.

5.4.3.2 National Standard of Treatment

There has been considerable disagreement between states on the question of state responsibility for injuries to aliens. Many Latin American countries and other capital-importing

[143] US memorial in *David Aven* v. *Costa Rica* UNCT/15/3 (18 September 2018). Also in memorials in *Spence International Investments* v. *Costa Rica* (Unreported); *Gramercy Funds* v. *Peru* ICSID Arb. UNCT/18/2.

[144] One such area, which is expressly addressed in Art. 10.5, concerns the obligation to provide 'fair and equitable treatment' which includes, for example, the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings. A denial of justice arises, for example, when a state's judiciary administers justice to aliens in a 'notoriously unjust' or 'egregious' manner 'which offends a sense of judicial propriety'.

[145] The term is used in the Havana Charter for an International Trade Organization in 1948 and later in the Abs Shawcross Convention on Investment Protection, 1958.

countries have argued for the national standard of treatment of aliens. Article 2(2)(c) of the Charter of Economic Rights and Duties of States articulates the national treatment principle. Capital-exporting states, however, have argued that aliens should be treated in accordance with an international minimum standard. If the national treatment principle is accepted, protection for the foreign investor will become minimal as legislation that affects property enacted uniformly to apply to all in the state irrespective of nationality will leave the alien without any remedy in international law.

Capital-exporting states have rejected this view, arguing for a minimum standard of treatment to be accorded to aliens. The recognition of a minimum standard of treatment will permit international scrutiny of the treatment of the foreign investor by the host state. However, unlike in the past when national treatment was rejected altogether because such treatment was in the case of some countries lower than the minimum standard contended for by the capital-exporting states, in modern times national treatment may have its advantages as states reserve many of their economic sectors and privileges to their nationals. In addition, national treatment at the stage of entry is regarded as an important right, as it entitles the foreign investor to a right of entry and establishment in the host state. Treaties which aim at liberalisation contain such pre-entry rights of establishment. The granting of national treatment after entry may confer advantages on aliens, as it will grant them the same privileges enjoyed by nationals. For this reason, there is a tendency among developed states to support national treatment as a relevant standard and to approach the issue of international responsibility on the basis of discrimination resulting from the failure of the host state to provide national treatment to the foreign investor. In fact, the violation of national treatment is emerging as a significant cause of action arising from investment treaties.[146]

The existence of a national treatment standard could provide a basis for the argument that performance requirements such as export quotas or local purchase requirements should not be imposed upon the foreign investor, at least after entry has been made. Such requirements are not imposed on local entrepreneurs, and it is to be expected that the national treatment standard would require that it not be imposed on foreign investors as well. National treatment standard may as a result work against the imposition of performance standards unless such performance requirements are exempted from the national treatment standard.[147]

Yet, treaties that refer to national treatment often have specific provisions excluding performance requirements, and often spell out the types of performance requirement that are excluded. The inclusion of national treatment will also mean that the existence of an economically valid reason for discrimination between nationals and foreign investors may

[146] Thus, under NAFTA, there are a significant number of cases which have been instituted on the basis of a violation of national treatment, principally between the United States and Canada. See, for example, *S. D. Myers* v. *Canada* (2000) 40 *ILM* 1408; (2002) 121 *ILR* 7; *UPS* v. *Canada*, UNCITRAL Arbitration Proceedings (NAFTA) (Award on the Merits, 24 May 2007); and *Marvin Feldman* v. *Mexico* (2002) 7 *ICSID Reports* 318; (2003) 42 *ILM* 625.

[147] *ADF* v. *United States*, ICSID Case No. ARB(AF)/00/1 (NAFTA) (Award, 9 January 2003) is a NAFTA case in which the issue was raised as to performance requirements, in this case the 'Buy American' statutes, being a violation of national treatment standards. *Apotex Holdings* v. *US*.

not provide a justification for the discrimination. The trade-related term 'in like circumstances' is used to limit the effect of the national treatment requirement. It is difficult to understand the nature of such a limitation in the context of investment. A large multinational corporation as an investor is never 'in like circumstances' because of its size and vertically integrated global organisation. If this is a basis for discrimination, then the granting of national treatment becomes pointless. It is the precise reason why foreign multinational corporations should be discriminated against. There is a dilemma presented by the unthinking extension of notions of trade law into the area of investment. The two areas do not mix that easily. Another exception, again from the trade arena, relates to the exceptions of discrimination based on national security, public health or morals. These exceptions are found in the more recent balanced treaties which aim to conserve the regulatory power of the state.

Recent writings on economics suggest that a state should be able to discriminate in favour of its own investors. These writings point out that most developed states adopted such discriminatory policies in the course of their own development and are now seeking to deny the benefits of such policies to developing countries. As a result, some views take the position that the preferences given to the nationals over foreign investors should remain.[148]

Wide sectoral exceptions are used, particularly where the treaty provides for pre-entry rights of national treatment and rights of establishment. The list is of considerable length. The use of a negative list of sectors is a common practice. Thus, for example, the Canada-Thailand investment treaty contains in its appendix the Thai investment laws, which list the sectors into which foreign investment is not permitted and the sectors into which foreign investment is permitted in partnership with its nationals. Where states have investment codes with such negative lists, it is sensible to include that list of sectors as industries that are not subject to national treatment. Since some investment treaties are made subject to the existing laws and regulations of the host state, discriminatory rules based on economic criteria will be captured in the treaties so that the discrimination will not violate the treaty standards.

