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Sovereign Policy Flexibility for Social Protection: Managing Regulatory Risk in International Investment Agreements

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SOVEREIGN POLICY FLEXIBILITY FOR SOCIAL PROTECTION: MANAGING REGULATORY RISK IN IIAs

Dr. Diane A. Desierto

Abstract:

This Article focuses on the design of regulatory risk in international investment agreements (IIAs), and its counterpart treatment in investment arbitral practices. It demonstrates that the uneven conception and treatment of regulatory risk in investment arbitrations stands to threaten the basic premise of regulatory predictability in IIA design. IIAs do not intend to entrench static or hermetically sealed regulatory frameworks, but rather, are designed to enable States Parties to the IIA as well as investors (as third-party beneficiaries of the IIA), to mutually, fairly, and transparently predict and estimate the economic returns and risks of investment. Thus, while the substantive standards of protection in the IIA provide criteria for future legal assessment of host States’ conduct towards investors, they must also be seen to establish the regulatory boundaries that States Parties to the IIA deem acceptably predictable for the duration of any investment to be covered under the IIA.

Part I (Regulatory Predictability in IIAs: Paradoxes over Policy Flexibility) of this Article describes the evolving substantive content and structural architecture of IIAs, and shows how various strategies have been deployed to maintain and constrain the regulatory prerogatives of a host State – from substantive standards (e.g. legality clauses, stabilization clauses, exceptions clauses, expanded definitions of investment and treaty applicability provisions, balance of payments provisions, among others), to procedural devices (e.g. dependence on jurisprudence constante in tribunal interpretations, State Parties’ joint decision mechanisms, authoritative interpretations and treaty compliance monitoring devices). As will be seen in Part I, these strategies rarely differentiate between regulatory risk in ordinary business cycles, and regulatory risk endogenous to financial or economic crises. A crystal example of the lack of differentiation may be seen from the disparate analytical treatment of regulatory risk in the issues of indirect (creeping) expropriations vis-à-vis non-compensable regulatory takings, as against the issue of “legitimate expectations” under the fair and equitable treatment (FET) standard. As investment arbitrations have shown, it has become entirely possible for a tribunal to find that, while a host State is not liable for indirect expropriation when it imposes a regulatory change, the same regulatory change may be found to have violated investors’ “legitimate expectations” and thus lead to a breach of the fair and equitable treatment standard, for which the host State is (often and problematically) found liable for compensation. Rather unusually, the value of compensation for these FET breach is frequently pegged at the level of the same indirect expropriation claim that the tribunal previously rejected.

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Part II (Managing Regulatory Risk from Social Protection Measures) proceeds to show that the estimation of regulatory risk from the design of IIAs can, and should, foreseeably include States Parties’ continuing dynamic obligations under the International Covenant on Economic Social and Cultural Rights (ICESCR). It shows, first, that the due diligence process can be revised to identify areas of host State policy flexibility that should be anticipated during the life of an investment as part of ICESCR compliance - Host States’ ICESCR compliance are now susceptible of empirical investigation and inclusion in investors’ regulatory risk assessments. Second, the ICESCR may have utility as an interpretive device read into the IIA – whether as part of the interpretation of standards of “treatment” made obligatory upon States Parties, or within the process of valuation of compensation for breaches of non-expropriation standards of the IIA. Finally, Part II also posits that an investor’s home State which is a party both to the ICESCR as well as any given IIA, assumes counterpart duties to ensure the extraterritorial application of the ICESCR to its nationals in other jurisdictions, including a duty to ensure that such nationals do not act in ways that cause States to violate the fundamental obligation to ‘respect’, ‘protect’, or ‘fulfill’ ICESCR rights.

Part III (Regulatory Risk Assessment for Diverse Investment Assets) then shows that different types or forms of investment require an appropriate analysis of the valuation method for each form. The assessment of regulatory risk for hedge funds, for example, may be tied more to generally to the assessments of a country’s macroeconomic political risk (usually based on inflation, the risk-free rate of a government security, among other variables). By contrast, it may be more appropriate to perform a regulatory regime assessment that is industry-specific for foreign direct investments (such as physical infrastructure or utilities), particularly where the regulatory process will entail inevitable impacts on ICESCR compliance. As seen in recent developments in Socially Responsible Investment (SRI) benchmarking and the UN Principles on Responsible Investment, it is not impossible to assess regulatory risk with a view to indexing the host State’s continuing social protection obligations under the ICESCR.

In the Conclusion (Shedding the Myth of Static Investment Regulation in an Era of Social Protection), this Article shows that, while regulatory predictability is a key objective of IIAs, it need not exclude dynamic host State regulations so long as the latter can be transparently tracked and verified by States Parties to the IIA. The kind of regulatory risk that should be deemed rightly compensable under IIAs should be tailored more towards host State conduct that prohibitively creates moral hazards and incentivizes adverse selection (fueled by the information asymmetry that favors the host State), ultimately resulting in violations to investors’ due process rights and foreseeable contractual expectations. The fundamental task of new IIA design must enable both investors and States Parties to endogenously factor in the costs of policy uncertainty as a result of the continuing demands upon host States to comply with the ICESCR. In this sense, ‘dynamic’ host State regulations (or the degree of policy flexibility that must be maintained to ensure that a State’s social protection measures to comply with the ICESCR remain in place during the life of an investment), should not be prohibited or penalized ex ante, as compensable breaches of an IIA. Where States Parties and investors have been transparently informed at the outset of this continuing dimension of regulatory risk on the ultimate price of investment, there can be no justifiable claim to compensation.
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I. REGULATORY PREDICTABILITY IN IIAS: PARADOXES OVER POLICY FLEXIBILITY

While regulatory risk has several specific economic meanings,2 in general, as a type of risk, this concept involves the presence of uncertainty that could lead to some damage or loss.3 For purposes of analyzing international investment agreements (IIAs) alongside their counterpart interpretative developments in arbitral practices, this Article focuses on the most parsimonious definition: “regulatory risk [is] the risk that regulatory agencies will change policy decisions.”4

The above definition is broad enough to capture industry-specific regulatory risk (e.g. the “risk arising from the quality of regulatory rules governing a particular

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3 According to Kolbe, Tye, Myers (1993, p. 33) “there appears to be no generally accepted definition of regulatory risk”. However, the analysis of different versions of regulatory risks has a long tradition within the economic theory of regulation (e.g. Ahn, Thompson, 1989), and becomes increasingly relevant within debates of regulatory reform of network industries (e.g. Ergas et al. 2001). Several definitions of regulatory risks are known from the literature. According to Wright et al. (2003, p. 118) the most obvious definition states that “regulatory risk arises whenever regulation affects the cost of capital of the regulated firm”. According to Kolbe et al. (1993, p. 33) “Here we define regulatory risk as the risk due to an asymmetric distribution of possible plant value outcomes”, and explicitly reject the application of the definition of regulatory risk as the impact of regulation on the cost of capital (see p. 33 footnote 56). Kolbe et al. (1993, pp. 37) focus on the regulatory risks due to some disallowances of the invested capital from the rate base or changes in the regulatory oversight. Ahn and Thompson (1989) analyze the way in which uncertainty in the application of a given regulatory instrument itself affects value (differing from the effect of regulation on the cost of capital). They analyze the risks involved in the process of rate of return regulation differentiating between the uncertainty of the initiation of a rate case (triggering rule risk) as well as the uncertainty involved in the actual assignment of the allowed rate of return (setting rule risk). Buckland, Fraser (2001) analyze the links between regulation and the risk faced by the regulated firm investigating the extent to which observed variation in betas is associated with regulatory factors (regulatory structure, regulatory review procedures etc.)…”

4 See Stanley Kaplan and B. John Garrick, Risk Analysis 1 (1981), at p. 12 (“The notion of risk, therefore, involves both uncertainty and some kind of loss or damage that might be received…Risk includes the likelihood of conversion of that source into actual delivery of loss, injury, or some form of damage.”)

industry, and from their application and enforcement\(^5\), as well as economy-wide regulatory risks (e.g. "risks arising from the application and enforcement of regulatory rules, both at the economy-wide and the industry- or project-specific level")\(^6\).

Regulatory risk may also be seen as an element of wider systemic risk, which arises from “gaps in regulatory oversight and the possibility that the failure of a large interconnected firm could lead to breakdown in the wider financial system”\(^7\). Over a decade ago, Thomas Wälde discussed this species of risks for foreign investments in private infrastructure as emerging “non-conventional forms of political risk”:

> “Modern versions of the "political risk" for infrastructure investment have less to do with a formal "taking" of property, but rather with the way government regulatory powers are used - or with omission by government to develop and exercise its regulatory powers "properly”. It is in essence the concept of good governance and its impact on foreign investors which is here at stake. The wide spread of privatisation of hitherto publicly owned and operated infrastructure facilities and services means that the foreign investor is now exposed to manifold influences on the "normal", commercial functioning of its enterprise. Such influences can come directly from government responding to the domestic political process, but they can also develop by emulation from other countries or on the basis of international guidelines and recommendations. Pressure from non-governmental organisations - directly on governments or by influence on home governments and home state or international financial institutions - can equally lead to a change in significant project variables which can be detrimental to the project’s financial health...

The most visible form of this risk is the government reneging on prices or other obligations contained in laws, licenses or contracts. The reason is that prices are in particular are politically sensitive, and political interest makes governments want to keep them down, irrespective of costs (in particular sunk costs). Such risk is heightened with respect to


monopolistic infrastructure assets where visibility is greater and where competition – as a way of controlling potential for abuse of dominant market power – is absent. Since foreign investors try to obtain contractual guarantees against such natural governmental attitudes, the politics of infrastructure investment will meet the obstacle of contractual commitments – and treaty protection is then sought against government attempts to free themselves from such commitments. But such contemporary forms of political risk consists not only in formal and explicit action by the governments, usually in the forms of legislation and captured by the modern term of “economic regulation”, but it can also consist in action by several groups of economic actors which may be semi-state, quasi-state, subnational state and non-state actors…”

Admittedly, the relative impact of IIAs in reducing political and regulatory risk remains an open question. Such a broader academic debate only serves to further underscore the importance of a focused analysis on regulatory risk, within the evolving design of IIA architecture as well as in its practical usages articulated in investment arbitral jurisprudence. To date, it has been increasingly acknowledged that the design of IIAs bears particular significance to the management of such political and regulatory risks. This Article aims to supply initial insights into the role of

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“Expropriation and regulation are different in nature. The former focuses on the taking of an investment; it is a targeted act. The latter is part of the common and normal functioning of the State where impairment to an investment can be a side effect. Expropriation is always compensable, whereas regulation is not. Drawing a line between the two is not easy but is of paramount importance: The international rules on expropriation should not diminish or alter in any degree the ability of States to regulate in the public interest. At the same time, regulation must not be used as a disguised mechanism to expropriate foreign property….State has a number of policy options at their disposal in order to address specific concerns, minimize risks and achieve desired policy objectives. When
regulatory risk in IIA and arbitral practices. It is especially relevant to ongoing controversies where host State governments have been hard-pressed to abandon regulatory commitments to foreign investors, in order to meet the increased demands for social protection measures during economic crises.\(^\text{11}\)

**A. Regulatory Predictability as the Design Premise of IIAs**

The history behind the rapid evolution of bilateral and regional IIAs shows that the neoliberal race to attract foreign investment initially began through a North-South paradigm,\(^\text{12}\) often accompanied by markedly uneven bargaining power between capital-exporting and capital-importing States.\(^\text{13}\) Whether this asymmetric bargaining dynamic has changed alongside the modern configurations of South-South and South-North investment flows\(^\text{14}\) is not the object of this Article. It will suffice to note that, despite numerous criticisms about the lack of undisputed causality between IIA design and investment promotion,\(^\text{15}\) the overwhelming majority of States nevertheless making relevant choices, it is crucial to keep in mind that an expropriation provision should not undermine or weaken the right of States to exercise their police powers and regulatory functions.”


\(^{12}\) *Kenneth J. Vandevelde, Bilateral Investment Treaties: History, Policy, and Interpretation* (Oxford University Press, 2010), at Chapter 2.

\(^{13}\) M. Sornarajah, *The International Law of Foreign Investment* (Oxford University Press, 2010 ed.) pp. 19-28, 53-54, 177 (“[a]nother feature of bilateral investment treaties is that they are made between unequal partners. They entrench an inequality that has always attended this area of international law. They are usually agreed between a capital-exporting developed state and a state keen to attract capital from that state…”) [hereafter, “Sornarajah 2010”]


continue to conclude IIAs.

Leaving aside the contested debate regarding the degree to which an IIA does (or does not) meet the empirical objectives of investment promotion, the phenomenon of IIA proliferation may also be understood from both a normative and functionalist perspective. Normatively, an IIA represents the tangible result of a mutual decision by States Parties to bind themselves to “precommitments”, a strategy which helps resolve the problem of enforcing government promises during the inevitable intervening time between a government promise and its performance. As Tom Ginsburg and his co-authors explain, international investment agreements resolve these problems “by making the government promise enforceable through international arbitration. The treaty regime makes the government’s commitments more credible because it removes the adjudication of disputes from the government’s hands and raises the possibility of externally imposed sanctions down the road. This in turn makes performance more likely.”

The substantive standards of protection in an IIA and FDI reveals fourteen studies that claim statistically significant findings to support the hypothesis that signing BITs increases FDI. This count includes: studies that find that only some types of BITs increase FDI; two studies reporting apparently contradictory findings – one that only US BITs increase co-signatories’ FDI and another that most BITs increase FDI but US BITs do not increase co-signatories’ FDI from the US; a study that finds only a ‘minor and secondary’ relationship between BITs and FDI; and a study that finds that BITs increase FDI but with diminishing returns of FDI to each additional BIT a country signs. A further five studies reject the hypothesis that BITs increase FDI.

16 “Precommitment” theory, particularly for international law, is attributable to Professor Tom Ginsburg and his co-authors in their landmark 2008 journal article. See Tom Ginsburg, Svitlana Chernykh, Zachary Elkins, Commitment and Diffusion: How and Why National Constitutions Incorporate International Law, 1 University of Illinois Law Review 201 (2008), at 211-212 (“To the extent that international law binds states and limits the options of policy-makers, it can serve as a precommitment device…Precommitment allows states to communicate to other states that they are serious about their promises. Certainly not all international agreements among states are precommitments, in the sense of giving up future choices to guard against preference shifts. States have many other reasons for entering into agreements. But some kinds of agreements certainly act as precommitments.”)

17 Id. at footnote 15, p. 212 and 214 (“International commitment devices work in three different ways. International obligations can generate information on the behavior of politicians in future periods. This is relevant when the behavior in question is difficult for the domestic constituents to observe…Second, politicians can, in effect, bond their behavior by making sure that any future violation of the promise will generate costs imposed by international actors. A government promise to submit to international arbitration for investment disputes means that the government may have to pay compensation if it
thus operate to precommit States Parties against unforeseeable or unreasonable regulatory changes. As a “precommitment” device, the IIA ultimately guarantees a certain level of regulatory predictability to States Parties and the investor-nationals of such States Parties as third-party beneficiaries of the IIA.

Regulatory predictability is economically significant to the ultimate investment decision, precisely because the host State’s regulatory regime “can affect (positively or negatively) not only the project return and risk, but also [the] asset value of the group as a whole....[through] the immediate impact on operating costs...the effect of uncertainty about future standards and property rights...[which] can require considerably increased ‘hurdle rates of return’ to invest in a particular country...[and] the influence on the asset value of a group as a whole due to the reaction of shareholders, consumers, and employees in the home country to group subsidiary operations abroad.”18 To the extent that an IIA contains transparent and determinable obligations of its States Parties, it establishes a common baseline of expectations of the quality of regulatory predictability that investors and host States could rightfully anticipate during the life of a covered investment.

On the other hand, a functionalist19 view of IIAs would recognize that the violates its promises. It is the simple cost associated with violation, rather than information generated from abroad, that renders the mechanism useful for enhancing the commitment. Third, politicians can make a credible commitment by delegating decision-making authority to an independent international actor. In this mode, the politician guards against her future preference shifts by completely ceding decision-making authority.”


19 Recall Morgenthau’s conception of functionalism in international law as an intertwined analysis of rules and social phenomena. See Hans J. Morgenthau, Positivism, Functionalism, and International Law, 34 American Journal of International Law 2 (April 1940), pp. 260-284, at 274 (“...international law is a social mechanism working towards certain ends within this same civilization which, in turn, as far as determined by it, become a function of this same international law. By systematizing the rules of a given international law under the viewpoint of this dual functional relationship between rules and social forces, the functional theory will arrive at a real scientific understanding of the material element of the legal rules...”)

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continued global proliferation of these types of treaties is not a random simultaneous phenomenon either. The International Institute for Sustainable Development (IISD) identifies three factors behind the marked growth of IIAs: 1) the deliberate agenda push in favor of IIAs by global economic institutions such as the UN Conference on Trade and Development (UNCTAD), in order to create an “added security” that would spur increases in foreign direct investment; 2) the international institutional preference for IIAs as “risk management tools”, where investment or political risk insurance would depend on whether developing states have concluded an IIA; and 3) capital-exporting states’ increased concern for investment protection, given the scale, frequency, and volume of their foreign direct investments spurred by worldwide liberalization and globalization trends.\(^\text{20}\) Moreover, where the provision of international aid, finance, bilateral or region sovereign lending attaches a requirement for recipient States to extend additional legal protections to foreign investors beyond those contained in their domestic laws,\(^\text{21}\) it would be inevitable that more IIAs would be concluded.

Furthermore, another functionalist view could also explain the proliferation of IIAs. It is also very likely that States are concluding IIAs in order to minimize opportunities for cross-border “regulatory arbitrage”\(^\text{22}\) – a situation where investment pricing differences (in this case, the expected transaction costs from investing in a particular country) arise due to the fact that “the same transaction receives different regulatory treatment under different regulatory regimes.”\(^\text{23}\) Foreign investors may


\(^{21}\) SORNARAJAH 2010, pp. 174-175.


\(^{23}\) Id. at p. 244.
prefer to invest in jurisdictions that commit to substantive standards of protection under an IIA, rather than in other jurisdictions that eschew similar international commitments in favor of using local law to protect investors against takings and other injurious deprivations. International investors may prefer IIA-covered jurisdictions in order to take advantage of the lower risk of non-compensability in those jurisdictions, for situations where the host State expropriates the investment or otherwise engages in morally hazardous conduct causing economic deprivation to the investor. According to some scholars, the presence of an IIA itself “provides a strong incentive for a host State to honor its obligations under international law and its agreements with the investor.” Ultimately, States could very likely be concluding IIAs so as not to lose out on potential similar investment prospects to competitor States that already make such guarantees in IIAs. In this sense, States compete through IIAs to offer similar, if not better, commitments of regulatory predictability to foreign investors.

Whether viewed from the normative or functionalist perspective, the proliferation of IIAs bears testament to how States value the need to maintain and guarantee regulatory predictability, at least sufficiently enough for these States to accept the tradeoff that future exercises of regulatory powers could be subjected to claims against the State for alleged international responsibility. The State’s authoritative decision-makers may choose to incur this tradeoff not just for the supposed ability of an IIA to attract foreign investment from new capital-exporting sources, but also for the fact that these decision-makers might also stand to reap other immediate indirect political and economic gains from choosing to entrench regulatory

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predictability through an IIA. Some of these collateral or indirect benefits from successfully negotiating an IIA could likely include: 1) obtaining favorable counterpart international lending or sovereign financing terms as part of a basket of international commitments with an IIA partner; 2) opening new market access through a broader free trade agreement that includes the IIA; 3) garnering favorable perceptions and increased support from domestic constituencies and local businesses; 4) institutionalizing an international investment regulatory policy that is consistent with the decision-makers’ own political views on resource allocation and development strategies; and 5) paving the way for other additional forms of strategic cooperation in the future with the new State partner under the IIA. Moreover, it is also possible that a State’s authoritative decision-makers see few costs in entering into an IIA – where the duration of an IIA’s applicability stands to outlast politicians’ electoral terms, these decision-making elites could be less concerned with the possibility of any future political fallout if the State were to be held internationally responsible under the IIA for regulatory actions that injure foreign investors. Under

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26 See Diane A. Desierto, For Greater Certainty: Balancing Economic Integration with Investment Protection in the New ASEAN Investment Agreements, 5 Transnational Dispute Management (2011) special issue on Resolving International Business Disputes by ADR in Asia; Oliver Morrissey, Investment Provisions in Regional Integration Agreements for Developing Countries, University of Nottingham CREDIT Research Paper No. 08/06, available at http://www.nottingham.ac.uk/credit/documents/papers/08-06.pdf (last accessed 10 September 2012); John Whalley, Why Do Countries Seek Regional Trade Agreements?, pp. 63-90 in JEFFREY A. FRANKEL (ED.), THE REGIONALIZATION OF THE WORLD ECONOMY (University of Chicago Press, 1998). See also Gus van Harten, Five Justifications for Investment Treaties: A Critical Discussion, 2 Trade Law and Development 1 (2010) (“…states might have decided to conclude investment treaties – however unequal in fact or in law – because they perceived other benefits of doing so (or other risks of not doing so)….the choices of states are made in a political context that goes beyond consideration of markets and the movement of capital flows or in themselves…”)

27 See Jide Nzelibe, Strategic Globalization: International Law as an Extension of Domestic Political Conflict, 105 Northwestern University Law Review 2 (2011) 633-688, at 638 (“…the politicians who accept or oppose international legal constraints on their authority come from all sides of the political spectrum, and they often do so because of the perceived political threats or opportunities arising from such constraints. And although international legal commitments are often framed as institutional arrangements rather than as prescribed policy outcomes, partisan politicians tend to rank these commitments based upon their expectations regarding future policy outcomes. Such expectations may depend on the partisan beliefs regarding the likely preferences of other states that are party to the
these circumstances, the functional gains from concluding an IIA make it only more politically expedient to do so than otherwise.

Regardless of the motivation for concluding an IIA, what is crucial for assessing its design is detecting how regulatory predictability could be achieved when States Parties to the IIA impose constraints on their own present and future regulatory powers with respect to covered investments under the IIA. In 1999, Thomas Waelde advanced the intuitive argument that States could reduce political and regulatory risks if they conclude international investment treaties. This argument presupposes that a State’s willingness to commit to a certain quality of investment protection linearly predicted its future conduct to investors. But such an intuition does not necessarily hold true if one takes into account the complex history of actual investor-State disputes administered under the ICSID system. On the contrary, States’ IIA breaches submitted to the investor-State dispute settlement mechanism firmly show how some States indeed deviate from the conduct promised under the IIA. As such, it is not exactly that IIAs causally reduce regulatory or political risks of investing in any given State, but rather, the IIAs establish the minimum regulatory predictability that States Parties bound themselves to observe, on pain of compensation should they fail to abide by this minimum.