National treatment seems a sensible answer in view of the increase of administrative controls over foreign investment. National treatment may, however, rebound on the foreign investor. A harsh measure taken against one's own nationals may be extended to the foreign investor and be justified on the basis of national treatment. For this reason, it is necessary to include other standards of treatment in the treaty.

The inclusion of better standards and their protection through foreign arbitration makes treaties open to the constitutional criticism that they privilege the foreign investor over the local entrepreneur. There is a strong constitutional argument based on equality provisions against investment treaties. The argument is enhanced by the fact that the foreign investor, unlike the local, is entitled to recourse through foreign arbitration. The existence of foreign arbitration also raises issues as to constitutionality of transferring judicial power over a purely internal matter to a foreign tribunal.

[148] Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (2005).

5.4.3.3 Fair and Equitable Standard

Treaties refer to 'fair and equitable treatment' to be accorded to the nationals of the contracting parties. This phrase is vague and is open to different interpretations. The content of this standard has caused much anxiety.[149] It was at one stage thought that the standard was a higher standard than the international minimum standard. But, in NAFTA litigation, the wide interpretation given to the formula resulted in the NAFTA Commission issuing an interpretative note declaring that the fair and equitable standard was no more than the international minimum standard of customary international law. The letters attached to the Singapore-United States Free Trade Agreement also take the position that the phrase 'fair and equitable treatment' as used in the treaty should be taken to refer to the international minimum standard of treatment. The new model investment treaties of both the United States and Canada repeat this formula. The USMCA spells it out further that the fair and equitable treatment standard does not create additional rights beyond the international minimum standard. If that is so, there is no explanation as to why the fair and equitable standard is not left out of the treaty altogether.[150]

The resulting practice should have made the phrase 'fair and equitable treatment' otiose at least as far as these treaties are concerned. But that was not the result. Some tribunals have ignored the restriction that the phrase must be read as no more than the customary international minimum standard. The Indian Model Investment Treaty, 2015 leaves the fair and equitable standard out altogether as the phrase has led to wide expansionary interpretation by arbitral tribunals. There have been a burgeoning number of arbitral awards seeking to make the fair and equitable standard the most important provision in the investment treaty, virtually absorbing all other claims that can be made under the treaties. For this reason, these trends deserve a fuller treatment. There is a discussion of the phrase and the arbitral awards interpreting it in Chapter 9. At this stage, it is sufficient to note that the fair and equitable treatment standard has been expanded to include notions of transparency and legitimate expectations of the foreign investor. But initial euphoria and expansionism has been considerably curtailed in later awards. Qualifications for using the standard have been stated. As has been pointed out, if notions of fairness are to be taken into account, they would make the context in which the fairness is to be assessed relevant so that the standard would require taking into account of whether or not the state interference was in response to the malpractices of the multinational corporation.[151] The evaluation of the standard may not be as one-sided as its original proponents had intended it to be. After the expansive interpretation, some arbitrators have sought to ensure that the basis on which these expansions are made are kept within strict limits, requiring the expectations to be reasonable in the context of the particular circumstances.

[149] UNCTAD, *Fair and Equitable Treatment* (1999).

[150] Art. 14(6)(2)(a) states: "'fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world'. The phrase 'fair and equitable treatment' could have been safely left out. Why it is included has never been explained, when the US statements routinely exclude the notion of legitimate expectations, the most fruitful basis for the use of the fair and equitable standard. The verbiage will create greater confusion.

[151] P. Muchlinski, 'Caveat Investor? The Relevance of the Conduct of the Investor under the Fair and Equitable Standard' (2006) *ICLQ* 527.

Because of the uncertainties involved in the interpretation of the fair and equitable treatment standard, some new treaties have left the standard out altogether. The Indian Model Treaty (2016) leaves the standard out, as do other recent treaties. Many African regional treaties also leave out the standard.[152] If treaties are to be made, it would be good to leave out this provision which many arbitrators have interpreted as giving them a licence to create law. Consequently, the degree of extension of this once dormant clause has been such as to see an expansive interpretation that would not have been contemplated by the states making the treaties. It is wise, if treaties are to be made, to leave out such nebulous provisions which enable arbitral adventurism.

5.4.3.4 Most-Favoured-Nation Treatment

A clause that is now commonly included in bilateral investment treaties was handed down from old FCN treaties, and provides for most-favoured-nation treatment, enabling the nationals of the parties to profit from favourable treatment that may be given to nationals of third states by either contracting state. The clause has its origin in trade treaties which deal with transfer of goods and tariff barriers. They are situations which stop at the boundaries of states. The clause sits uncomfortably in investment treaties which deal with conduct within states. Its interpretation in investment arbitration has caused much difficulty. Once more, what was originally an innocuous provision has been given interpretations unintended by the parties.