Furthermore, while the willingness to commit to an IIA could well be an endogenous variable for estimating regulatory risk within the host State, it is not the only variable to consider when attempting a future forecast of how that host State

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28 Id. at footnote 8.

29 See ANTONIO R. PARRA, THE HISTORY OF ICSID (Oxford University Press, 2012), at pp. 119-320 (for the most comprehensive discussion on the features of ICSID investor-State disputes from its earliest beginnings in 1965 to the year 2010).
would be likely to change its policy decisions relating to foreign investment. There are numerous empirical methods in the estimation of regulatory risk in relation to foreign investment, for which the analysis of regulatory risk in IIAs and arbitral practices should only serve as a starting point, albeit a fundamentally critical one. This Article attempts to supply the latter gap in the literature, in order to contribute to current scholarship that already explores the role of regulatory regimes in the actual economic returns and risks of IIA-covered investments. As a highly subjective discipline, risk analysis and empirical estimation can also benefit from insights into IIA design, as well as the treatment of regulatory risk to date by arbitral tribunals. Sections B and C of this Part I turn to these matters, respectively.


33 See Reid W. Click, Financial and Political Risks in US Direct Foreign Investment, 36 Journal of International Business Studies 5 (September 2005), 559-575, at 561 (“Political risk is defined as the possibility that political decisions or political and social events in a country will affect the business climate in such a way that investors will lose money or not make as much money as they expected. It has not yet been investigated in finance, owing primarily to lack of high-quality data. In contrast to the widespread availability of data on financial variables, the underlying sources of political risk are not readily measured.”)
B. IIA Design: Methods for Maintaining and Constraining the Regulatory Prerogatives of the host State

An IIA will reflect how States Parties choose to constrain regulatory prerogatives, or conversely, carve out future policy flexibility to meet public interest objectives from investment protection guarantees. IIAs will typically contain some combination of, if not both, *structural devices* as well as *substantive standards*.

1. Structural devices

Rather than completely deferring to individual arbitral tribunals’ interpretation of IIA standards on a case-by-case basis, 34 States are increasingly incorporating other mechanisms within the IIA to retain control over, and possibly harmonize, IIA interpretation. 35 These include: 1) ad hoc joint decision mechanisms; 2) treaty-based institutional commissions; 3) inter-State consultative mechanisms; 4) incorporation of other subject matter-specific treaties (e.g. environmental, labor, human rights); and 5) inter-State bilateral appellate mechanisms to review arbitral awards under the IIA’s investor-State dispute settlement mechanism, or the outright omission of investor-State dispute settlement mechanisms under the IIA. 36 The following subsections

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discuss how each of these respective structural devices could assist States in managing the balance between investors’ perceived regulatory risks and the host State’s need to retain policy flexibility within the IIA to continue meeting regulatory and public interest objectives.

1.1. Ad hoc joint decision mechanisms

The ad hoc joint decision mechanism is a relatively recent device in the newer generations of IIAs, and it may be utilized in the future to enable States to control the interpretation of an IIA so that States continue to retain sufficient policy flexibility to respond to domestic public interest and regulatory objectives.\(^{37}\) As seen from Article 30(3) of the United States Model Bilateral Investment Treaty (BIT),\(^{38}\) States Parties to an IIA reserve the right to issue a “joint decision” declaring their interpretation of any provision of the IIA, which would be binding on any present or future arbitral tribunal constituted under the IIA’s dispute settlement mechanism. The States Parties may issue the joint decision interpreting an IIA standard (such as, for example, the fair and equitable treatment standard) at any stage, with or without reference to pending investor-State disputes, and with or without reference to contemporaneous interpretations by other international tribunals of the same IIA standard contained in other IIAs. Other joint decision mechanisms are present in Article 30(3) of the 2005


\(^{38}\) Full text of the 2012 United States Model BIT available at http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf (last accessed 10 September 2012). Article 30(3) of the US Model BIT states: “A joint decision of the Parties, each acting through its representative designated for the purpose of this Article, declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that decision.”
United States-Uruguay BIT, Article 30(3) of the 2008 United States-Rwanda BIT, Article 29(2) in relation to Article 18(2) of the 2007 India-Mexico BIT, Article X(6) of the 2009 Canada-Czech Republic BIT, Article 27(3) of Chapter 11 (Investment) of the 2010 ASEAN-Australia-New Zealand Free Trade Agreement.

While these mechanisms openly permit States Parties to the IIA to agree on any interpretation of IIA provisions that would prevail over any arbitral tribunal, they problematically do not refer to international law as the Parties’ guiding principles when deciding on any future agreed interpretation of the IIA. Neither do the joint decision mechanisms provide for any internal control or guidance for the States Parties when their interpretation frontally collides with an arbitral tribunal’s legal interpretation of an IIA standard, issued by arbitrators in observance of their

39 Treaty Between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (United States/Uruguay BIT 2005), S Treaty Doc No. 109-9 (2006), Article 30(3): “A joint decision of the Parties, each acting through its representative designated for purposes of this Article, declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision.”

40 Treaty Between the Government of the United States of America and the Government of the Republic of Rwanda Concerning the Encouragement and Reciprocal Protection of Investment (United States/Rwanda BIT 2008), available at http://www.ustr.gov/sites/default/files/uploads/agreements/bit/asset_upload_file743_14523.pdf (last accessed 10 September 2012), Article 30(3): “A joint decision of the Parties, each acting through its representative designated for purposes of this Article, declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision.”

41 Agreement between the United Mexican States and the Government of the Republic of India on the Promotion and Reciprocal Protection of Investments (India/Mexico BIT 2007), IC-BT 742 (2007), Article 29(2): “The Contracting Parties agree to consult each other on having a joint interpretation on Article 7 [Expropriation] in accordance with paragraph 2 of Article 18 [“An interpretation jointly formulated and agreed upon by the Contracting Parties with regard to any provision of this Agreement shall be binding on any tribunal established under this Section.”] of this Agreement at any time after the entry into force of this Agreement.”


43 2010 Agreement Establishing the ASEAN-Australia-New Zealand Free Trade Area, available at http://www.asean.fta.govt.nz/assets/Agreement-Establishing-the-ASEAN-Australia-New-Zealand-Free-Trade-Area.pdf (last accessed 10 September 2012), Article 27(3) of Chapter 11: “A joint decision of the Parties, declaring their interpretation of a provision of this Agreement shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision.”
fundamental duties to maintain independence and impartiality. There has not yet been an occasion to resolve the potential jurisdictional tension between arbitral tribunals’ exercise of their competences to interpret and apply the IIA to concrete investor-State disputes, and how States Parties to the IIA might strategically wield the joint decision mechanism to minimize or avoid liability under the IIA by controlling the latter’s ultimate interpretation at any stage of a given investor-State dispute.

1.2. Treaty-based institutional commissions

Treaty-based institutional commissions or inter-State consultative bodies could pose less of a danger of undue interference with arbitral tribunals’ competences in specific pending investor-State disputes. While the IIA interpretations of treaty-based commissions are generally binding on arbitral tribunals, they are nevertheless issued presumably with a more institutional view of the interpretation’s consequences for the future implementation, oversight, supervision of the IIA. A treaty-based institutional commission also has the advantage of entrenching regular consultations and dialogue between the States Parties to the IIA, and thus may be said to have a more long-term view of the IIA’s implementation when it issues an interpretation, as opposed to an ad hoc joint decision mechanism which may be triggered purposely only to affect the outcome of specific pending investor-State disputes.

One example of such a treaty-based institutional commission is the North American Free Trade Area (NAFTA) Free Trade Commission,\(^4^4\) which was set up as an institution composed of cabinet-level representatives from the three contracting States, with the specific powers to “supervise the implementation” of the treaty.\(^4^5\)


\(^{45}\) Id. at footnote 44, Article 2001 (2)(a).
“oversee its further elaboration”, and “resolve disputes that may arise regarding its interpretation or application”. The Free Trade Commission issued Notes of Interpretation in 2001, although admittedly it has since been criticized for the seeming *de facto* amendment of NAFTA treaty provisions as a result of the Notes. Other IIAs that establish institutional commissions authorized to undertake IIA interpretation binding upon future arbitral tribunals include: Article 10.22(3) of the 2004 Dominican-Republic-Central America-United States Free Trade Agreement (DR-CAFTA), Article 40(3) of the 2006 Canada/Peru BIT, Article 40(2) of the 2009 Canada/Jordan BIT, and Article X(6) of the 2010 Canada/Slovakia BIT.

### 1.3. Inter-State consultation mechanisms

In contrast to ad hoc joint decision mechanisms and treaty-based institutional commissions, inter-State consultation mechanisms in an IIA have the least potential

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46 Id. at footnote 44, Article 2001 (2)(b).
47 Id. at footnote 44, Article 2001 (2)(c).
50 Dominican Republic-Central America-United States Free Trade Agreement, Chapter 10: Investment (DR-CAFTA 2004), IC-MT 012 (2004), Article 10.22(3) (Governing Law): “A decision of a provision of this Agreement under Article 19.13(c) (The Free Trade Commission) shall be binding on a tribunal established under this Section, and any decision or award issued by the tribunal must be consistent with that decision.”
51 Agreement between the Government of Canada and the Government of the Republic of Peru for the Promotion and Protection of Investments (Canada/Peru BIT 2006), IC-BT 014 (2006), Article 40(3): “An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section, and any award under this Section shall be consistent with such interpretation.”
52 Agreement between Canada and the Hashemite Kingdom of Jordan for the Promotion and Protection of Investments (Canada/Jordan BIT 2009), IC-BT 1154 (2009), Article 40(2): “An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section, and any award under this Section shall be consistent with such interpretation.”
53 Agreement between the Government of Canada and the Slovak Republic for the Promotion and Protection of Investments (Canada/Slovakia BIT 2010), IC-BT 1533 (2010), Article X(6): “An interpretation of this Agreement agreed between the Contracting Parties shall be binding on a Tribunal established under this Article.”
for disrupting arbitral independence and impartiality in handling investor-State disputes. They are not likely to affect the substantive content of an IIA, but rather, could serve as a structural device to facilitate continuing communications between States Parties to the IIA. This structural device could be particularly useful for States Parties to transparently articulate and make of record any ongoing regulatory and public interest concerns that could affect the future implementation of the IIA. Examples of these consultation mechanisms include Article 12 of the 1996 Greece/Chile BIT,54 Article 12 of the 1989 Netherlands/Ghana BIT,55 Article VIII of the 1993 Spain/Philippines BIT,56 Article XI of the 1997 Denmark/Philippines BIT,57 Article 43 of the 2009 ASEAN Comprehensive Investment Agreement,58 Article VIII of the 1995 Czech Republic/Philippines BIT,59 Article 8 of the 1985 Greece/Chile BIT.

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54 Agreement between the Government of the Hellenic Republic and the Government of the Republic of Chile on the Promotion and Reciprocal Protection of Investments (Greece/Chile BIT 1996), IC-BT 1475 (1996), Article 12: "Representatives of the Contracting Parties shall, whenever necessary, hold consultations on any matter affecting the implementation or interpretation of this Agreement. These consultations shall be held on the proposal of one of the Contracting Parties at a place and at a time to be agreed upon through diplomatic channels."

55 Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Ghana (Netherlands/Ghana BIT 1989), IC-BT 938 (1989), Article 12: “Either Contracting Party may propose the other Party to consult on any matter concerning the interpretation or application of the Agreement. The other Party shall accord sympathetic consideration and shall afford adequate opportunity for such consultation.”

56 Agreement on the Reciprocal Promotion and Protection of Investments between the Kingdom of Spain and the Republic of the Philippines (Spain/Philippines BIT 1993), 1842 U.N.T.S. 91, IC-BT 1369 (1993), Article VIII: “Both Parties agree to consult each other at the request of either Party on any matter relating to the investment between the two countries, or otherwise affecting the implementation of this Agreement.”

57 Agreement between the Government of the Kingdom of Denmark and the Government of the Republic of the Philippines Regarding the Promotion and Reciprocal Protection of Investments (Denmark/Philippines BIT 1997), IC-BT 893 (1997), Article XI: “The Contracting Parties agree to consult each other at the request of either Party on any matter affecting the implementation of this Agreement. The consultations shall be held on the proposal of one of the Contracting Parties at a place and date agreed upon through diplomatic channels.”

58 2009 ASEAN Comprehensive Investment Agreement (ACIA), Article 43: “The Member States agree to consult each other at the request of any Member State on any matter relating to investments covered by this Agreement, or otherwise affecting the implementation of this Agreement.”

59 Agreement between the Czech Republic and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (Czech Republic/Philippines BIT 1995), IC-BT 592 (1995), Article VIII: “The Contracting Parties agree to consult each other at the request of either Contracting Party on any matter relating to investment between the two countries, or otherwise affecting the implementation of this Agreement.”
Netherlands/Philippines BIT,\textsuperscript{60} Article VIII of the 1999 Philippines/Pakistan BIT,\textsuperscript{61} Article 7 of the 1997 Germany/Philippines BIT,\textsuperscript{62} and Article 29(1) of the 2007 India/Mexico BIT.\textsuperscript{63}

By proactively availing of the IIA’s inter-State consultations mechanism to periodically inform counterpart State Parties of any public interest developments that might conceivably result in administrative or legislative actions affecting regulatory frameworks, a host State can improve transparency, manage expectations between States, and ultimately help diminish investors’ perceived regulatory risks.\textsuperscript{64}

\textbf{1.4. Incorporation of other treaties}

Some IIAs purposely contain structural devices that enable cross-references to

\textsuperscript{60} Agreement between the Kingdom of the Netherlands and the Republic of the Philippines for the Promotion and Protection of Investments, Article 8: “The Contracting Parties agree to consult each other at the request of either Contracting Party on any matter relating to investment between the two countries, or otherwise affecting the implementation of this Agreement.”

\textsuperscript{61} Agreement between the Government of the Republic of the Philippines and the Government of the Islamic Republic of Pakistan for the Promotion and Reciprocal Protection of Investment (Philippines/Pakistan BIT 1999), IC-BT 668 (1999), Article VIII: “The Contracting Parties agree to consult each other at the request of either Contracting Party on any matter relating to investment between the two countries, or otherwise affecting the implementation of this Agreement.”

\textsuperscript{62} Agreement between the Federal Republic of Germany and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (Germany/Philippines BIT 1997), IC-BT 123 (1997), Article 7: “The Contracting Parties agree to consult each other at the request of either Contracting Party on any matter relating to investment between the two countries, or otherwise affecting the implementation of this Agreement.”

\textsuperscript{63} Agreement between the United Mexican States and the Government of the Republic of India on the Promotion and Reciprocal Protection of Investments (India/Mexico BIT 2007), IC-BT 742 (2007), Article 29(1): “A Contracting Party may propose to the other Contracting Party to carry out consultations on any matter relating to this Agreement. These consultations shall be held at a place and at a time agreed by the Contracting Parties.”

other treaty obligations that involve social protection measures and public interest objectives. Article 18(2) of the 2002 Austria/Malta BIT, for example, specifically provides that the application of the European Convention on Human Rights “shall not be excluded”.\textsuperscript{65} Clause 1 of the Protocol to the 1998 Japan/Pakistan BIT prohibits the interpretation of the treaty in a way that would derogate from intellectual property rights agreements, such as the Agreement on Trade-Related Aspects of Intellectual Property Rights, “and other treaties concluded under the auspices of the World Intellectual Property Organization.”\textsuperscript{66} Article 5(3) of the 2004 Belgium-Luxembourg Economic Union/Serbia and Montenegro BIT reaffirms the States’ Parties “commitments under international environmental agreements”.\textsuperscript{67} While Article 12 of

\textsuperscript{65} Agreement between the Republic of Austria and Malta on the Promotion and Mutual Protection of Investments (Austria/Malta BIT 2002), IC-BT 1425 (2002), Article 18 (2): “The application of the European Convention on Human Rights shall not be excluded.”

\textsuperscript{66} Agreement between Japan and the Islamic Republic of Pakistan Concerning the Promotion and Protection of Investments (Japan/Pakistan BIT 1998), IC-BT 655 (1998), Protocol, Clause 1: “Nothing in the Agreement shall be construed so as to derogate from the rights and obligations under international agreements in respect of protection of intellectual property rights to which they are parties, including Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 1C of Marrakesh Agreement Establishing the World Trade Organization, and other treaties concluded under the auspices of the World Intellectual Property Organization.” \textit{See also identical provisions in} Agreement between Japan and the People’s Republic of Bangladesh Concerning the Encouragement and Protection of Investment (Japan/Bangladesh BIT 1998), Protocol Clause 1; Agreement between Japan and Mongolia Concerning the Promotion and Protection of Investment (Japan/Mongolia BIT 2001) Protocol Clause 1; Agreement between the Government of Japan and the Government of the Republic of Korea for the Liberalisation, Promotion and Protection of Investment Protocol Clause 1.

\textsuperscript{67} Agreement between the Belgium-Luxembourg Economic Union, on the one hand, and Serbia and Montenegro, on the other hand, on the Reciprocal Promotion and Protection of Investments (Belgium-Luxembourg Economic Union/Serbia and Montenegro BIT 2004), Article 5(3): “The Contracting Parties reaffirm their commitments under the international environmental agreements, which they have accepted. They shall strive to ensure that such commitments are fully recognized and implemented by their national legislation.” \textit{See identical or similar provisions in} Article 5(3) of the Agreement between the Belgian-Luxembourg Economic Union, on the one hand, and the Republic of Sudan, on the other hand, on the Reciprocal Promotion and Protection of Investments (Belgium-Luxembourg Economic Union/Sudan BIT 2005); Article 5(3) of the Agreement between the Belgian-Luxembourg Economic Union, on the one hand, and the Federal Democratic Republic of Ethiopia, on the other hand, on the Reciprocal Promotion and Protection of Investments (Belgium-Luxembourg Economic Union/Ethiopia BIT 2006); Article 13(3) of the Agreement between the Belgo-Luxembourg Economic Union and the Government of the Republic of Guatemala on the Reciprocal Promotion and Protection of Investments (Belgium-Luxembourg Economic Union/Guatemala BIT 2005); Article 5(3) of the Agreement between the Belgo-Luxembourg Economic Union and the Great Socialist People’s Libyan Arab Jamahiriya, on the other hand, on the Reciprocal Promotion and Protection of Investments (Belgium-Luxembourg Economic Union/Libyan Arab Jamahiriya BIT 2004); Article 5(3) of the Agreement between the Belgo-Luxembourg Economic Union, on the one hand, and the Republic of Mauritius, on the other hand, on the Reciprocal Promotion and Protection of Investments (Belgium-
the 2005 United States/Uruguay BIT holds that “it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws”\(^68\). Articles 13(1) and 13(2) of the same treaty makes references to “internationally recognized labor rights”\(^69\). On the other hand, other IIAs tend to provide rules governing the application of other international agreements along with the IIA, usually calling for the application of the “more favorable” provision to the States Parties without indicating the criteria for determining the “favorability” of the applicable agreement. Examples of these types of references to the application of other treaties include: Article 11 of the 1993 Slovenia/Slovakia BIT,\(^70\) Article 10 of the 1994 Hungary/Bulgaria BIT,\(^71\) and Article 13(1) of the 1994 Czech Republic/United Arab Emirates BIT.\(^72\) Apart from these modes of referring to other

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\(^69\) Id. at footnote 68, Articles 13(1) and 13(2). Italics added.

\(^70\) Agreement on Reciprocal Investment Protection and Promotion between the Republic of Slovenia and the Slovak Republic (Slovenia/Slovakia BIT 1993), IC-BT 1522 (1993), Article 13(1): “When any matter is treated simultaneously by this agreement and some other international agreements of which the two parties hereof are signatories, or the matter is governed by the general international law, then the most favourable provisions shall apply to both parties hereof and their respective investors, on a case-by-case basis.”

\(^71\) Agreement between the Republic of Hungary and the Republic of Bulgaria on Mutual Promotion and Protection of Investments (Hungary/Bulgaria BIT 1994), Article 10: “Should national legislation of the Contracting Parties or present or future international agreements applicable between the Contracting Parties or other international agreements entered into by both Contracting Parties contain regulations, whether general or specific, entitling investments by investors of the other Contracting Party to a treatment more favourable than is provided for by this Agreement, such regulation shall to the extent that it is more favourable prevail over the present Agreement.” See similar or identical provision in Article 11 of the Agreement between the Czech Republic and the Republic of Bulgaria for the Promotion and Reciprocal Protection of Investments (Czech Republic/Bulgaria BIT 1999).

\(^72\) Agreement between the Government of the Czech Republic and the Government of the United Arab Emirates for the Promotion and Protection of Investments (Czech Republic/United Arab Emirates BIT 1994), Article 13(1): “Where a matter is governed simultaneously both by this Agreement and by other international agreements to which both the Contracting States are parties or general principles of law commonly recognized by both Contracting States or domestic law of the host State, nothing in this Agreement shall prevent either Contracting State or any of its investors who own investments in the territory of the other contracting State from taking advantage of whichever rules are the more favourable to their case.”
applicable treaties, current IIAs seldom contain language that explicitly integrates international human rights treaties, environmental, or labor agreements as part of subsisting obligations to be observed alongside IIA obligations.

Significantly, no IIA to date has ever expressly integrated the International Covenant on Economic Social and Cultural Rights – the one treaty that most comprehensively implicates a host State’s dynamic and continuing obligations to enact social protection measures in the public interest in times of economic prosperity as well as economic crises.\(^\text{73}\) The absence of any express incorporation of these treaties, as well as the marked silence within the IIAs on the normative or hierarchical relationship between the host State’s other international obligations in human rights treaties with its IIA obligations, heightens regulatory risk by fomenting uncertainty to all States Parties to the IIA as well as their respective investor-nationals. If a host State were to invoke compliance with an international human rights treaty as its justification for a social protection measure that incidentally results in non-compliance with IIA obligations, there is an increased burden for the host State to prove that its conduct is not pretextual and indeed carves out a justification against liability. As will be shown in Section B.2. (Substantive standards), such a defense has yet to be accepted by arbitral tribunals.