The inclusion of most-favoured-nation treatment presents the difficulty that the foreign investor could latch onto more favourable treatment provided in past or future treaties. Already, a precedent for this has been established in relation to dispute settlement. It has been held in some arbitrations that it is possible for a foreign investor who is protected by an investment treaty with a most-favoured-nation clause to use a better dispute settlement provision in a treaty made by the respondent state with a third state.[153] This would be particularly the case where a multilateral or regional treaty is concluded. If a state enters into a multilateral treaty which contains a most-favoured-nation clause, the number of states that could utilise a more favourable provision in a future bilateral investment treaty could become greater. This may be an unintended result, and care must therefore be exercised to avoid this. As a result, the scope and use of most-favoured-nation clauses in

[152] The ECOWAS Investment Code and the Pan African Investment Code leave out the fair and equitable standard clause. Most modern treaties either leave it out or seek to define it in terms that identify the customary international law content involving denial of justice, discrimination and harassment. In that scenario, since discrimination is already provided for in the national treatment standard and expropriation and harassment is negated in the full protection and security standard, fair and equitable standard becomes relevant only in situations of denial of justice.

[153] *Maffezini* v. *Spain* (2000) 5 *ICSID Reports* 396; (2004) 40 *ILM* 1129. *Tza Yap Shum* v. *Peru*, ICSID Case No. ARB/07/6 (Decision on Jurisdiction and Competence, 19 June 2009). There is a line of cases which follow *Maffezini*. Equally, there is another line of cases which point out the illogicality of a tribunal whose jurisdiction is contested, using the treaty's most-favoured-nation clause to assume jurisdiction when the primary issue is whether the tribunal has any jurisdiction at all under the treaty. Logic does not deter investment arbitrators; see *Plama* v. *Bulgaria* and awards following it. The view that the dispute resolution provision in other treaties cannot be imported into an investment treaty through an MFN clause is stated expressly in modern treaties. See also *Itisaluna Iraq LLC* v. *Iraq* ICSID Case ARB/17/10 (3 April 2020). P. Sturma, 'Goodbye, Maffezini: On the Recent Developments of Most-Favoured-Nation Clause Interpretation in International Investment Law' (2016) 15 *Law and Practice of International Courts and Tribunals* 81.

investment treaties have attracted controversy. There is a tendency to leave out the clause in some recent treaties.[154]

Where a state belongs to a regional organisation, and as a result the state gives special privileges to other member states of the organisation, it will seek to exclude those privileges from applying to a state with which it makes a bilateral investment treaty by the automatic operation of the most-favoured-nation clause. This will be stated in the treaty itself. It cannot therefore later be argued that measures conferring privileges under these regional arrangements should be conferred upon foreign investors on the basis of the most-favoured-nation clause.

5.4.3.5 Full Protection and Security

The treatment provision also includes the provision of 'full protection and security' to the foreign investment. It has been held in arbitral awards that this again adverts to customary law standards which require either that the state's forces should not be utilised to harm the foreign investor's property or that the state should give protection from violence against the interests of the foreign investor if such violence could be reasonably anticipated.[155] Again, there has been a tendency to expand the scope of the provision well beyond its moorings in customary law to include a wider notion that the clause mandates the maintenance of conditions of stability for the investment. The reaction in the newer treaties is to spell out that the provision applies only to the protection of the investors from violence.[156]

5.4.4 Performance Requirements

Treaties made by the United States and Canada in particular have sought to do away with performance requirements. Performance requirements are imposed by host states in order to ensure that the foreign investor exports a percentage of his production, buys local products and services, and employs local labour. From the point of view of developing countries, the imposition of such requirements enhances the value of the foreign investment. Thus, the requirement of export ensures that more foreign exchange is earned for the host state than profits made for the foreign investor through sales on the local market. Such profits will be repatriated, causing a possible loss to the foreign investor which could be balanced against profits made on exports. Another reason for the export requirement is that it preserves the market for local entrepreneurs. Local entrepreneurs are likely to be driven out of the market if they are obliged to compete with foreign multinational corporations able to produce goods at a lower cost. This effect will mean that incipient local industry will be strangled. Export requirements are justified on the basis that such a crowding-out effect will be avoided.[157] Multinational corporations are averse to export requirements, as they require internal competition within the production systems of the multinational corporation. The

[154] For example, Indian Model Treaty (2016).

[155] *American Machine Tools* v. *Zaire* (1997) 36 *ILM* 1531; *Wena Hotels* v. *Republic of Egypt* (2002) 41 *ILM* 896; *Von Pezold* v. *Zimbabwe*, ICSID Case No. ARB/10/15 (28 July 2015). The Arab Spring cases continue this view.

[156] For example, the Indian Model Treaty, 201 5.

[157] See further UNCTAD, *World Investment Report* (2003).