1.5. Bilateral appellate mechanisms; Omission of investor-State dispute settlement mechanism

Investor-State disputes under IIAs are predominantly referred to the arbitration procedures under the 1965 Convention on the Settlement of Investments Disputes Between States and Nationals of Other States (otherwise known as the

\(^{73}\text{See Diane A. Desierto, ICESCR Minimum Core Obligations and Investment: Recasting the Non-Expropriation Compensation Model during Financial Crises, George Washington International Law Review (Fall 2012).}\)
The ICSID arbitration system does not contain any full-blown appeals procedure to review arbitral awards’ factual and legal findings, instead providing for limited annulment procedures in Article 52 of the ICSID Convention.\(^7\)

States Parties tend to rely on the “self-contained”\(^7\) dispute settlement system under the ICSID Convention, and thus rarely contemplate building any bilateral appellate mechanism into their IIAs. The 2005 United States/Uruguay BIT provided for the possibility of creating such a bilateral appellate mechanism,\(^7\) but none of the other IIAs concluded by the United States contain such a provision. Unlike this unusual practice, IIAs would usually state that an arbitral award “shall not be subject to any appeal or remedy other than those provided for in [the ICSID] Convention.”\(^7\)

In this sense, carving out a bilateral appellate mechanism from the investor-State dispute settlement mechanism under the IIA, well outside of the self-contained dispute settlement procedures in the ICSID system, problematically introduces more

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\(^7\) ICSID Commentary, pp. 890-1095.


\(^7\) Treaty Between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (United States/Uruguay BIT 2005) Annex E (Possibility of a Bilateral Appellate Mechanism): “Within three years after the date of entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism.”

\(^7\) See for example Agreement between Federal Republic of Germany and the Republic of Indonesia concerning the Encouragement and Reciprocal Protection of Investments (Germany/Indonesia BIT 2003) Article 10(3); Agreement between the Kingdom of Saudi Arabia and the Belgo-Luxembourg Economic Union concerning the Reciprocal Promotion and Protection of Investments (Saudi Arabia/Belgium-Luxembourg Economic Union BIT 2001) Article 10(3)(b); Agreement between the Government of the Kingdom of Denmark and the Government of the Republic of Zimbabwe concerning the Promotion and Reciprocal Protection of Investments (Denmark/Zimbabwe BIT 1996), Article 9(3)(b).
uncertainty over the future enforceability of arbitral awards issued under the IIA.79

On the other hand, a State may choose to ensure that it has full policy flexibility by altogether omitting any investor-State dispute settlement mechanism in the IIA. This structural omission insulates the host State from investors’ direct recourse to investor-State arbitration, thereby diminishing the possibility that the host State could be held liable to pay compensation for IIA breaches against investors. Moreover, investors would be forced to seek legal remedies from local courts of the host State, or apply with their respective home States to exercise diplomatic protection over their claims. While removing the investor-State dispute settlement mechanism from an IIA would thus make it much easier for a host State to implement policy changes at its own wherewithal in the future, it would also correspondingly increase regulatory risks for foreign investors. This is best illustrated in the Australian Government’s April 2011 announcement that it would reject any investor-State dispute settlement mechanism from its IIAs,80 potentially making foreign investors in this particular jurisdiction more vulnerable to regulatory risks due to the increased possibility of unpredictable government policy changes affecting investments years down the line.

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2. Substantive standards

States may choose to adopt language in the substantive standards of an IIA to ensure that they retain policy flexibility to meet regulatory and public interest objectives, alongside their IIA obligations. These substantive standards include: 1) “in accordance with host State law” clauses; 2) stabilization clauses; 3) exceptions clauses or “measures not precluded” clauses; 4) the investment definition clause or similar treaty applicability provisions; and 5) balance of payments provisions and other financial crises provisions. As will be shown in the following sections, the main difficulty with relying on the IIA’s substantive standards to underwrite a host State’s policy flexibility to meet regulatory and public interest objectives, is that the actual width of the latter appears a matter for the interpretive appreciation by arbitral tribunals on a case-by-case basis. Arbitral tribunals have not been consistent at all in defining the actual policy space of host States in relation to these substantive standards.81 States would be ill-advised to depend too heavily on the ambiguity of the language of some IIA substantive standards to defend their policy flexibility to implement social protection measures consistent with regulatory and public interest objectives.

2.1. “In accordance with host State law” clauses

Several international investment law experts have taken the position that “in accordance with host State law” clauses might possibly provide an interpretive link to

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international human rights treaties when the latter are fully incorporated into, and
demed a part of, a host State’s law. Stephan Schill observed that these clauses
generally appear either as “clauses that tie compliance with domestic law directly to
the definition of ‘investment’ protected under international investment treaties”, or as
“clauses linking compliance with domestic law to the provision on admission of new
investments…with a limitation of the scope of the application of the relevant
investment treaty to existing investments made in accordance with host State law.”

Furthermore, the “in accordance with host State law” clause does not require
an investment’s compliance with every host State regulation, administrative issuance,
or law – it generally refers to those species of host State law that are of such
fundamental importance that they must be included in the due diligence to be
conducted by the investor and the host State. While there is a line of arbitral
awards that narrowly identifies host State’s corporate registration requirements as the

82 Christoph Schreuer and Ursula Kriebaum, From Individual to Community Interest in International
Investment Law, pp. 1079-1096, at 1095, in ULRICH FASTENRATH, RUDOLF GEIGER, DANIEL-ERASMUS
KHAN, ANDREAS PAULUS, SABINE VON SCHORLEMER, CHRISTOPH VEDDER (EDS.), FROM
BILATERALISM TO COMMUNITY INTEREST: ESSAYS IN HONOUR OF JUDGE BRUNO SIMMA (Oxford
University Press, 2011); Pierre-Marie Dupuy, Unification Rather than Fragmentation of International
Law? The Case of International Investment Law and Human Rights Law, pp. 45-62, at 59-60 in
PIERRE-MARIE DUPUY, FRANCESCO FRANCIONI, AND ERNST-ULRICH PETERSMANN (EDS.), HUMAN
RIGHTS IN INTERNATIONAL INVESTMENT LAW AND ARBITRATION (Oxford University Press, 2009)
[hereafter, “DUPUY, FRANCIONI, & PETERSMANN”].

83 Stephan Schill, Illegal Investments in Investment Arbitration, working paper available at
eample of two “in accordance with laws and regulations” clauses that fulfill the two functions
described by Schill are Articles 3(2) and 3(3) of the Croatia BIT discussed in paras. 190 and 197 of
MTD Equity Sdn Bhd and MTD Chile SA v. Chile, Award, ICSID Case No. ARB/01/7, 25 May 2004.

84 Fraport AG Frankfurt Airport Services Worldwide v. Philippines, Award, ICSID Case No.
ARB/03/25, 16 August 2007, at para. 396 (“[w]hen the question is whether the investment is in
accordance with the law of the host State, considerable arguments may be made in favour of construing
jurisdiction ratione materiae in a more liberal way which is generous to the investor. In some
circumstances, the law in question of the host State may not be entirely clear and mistakes may be
made in good faith. An indicator of a good faith error would be the failure of a competent legal
counsel’s legal due diligence Article to flag that issue.”) On the other hand, a host State unsuccessfully
attempted to argue the “non-resident” character of tax treatment in order to deny that an investment met
the territorial requirement “in accordance with its laws and regulations”, in SGS Societe Generale de
Surveillance SA v. Philippines, Decision on Objections to Jurisdiction and Separate Declaration, ICSID
Case No. ARB/02/6, 29 January 2004, at paras. 99-112.
only “law” contemplated by this clause, there are also other arbitral awards that suggest that the clause applies to other sources of law that are consistent with the teleological purposes of an IIA, such as anti-dummy legislation, bribery laws, and contractual fraud, and central bank regulations. For States thus concerned with maintaining policy flexibility to meet their social protection obligations under international human rights, environmental, and labor treaties, these treaties must be flagged to the investor at the outset of the process of establishing an investment, in such a way that the host State’s compliance with these treaties cannot be left out of the due diligence process. **Part II (Managing Regulatory Risk from Social Protection Measures)** submits some suggestions for reforming the due diligence process in international investment transactions to purposely track and identify the host State’s parallel continuing obligations under the International Covenant on Economic Social and Cultural Rights.

### 2.2. Stabilization clauses

While stabilization clauses appear in investment contracts, breaches of these

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85 Veteran Petroleum Ltd. v. Russian Federation, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 228, 30 November 2009, at paras. 20-21; Yaug Chi Oo Trading Pte Ltd v. Government of the Union of Myanmar, ASEAN Case No. ARB/01/1, 31 March 2003, at para. 62; Siag and Vecchi v. Egypt, Decision on jurisdiction and partial dissenting opinion, ICSID Case No. ARB/05/15, 11 April 2007, at paras. 198-201; Middle East Cement Shipping and Handling Co SA v. Egypt, Award, ICSID Case No. ARB/99/6, 12 April 2002, paras. 131-138.

86 Salini Costruttori SpA and Italstrade SpA v. Morocco, Decision on Jurisdiction, ICSID case No. ARB/00/4, 23 July 2001, at para. 46. This standard was expressly adopted by the arbitral tribunal in Mytilineos Holdings SA v. Serbia and Montenegro and Serbia, Partial Award on Jurisdiction and Dissenting Opinion, UNCITRAL, 8 September 2006, at para. 152.

87 Fraport AG Frankfurt Airport Services Worldwide v. Philippines, Award, ICSID Case No. ARB/03/25, 16 August 2007 (involving local anti-dummy legislation); World Duty Free Company Ltd. v. Kenya, Award, ICSID Case No. ARB/00/7, 25 September 2006 (involving local bribery laws); Inceysa Vallisoioteane SL v. El Salvador, Award, ICSID Case No. ARB/03/26, 2 August 2006 (involving local contract principles against undue enrichment and fraud); Anderson and ors v. Costa Rica, Award, ICSID Case No. ARB (AF)/07/3, 10 May 2010, para. 55-59.

88 On the argument that foreign investors and host States effectively contract around the risk of changes in the applicable regulatory framework to the investment, see Sam Foster Halabi, Efficient Contracting
clauses may give rise to an IIA claim.\(^89\) IIA provisions “on the mutual obligation of parties to provide ‘full protection and security’ and to ensure ‘fair and equitable treatment’ of investments…may confer treaty status on the stabilization clauses in an investment contract.”\(^90\) These kinds of clauses purposely “aim to ‘stabilize’ the terms and conditions of an investment project, thereby contributing to manage non-commercial (that is, fiscal, regulatory) risk. They involve a commitment by the host government not to alter the regulatory framework governing the project, by legislation or any other means, outside specified circumstances (e.g. consent of the other contracting party, restoration of the economic equilibrium, and/or payment of compensation.)”.\(^91\) In principle, a stabilization clause commits a host State to “alienate[] its right to unilaterally change the regime and rights relied upon by, and promised to, the investor.”\(^92\) A stabilization clause would help reduce the regulatory risks of an investment, as the foreign investor would, in effect, be entitled to rely wholly (and somewhat statically) on the host State’s regulatory framework at the time of the establishment of the investment. Should the host State fail to maintain this pre-

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\(^89\) Note that an arbitral tribunal has ruled that stabilization clauses “do not ‘cap’ damages for the purposes of valuing the Claimants’ rights, nor do they establish a ceiling of compensation beyond which the Claimants could not have legitimately expected to recover in the event of an expropriation.” *Kardassopoulos v. Georgia and joined case*, Award, ICSID Case Nos. ARB/05/18, ARB/07/15, 28 February 2010, at para. 485.

\(^90\) See Evaristus Oshionebo, *Stabilization Clauses in Natural Resource Extraction Contracts: Legal, Economic, and Social Implications for Developing Countries*, 10 Asper Review of International Business and Trade Law 1 (2010) at 25. Although note that an arbitral tribunal expressly rejected viewing an IIA’s fair and equitable treatment standard as bearing the same purpose as stabilization clauses specifically granted to foreign investors. *See EDF (Services) Ltd v. Romania*, Award, ICSID Case No. ARB/05/13, 2 October 2009, at para. 218.


identified regulatory framework, it would be liable to compensate the investor for economic losses arising from changes in the law.

Stabilization clauses have been classified into three categories: “freezing clauses” (which are “designed to make new laws inapplicable to the investment”); “economic equilibrium clauses” (which “aim to maintain the economic equilibrium of the project”, by providing compensation to the investor if new laws are applied to the investment); and “hybrid clauses” (which “require the State to restore the investor to the same position it had prior to changes in law, and the contract states explicitly that exemptions in law are one way of doing this”). Among these categories, freezing clauses appear most restrictive upon a host State’s policy flexibility, insofar as it can be shown that the investment would be affected by future regulatory changes. Under a freezing clause, the investment is wholly insulated from the applicability of the host State’s policy or regulatory changes. On the other hand, an economic equilibrium clause does not strictly prohibit a host State from making such policy or regulatory changes, but only provides an economic disincentive against making such changes (e.g. the cost of restoring an affected investor to his economic position before the regulatory or policy change was implemented).

Some recent innovations to the design of stabilization clauses expressly exempt from stabilization those changes in law, regulations, or policies, which are reasonably required to ensure that host States to meet international human rights obligations. One such examples is the issuance in 2003 by British Petroleum (BP)

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94 Shemberg, at p. 27. See also Jernej Letnar Černič, Corporate Human Rights Obligations Under Stabilization Clauses, 11 German Law Journal 2 (2010) 210-229 (also arguing that beyond the interpretation of the stabilization clauses in light of the fundamental human rights obligations of
of the “BTC Human Rights Undertaking” for the Baku-Tbilisi-Ceyhan (BTC Co.) pipeline project,\textsuperscript{95} which committed the special purpose vehicle (SPV) constructing the pipeline, BTC Co., to guarantee, among others, that: 1) “host Governments be able to regulate human rights and [health, safety and environmental] HSE under domestic law and in accordance with relevant standards…[including] under applicable international labor and human rights treaties”;\textsuperscript{96} 2) “the HSE and human rights standards [are] dynamic and evolve in accordance with the highest of international standards”;\textsuperscript{97} 3) the “arbitration clause does not prevent claims by persons in [the] Project State courts re human rights and HSE”;\textsuperscript{98} and 4) “economic equilibrium [shall] not be used to seek compensation for actions required under human rights, labor, and HSE treaties”.\textsuperscript{99} BTC warranted that the BTC Human Rights Undertaking was a “legal, valid, and binding obligation” and that BTC Co. has taken “all necessary corporate action to authorize the entry into, delivery and performance by it of this BTC Human Rights Undertaking.”\textsuperscript{100}

While this model of contractual guarantees is not yet the predominant norm among foreign investment contracts, proposals have been advanced to redesign stabilization clauses – either to limit their scope of application or to permit their evolving interpretation – to purposely ensure that both investors and host States still comply with international human rights, environmental, and labor obligations and corporate investors, such investor obligations be explicitly included in international investment agreements).


\textsuperscript{96} Id. at Clause 2(a).

\textsuperscript{97} Id. at Clause 2(b).

\textsuperscript{98} Id. at Clause 2(c).

\textsuperscript{99} Id. at Clause 2(d).

\textsuperscript{100} Id. at Clauses 3(a) and 3(b).
standards before, during, and well beyond the investment term.  

2.3. Exceptions clauses or “measures not precluded” clauses

While exceptions clauses or “measures not precluded” clauses have proliferated throughout the universe of IIAs, these clauses appear in multiple textual forms, and correspondingly, provoke diverse interpretations. The much-litigated “necessity” defense in the Argentine investment arbitrations, for example, advances

101 See Lorenzo Cotula, Reconciling regulatory stability and evolution of environmental standards in investment contracts: Towards a rethink of stabilization clauses, 1 Journal of World Energy Law & Business 2 (2008), at 158-179; Sheldon Leader, Risk management, project finance and rights-based development, pp. 107-141 in SHELDON LEADER AND DAVID ONG (EDS,), GLOBAL PROJECT FINANCE, HUMAN RIGHTS AND SUSTAINABLE DEVELOPMENT (Cambridge University Press, 2011) [hereafter, “LEADER AND ONG 2011”] (arguing in particular at p. 121 that “[i]f lenders and borrowers are to create projects able to give adequate place to the avoidance of damage…it may be necessary at certain points to carve out exceptions to the classic non-recourse model…this might only be a realistic prospect if either the sponsor is required to help meet the company’s shortfall in funds, or the lender relaxes its reimbursement schedule to make room for such delays. Negotiation among the parties, reflecting the impact of CSR (corporate social responsibility), would add this necessary element of flexibility to the positions…”); Lorenzo Cotula, Freezing the balancing act? Project finance, legal tools to manage regulatory risk, and sustainable development, pp. 142-173 in LEADER AND ONG 2011 (observing at p. 144 that while “increasingly broad stabilization clauses tend to ensure a level of regulatory stability that far exceeds that accorded by international law under regulatory taking doctrine”, while proposing in p. 162 two options for the construction and treatment of stabilization clauses to reflect sustainable development compliance – “(a) carefully limiting the scope of stabilization clauses; and (b) adopting an evolutionary approach to their application.”).


a justificatory interpretation of the IIA exceptions clause that calls for preventing any breach of an IIA obligation from arising in the first place (and therefore obviating the need for any degree of compensability whatsoever), on the theory that any IIA obligation becomes inapplicable whenever a host State invokes the IIA exceptions or “measures not precluded” clause to defend its “essential security interests”. To date, the majority of arbitral tribunals have rejected this sweeping interpretation of the IIA exceptions or “measures not precluded” clauses in the Argentine arbitrations, primarily due to interpretive remit of the actual text of the IIA exceptions clause.

Other exceptions clauses employ language seemingly more aligned with the enumeration of public health, labor, and public policy exceptions in GATT Article XX (General Exceptions) clause or GATS Article XIV (General Exceptions) clause. These kinds of exceptions clauses appear to be quite preponderant where States undertake investment negotiations within the broader context of (or in the shadow of) trade negotiations, such as Article 10.9.3(c) of Chapter 10 (Investment) of

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104 DESIERTO 2012, at pp. 171-183.


106 See full text of GATT Article XX (General Exceptions) in http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm (last accessed 10 September 2012) and GATS Article XIV (General Exceptions) in http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm (last accessed 10 September 2012).
the 2004 Dominican Republic-Central America-United States Free Trade Agreement (DR-CAFTA); 107 Article 17 of the 2009 Association of Southeast Asian Nations (ASEAN) Comprehensive Investment Agreement; 108 Article 1106, Section 6 of Chapter 11 (Investment) of the 1992 North American Free Trade Agreement (NAFTA). 109 Other IIAs that facially bear similar language with GATT Article XX or GATS Article XIV provisions are Article 24(2)(b)(i) of the 1994 Energy Charter Treaty; 110 Article 8(3)(c) of the 2005 United States/Uruguay BIT; 111 a substantial number of Canadian BITs [e.g. Clause III of the detailed Annex 1 (General and Specific Exceptions) to the 1997 Canada/Lebanon BIT, 112 Article XVII(2) and (3) of

107 Dominican Republic-Central America-United States Free Trade Agreement, Chapter 10: Investment (DR-CAFTA 2004), Article 10.9.3.(c): “(c) Provided that such measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment, paragraphs 1(b), (c), (f) and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures: (i) necessary to secure compliance with laws and regulations that are not inconsistent with this Agreement; (ii) necessary to protect human, animal, or plant life or health; or (iii) related to the conservation of living or non-living exhaustible natural resources.”

108 ASEAN Comprehensive Investment Agreement, Article 17 (General Exceptions) available at http://www.aseansec.org/documents/ASEAN%20Comprehensive%20Investment%20Agreement%20( ACIA)%202012.pdf (last accessed 10 September 2012), which is almost wholly identical with GATT Article XX and GATS Article XIV.

109 North American Free Trade Agreement, Chapter 11: Investment, 1992, Article 1106, Section 6: “6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures: (a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; (b) necessary to protect human, animal or plant life or health; or (c) necessary for the conservation of living or non-living exhaustible natural resources.”

110 Energy Charter Treaty, 1994, Article 24(2)(b)(i): “(2) The provisions of this Treaty…other than with respect to subparagraph (i), Part III of the Treaty shall not preclude any Contracting Party from adopting or enforcing any measure (i) necessary to protect human, animal or plant life or health.”

111 Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (United States/Uruguay BIT 2005), Article 8(3)(c): “Provided that such measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment, paragraphs 1(b), (c) and (f) and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures: (i) necessary to secure compliance with laws and regulations that are not inconsistent with this Treaty; (ii) necessary to protect human, animal or plant life or health; or (iii) related to the conservation of living or non-living exhaustible natural resources.”

112 Agreement between the Government of Canada and the Government of the Lebanese Republic for the Promotion and Protection of Investments (Canada/Lebanon BIT 1997), Annex 1, Clause III (General Exceptions and Exemptions):

“1. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting,
the 1996 Canada/Panama BIT, 113 Article XVII of the 1997 Canada/Thailand BIT, 114 maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

2. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures:

(a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;

(b) necessary to protect human, animal or plant life or health; or

(c) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

3. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining reasonable measures for prudential reasons, such as:

(a) the protection of investors, depositors, financial market participants, policy-holders, policy-claimants, or persons to whom a fiduciary duty is owed by a financial institution;

(b) the maintenance of the safety, soundness, integrity or financial responsibility of financial institutions; and

(c) ensuring the integrity and stability of a Contracting Party's financial system.

4. Investments in cultural industries are exempt from the provisions of this Agreement. “Cultural industries” means natural persons or enterprises engaged in any of the following activities:

(a) the publication, distribution, or sale of books, magazines, periodicals or newspapers in print or machine readable form but not including the sole activity of printing or typesetting any of the foregoing;

(b) the production, distribution, sale or exhibition of film or video recordings;

(c) the production, distribution, sale or exhibition of audio or video music recordings;

(d) the publication, distribution, sale or exhibition of music in print or machine readable form; or

(e) radiocommunications in which the transmissions are intended for direct reception by the general public, and all radio, television or cable broadcasting undertakings and all satellite programming and broadcast network services.

5. The provisions of Articles II, III, IV, V and VI of this Agreement do not apply to:

(a) procurement by a government or state enterprise;

(b) subsidies or grants provided by a government or a state enterprise, including government–supported loans, guarantees and insurance;

(c) any measure denying investors of the other Contracting Party and their investments any rights or preferences provided to the aboriginal peoples of Canada; or

(d) any current or future foreign aid program to promote economic development, whether under a bilateral agreement, or pursuant to a multilateral arrangement or agreement, such as the OECD Agreement on Export Credits.”

113 Agreement between the Government of Canada and the Government of the Republic of Panama for the Promotion and Protection of Investments (Canada/Panama BIT 1996), Article XVII(2) and (3) (Application and General Exceptions): “2. Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns. 3. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting
Article XVII of the 1996 Canada/Barbados BIT,\textsuperscript{115} Article XVII of the 1996 Canada/Ecuador BIT,\textsuperscript{116} Article XVII of the 1996 Canada/Egypt BIT,\textsuperscript{117} Clause III of the detailed Annex I (General and Specific Exceptions) to the 1999 Canada/El Salvador BIT,\textsuperscript{118} Clause III of the detailed Annex I (General and Specific Exceptions) or maintaining measures, including environmental measures: (a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; (b) necessary to protect human, animal or plant life or health; or (c) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.”

\textsuperscript{114} Agreement between the Government of Canada and the Government of the Kingdom of Thailand for the Promotion and Protection of Investments (Canada/Thailand BIT 1997), Article XVII (Application and General Exceptions):

“(1) This Agreement shall apply to any investment made by an investor of one Contracting Party in the territory of the other Contracting Party before or after the entry into force of this Agreement.

(2) Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting, maintaining or enforcing any measure otherwise consistent with this Agreement that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

(3) Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures, including environmental measures:

(a) necessary to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;

(b) necessary to protect human, animal or plant life or health; or

(c) relating to the conservation of living or non-living exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

(d) imposed for the protection of national treasures of artistic, historic or archaeological value;

(e) essential to the acquisition or distribution of products in general or local short supply, provided that any such measures shall be consistent with the principle that all investors are entitled to an equitable share of the international supply of such products, and that any such measures, which are inconsistent with the other provisions of this Agreement shall be discontinued as soon as the conditions giving rise to them have ceased to exist.

(4) The Annexes shall form an integral part of this Agreement.”


\textsuperscript{118} Language similar to footnote 112. Agreement between the Government of Canada and the Government of the Republic of El Salvador for the Promotion and Protection of Investments (Canada/El Salvador BIT 1999), Annex I (General and Specific Exceptions), Clause III (General Exceptions and Exemptions).
to the 1998 Canada/Costa Rica BIT,\(^{119}\) Clause III of the detailed Annex I (General and Specific Exceptions Special Provisions) to the 1997 Canada/Croatia BIT,\(^{120}\) Article XVII of the 1995 Canada/Latvia BIT,\(^{121}\) Article XVII of the 1996 Canada/Romania BIT,\(^{122}\) Article XVII of the 1995 Canada/South Africa BIT,\(^{123}\) Article XVII of the 1995 Canada/Trinidad and Tobago BIT,\(^{124}\) Article XVII of the 1994 Canada/Ukraine BIT,\(^{125}\) Clause III in the detailed Annex I (General and Specific Exceptions Special Provisions) to the 1997 Canada/Uruguay BIT,\(^{126}\) Clause II of detailed Annex to the 1996 Canada/Venezuela BIT,\(^{127}\) and Article XVII of the 1997 Canada/Armenia BIT\(^{128}\); as well as several Japanese BITs which also contain


\(^{120}\) *Language similar to footnote 112.* Agreement between the Government of Canada and the Government of the Republic of Croatia for the Promotion and Protection of Investments (Canada/Croatia BIT 1997), Annex I (General and Specific Exceptions Special Provisions), Clause III (General Exceptions and Exemptions).

\(^{121}\) *See similar language in footnote 114.* Agreement between the Government of Canada and the Government of Latvia for the Promotion and Protection of Investments (Canada/Latvia BIT 1995), Article XVII (Application and General Exceptions).

\(^{122}\) *See similar language in footnote 114.* Agreement between the Government of Canada and the Government of the Republic of Romania for the Promotion and Reciprocal Protection of Investments, Article XVII (Application and General Exceptions).


\(^{124}\) *See similar language in footnote 114.* Agreement between the Government of Canada and the Government of the Republic of Trinidad and Tobago for the Reciprocal Promotion and Protection of Investments (Canada/Trinidad and Tobago BIT 1995), Article XVII (Application and General Exceptions).

\(^{125}\) *See similar language in footnote 114.* Agreement between the Government of Canada and the Government of Ukraine for the Promotion and Protection of Investments (Canada/Ukraine BIT 1994), Article XVII (Application and General Exceptions).

\(^{126}\) *Language similar to footnote 112.* Agreement between the Government of Canada and the Government of the Eastern Republic of Uruguay for the Promotion and Protection of Investments, Annex I (General and Specific Exceptions Special Provisions), Clause III (General Exceptions and Exemptions).


procedural requirements for a State Party implementing a non-conforming measure [e.g. non-conforming measures under Article 16 of the 2002 Japan/Korea BIT, Article 15 of the 2003 Japan/Vietnam BIT, and Article 18 (General and Security Exceptions) of the 2008 Japan/Lao People’s Democratic Republic BIT)]. While these examples of IIA practices purposely reflect States’ tangible adoption of international trade law public policy exceptions, the greater majority of IIAs at large do not uniformly refer to GATT Article XX or GATS Article XIV. This makes a

129 Agreement between the Government of Japan and the Government of the Republic of Korea for the Liberalisation, Promotion and Protection of Investment (Japan/Republic of Korea BIT 2002), Article 16:

“1. Notwithstanding any other provisions in this Agreement other than the provisions of Article 11, each Contracting Party may:

(a) take any measure which it considers necessary for the protection of its essential security interests;

(i) taken in time of war, or armed conflict, or other emergency in that Contracting Party or in international relations; or

(ii) relating to the implementation of national policies or international agreements respecting the non-proliferation of weapons;

(b) take any measure in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security;

(c) take any measure necessary to protect human, animal or plant life or health; or

(d) take any measure necessary for the maintenance of public order. The public order exceptions may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.

2. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall not use such measure as a means of avoiding its obligations.

3. In cases where a Contracting Party takes any measure, pursuant to paragraph 1 above, that does not conform with the obligations of the provisions of this Agreement other than the provisions of Article 11, that Contracting Party shall, prior to the entry into force of the measure or as soon thereafter as possible, notify the other Contracting Party of the following elements of the measure: (a) sector and sub-sector or matter; (b) obligation or article in respect of which the measure is taken; (c) legal source or authority of the measure; (d) succinct description of the measure; and (e) motivation or purpose of the measure.

4. Notwithstanding the provisions of paragraph 1 of Article 2 of this Agreement, each Contracting Party may prescribe formalities in connection with investment and business activities of investors of the other Contracting Party in its territory, provided that such formalities do not impair the substance of the rights under this Agreement.”


131 See identical provision in footnote 129. Agreement between Japan and the Lao People’s Democratic Republic for the Liberalization, Promotion and Protection of Investment (Japan/Lao People’s Democratic Republic BIT 2008), Article 18 (General and Security Exceptions).
centralized interpretation of an “economic security defense” or public policy exception in an IIA difficult to achieve between international investment tribunals confronted with diverse treaty language and contexts. States concerned with retaining sufficient policy flexibility in an IIA to meet social protection objectives in the future should carefully craft the exceptions clause to reflect its precise scope and effects.

2.4. Investment definition and treaty applicability provisions

States can also use treaty applicability provisions as further means to retain policy flexibility to meet social protection and public interest objectives. IIA coverage (including the ability for investors to seek direct recourse through the investor-State dispute settlement mechanism in the IIA) could be designed to apply only to investments that comport with a State’s development and public policy objectives. The definition of an investment, or including other provisions in the IIA that expressly determine its applicability to certain types of investment, could act as possible filters to reinforce host States’ regulatory prerogatives in relation to IIA-covered investments. In practice, however, treaty applicability remains a delicate line that arbitral tribunals tread in very different ways.

Recent controversies, for example, reveal a continuing debate on the requisite elements of an “investment” for purposes of IIA coverage as well as for Article 25(1) of the ICSID Convention. The polemical question involves determining whether the “contribution to a host State’s development” (otherwise known as the *Salini*...
test) should be part of the required jurisdictional criteria that investors must hurdle to be able to avail of the direct recourse opened to covered investors under the IIA’s investor-State dispute settlement mechanism. While the majority of arbitral tribunals thus far have preferred to regard this aspect as a mere feature, and not a definitive criterion or threshold requirement to establish the existence of an investment, some tribunals have chosen to admit “contribution to a host State’s development” in any event as a relatively easy and porous standard for investors to satisfy, so long as some linkage could be shown between the investment and a favorable impact upon the host State’s overall macroeconomy (and no matter how attenuated or empirically unverified that linkage is in reality). The unscientific approach to the concept of “contribution to economic development” has made this a relatively ineffective

134 Salini Costruttori SpA and Italstrade SpA v. Kingdom of Morocco, ICSID Case No. ARB/00/4, Decision on Jurisdiction, para. 52: “…doctrine generally considers that investment infers: contributions, a certain duration of the performance of the contract and a participation in the risks of the transaction…In reading the Convention’s preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition.”

135 Bureau Veritas, Inspection, Valuation, Assessment and Control, BIVAC BV v. Paraguay, ICSID Case No. ARB/07/9, Decision on Objection to Jurisdiction, paras. 82, 83, 94, 96 (May 29, 2009); Panatechniki SA Contractors and Engineers v. Albania, ICSID Case No. ARB/07/21, Award, paras. 36, 43, 38, (July 28, 2009); Fakes v. Turkey, ICSID Case No. ARB/07/20, Award, para. 111 (July 12, 2010); Alpha Projektengagement GMBH v. Ukraine, ICSID Case No. ARB/07/16, Award, paras. 312-313 (October 20, 2010); Consorzio Groupement LESI and ASTALDI v. Algeria, ICSID Case No. ARB/05/3, Decision on Jurisdiction, paras. 72-73 (July 12, 2006); Phoenix Action Ltd. v. Czech Republic, ICSID Case No. ARB/06/5, Award, paras. 114-115 (April 9, 2009); Malicorp Ltd. v. Egypt, ICSID Case No. ARB/08/18, Award, para. 113 (January 31, 2011); Global Trading Resource Corp. and Globex International Inc. v. Ukraine, ICSID Case No. ARB/09/11, Award (November 23, 2010); RSM Production Corporation v. Grenada, ICSID Case No. ARB/05/14, Award, paras. 244, 264 (March 11, 2009); Lemire v. Ukraine, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, para. 273 (January 14, 2010).

136 Consortium RFCC v. Morocco, ICSID case No. ARB/00/6, Decision on Jurisdiction, para. 65 (July 16, 2001); Bayindir Insaat Turizm Ticaret ve Sanayi A S v. Pakistan, ICSID Case No. ARB/03/29, Decision on Jurisdiction, para. 137 (November 14, 2005); Toto Costruzioni Generali SpA v. Lebanon, ICSID Case No. ARB/07/12, Decision on Jurisdiction, para. 86 (September 8, 2009); Kardassopoulos v. Georgia, ICSID Case No. ARB/05/18, Decision on Jurisdiction, paras. 116-117 (July 6, 2007); Helnan International Hotels A/S v. Egypt, ICSID Case No. ARB/05/19, Decision of the Tribunal on Objection to Jurisdiction, para. 77 (October 17, 2006); Saipem SpA v. Bangladesh, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures, para. 101 (March 21, 2007); Jan de Nul NV and Dredging International NV v. Egypt, ICSID Case No. ARB/04/13, Decision on Jurisdiction, para. 92 (June 16, 2006); Noble Energy Inc. and Machala Power Cia Ltd. v. Ecuador and Consejo Nacional de Electricidad, ICSID Case No. ARB/05/12, Decision on Jurisdiction, para. 132 (March 5, 2008); Ceskoslovenska Obchodni Banka As (CSOB) v. Slovakia, ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction and Admissibility, para. 378 (August 4, 2011); Societe Generale v. Dominican Republic, LCIA Case No. UN 7927, Award on Preliminary Objections to Jurisdiction, paras. 16, 30 (September 19, 2008).
standard by which investments could be excluded from the coverage of IIAs.\textsuperscript{137} IIA practices show how States also choose to differentiate between aspects of social protection and the public interest for which they will design \textit{relative} policy flexibility (e.g. non-applicability of IIA standards to certain measures), as opposed to \textit{absolute} policy flexibility (e.g. complete inapplicability of the entire IIA). Many IIAs show that States favor institutionalizing relative policy flexibility for most public policy areas,\textsuperscript{138} and rarely reserve absolute policy flexibility except for key sovereign functions such as taxation matters.\textsuperscript{139}

\textsuperscript{137} For the few awards that denied the existence of a covered investment under an IIA, see \textit{Malaysia Historical Salvors Sdn Bhd v. Malaysia}, ICSID Case No. ARB/05/10, Award on Jurisdiction (May 17, 2007) paras. 123-124; \textit{Joy Mining Machinery Ltd. v. Egypt}, ICSID Case No. ARB/03/11, Award on Jurisdiction, para. 57 (July 30, 2004); \textit{Mitchell v. The Democratic Republic of the Congo}, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Award, para. 33 (October 27, 2006).

\textsuperscript{138} See 1998 United States/Bolivia BIT Article II(2(b) (on intellectual property); 1982 United States/Egypt BIT Protocol, Clause 4 (on ownership of real estate); NAFTA Article 1108 (Reservations and Exceptions); 2004 DR-CAFTA Article 10.9(3)(b) (making some IIA provisions inapplicable to intellectual property, competition laws, procurement, among others); 2005 United States/Uruguay BIT, Article 8(3) [identical to DR-CAFTA Article 10.9(3)]; 2006 Canada/Peru BIT, Article 9(5) (removing public procurement, sovereign subsidies/loans/insurance, and public retirement pension/social security systems from the coverage of national treatment and MFN obligations in the IIA); 2009 Canada/Czech Republic BIT, Article IV(2) (removing sovereign subsidies, grants, and government-supported loans from national treatment and MFN obligations); 2010 Canada/Slovakia BIT, Article IV(2) (removing obligations as a member of a customs, economic or monetary union, common market, or free trade area from the coverage of national treatment and MFN obligations); 2007 Hungary/Azerbaijan BIT, Article 3(3) (removing obligations as a member of a customs, economic or monetary union, common market, or free trade area from the coverage of national treatment and MFN obligations); 2007 Hungary/Jordan BIT, Article 3(3) (removing obligations as a member of a customs, economic or monetary union, common market, or free trade area from the coverage of national treatment and MFN obligations); 1994 United States/Jamaica BIT Article II(9) (which does not apply MFN obligations to advantages accorded by either State to third-country investors under free trade or customs unions agreements or GATT).

\textsuperscript{139} See 2009 Canada/Jordan BIT, Article 10(6) (“The provisions of this Agreement shall not apply to investments in cultural industries.”); 1988 China/New Zealand BIT, Article 5(2) (“The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting State…’’); 1999 Argentina/New Zealand BIT, Article 5(2) (“The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party…”); 1985 China/Singapore BIT, Article 5(2) (“The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party…”); 2002 Spain/Bosnia and Herzegovina BIT, Article 12(2) (“The treatment granted under this Agreement shall not apply to tax matters.”); 1995 Czech Republic/Singapore BIT, Article 5(2) (“The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party…”); 1993 Poland/Singapore BIT, Article 5(2) (“The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party…”); 1995 Russian Federation/Hungary BIT, Article 11(2) (“The provisions of this Agreement shall not apply to taxation matters.”); 1993 Russian Federation/Denmark BIT Articles 11(2) and (3) (“This Agreement shall not apply to the Faroe Islands and Greenland…The provisions of this Agreement shall not apply to taxation.”); 1999 Slovenia/Singapore BIT, Articles 5(2) (“The provisions of this Agreement shall not apply to matters of taxation in the territory of either Contracting Party…”); 2002 Spain/Jamaica BIT,
2.5. Balance of payments and financial crises provisions

Newer generations of IIAs have started to emulate GATT Article XII and GATS Article XII – provisions in international trade law that authorize States to impose certain restrictions in order to safeguard their balance of payments position. Recent investment agreements concluded by the Association of Southeast Asian Nations (ASEAN) – a region particularly alert to currency risks and capital flight after its experience with the 1998 Asian financial crisis – all contain extensive provisions authorizing States to take temporary “measures to safeguard balance of payments”, such as restrictions on transfers of capital. These provisions appear more detailed (and are worded in a more expansive and self-judging manner) than other IIAs that only recognize States’ rights to equitably exercise sovereign powers to temporarily limit transfers during exceptional balance of payments difficulties.

**United Kingdom BITs**, for example, often put a cap on the period for imposing restrictions and the extent of such restrictions, also stipulating a mandatory

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141 2009 ASEAN Comprehensive Investment Agreement, Article 16 (Measures to Safeguard Balance of Payments); 2008 Agreement on Comprehensive Economic Partnership among Japan and Member States of the Association of Southeast Asian Nations, Article 21 (Measures to Safeguard Balance of Payments); 2009 Agreement on Investment under the Framework Agreement on Comprehensive Economic Cooperation among the Governments of the Member Countries of the Association of Southeast Asian Nations and the Republic of Korea, Article 11 (Temporary Safeguard Measures); 2009 Agreement on Investment of the Framework Agreement on Comprehensive Economic Cooperation between the Association of Southeast Asian Nations and the People’s Republic of China, Article 11 (Measures to Safeguard the Balance of Payments).
minimum amount to be transferred annually [e.g. Article 4(2)(b) of the 1987 United Kingdom/Jamaica BIT, Article 6(1) of the 1987 United Kingdom/Antigua and Barbuda BIT, Article 6(4) of the 1990 United Kingdom/Argentina BIT, Article 6 of the 1987 United Kingdom/Benin BIT, Article 6(1) of the 1988 United Kingdom/Grenada BIT, Article 6 of the 1985 United Kingdom/Haiti BIT, Article 7(2) of the 1987 United Kingdom/Hungary BIT, Article 5 of the 1981

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142 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Jamaica for the Promotion and Protection of Investments (United Kingdom/Jamaica BIT 1987), Article 4(2)(b) ("...Resulting payments shall be freely transferable, subject to the right of each Contracting Party in exceptional balance of payments difficulties to exercise equitably and in good faith powers conferred by its laws to place limits on the amount transferred in cases where the compensation constitutes a large sum, provided however that the transfer of a minimum of 33 1/3 percent a year is guaranteed...").

143 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Antigua and Barbuda for the Promotion and Protection of Investments (United Kingdom/Antigua and Barbuda BIT 1987), Article 6(1) ("...either Contracting Party may in exceptional balance of payments difficulties exercise equitably and in good faith powers conferred by its laws to deter transfer for a limited period, other than transfers of profits, interests, dividends, royalties and fees, which shall not be impeded...").

144 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments (United Kingdom/Argentina BIT 1990), Article 6(3) ("Each Contracting Party shall have the right in exceptional balance of payments difficulties and for a limited period to exercise equitably and in good faith powers conferred by its laws and procedures to limit the free transfer of investments and returns. Such limitation shall not exceed a period of eighteen months in respect of each application to transfer and shall allow the transfer to be made in instalments within that period but the transfer of at least fifty per cent of the capital and of the returns shall be permitted by the end of the first year. In no circumstances may such limitations be imposed on the same investor after a period of three years from the start of the first such limitation. Pending the transfer of his capital and returns, the investor shall have the opportunity to invest them in a manner which will preserve their real value until the transfer occurs.")

145 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People’s Republic of Benin for the Promotion and Protection of Investments (United Kingdom/Benin BIT 1987), Article 6 similar to footnote 144.

146 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Grenada for the Promotion and Protection of Investments (United Kingdom/Grenada BIT 1988), Article 6(1) similar to footnote 144.

147 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Haiti for the Promotion and Protection of Investments (United Kingdom/Haiti BIT 1985), Article 6 similar to footnote 144.

148 Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Hungarian People’s Republic for the Promotion and Reciprocal Protection of Investments (United Kingdom/Hungary BIT 1987), Article 7(1) ("...subject to the right of each Contracting Party in exceptional balance of payments difficulties and for a limited period to exercise equitably and in good faith powers conferred by its laws. Such powers shall not however be used to impede the transfer of profit, interest, dividends, royalties or fees; as regards investments and any other form of return, transfer of a minimum of 20 per cent a year is guaranteed.")
United Kingdom/Malaysia BIT,\(^{149}\) Article 6(1) of the 1986 United Kingdom/Malta BIT,\(^{150}\) Article 6 of the 1986 United Kingdom/Mauritius BIT,\(^{151}\) Article 7 of the 1990 United Kingdom/Morocco BIT,\(^{152}\) Article 6(1) of the 1987 United Kingdom/Poland BIT,\(^{153}\) Article 6 of the 1989 United Kingdom/Tunisia BIT,\(^{154}\) Article 6(1) of the 1991 United Kingdom/Turkey BIT,\(^{155}\). **Hungarian BITs**, on the other hand, tend to use more general language focusing on standards of equitableness, non-discrimination, and good faith [e.g. Article 13(2)(a) and (b) of the 2007 Hungary/Azerbaijan BIT\(^{156}\) and the 2007 Hungary/Jordan BIT\(^{157}\)], while several **Netherlands BITs** stress the importance of a restriction’s consistency with the

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\(^{149}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Malaysia for the Promotion and Protection of Investments (United Kingdom/Malaysia BIT 1981), Article 5 (“…each Contracting Party shall have the right to restrict in exceptional circumstances for balance of payments needs the transfer of such proceeds in a manner consistent with its rights and obligations as a member of the International Monetary Fund.”).

\(^{150}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Malta for the Promotion and Protection of Investments (United Kingdom/Malta BIT 1986), Article 6(1) *similar to footnote 148*.

\(^{151}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Mauritius for the Promotion and Protection of Investments (United Kingdom/Mauritius BIT 1986), Article 6 *similar to footnote 148*.

\(^{152}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of Morocco for the Promotion and Protection of Investments (United Kingdom/Morocco BIT 1990), Article 7 *similar to footnote 148*.

\(^{153}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Polish People’s Republic for the Promotion and Reciprocal Protection of Investments (United Kingdom/Poland BIT 1987), Article 6(1) *similar to footnote 148*.

\(^{154}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Tunisian Republic for the Promotion and Protection of Investments (United Kingdom/Tunisia BIT 1989), Article 6 *similar to footnote 148*.

\(^{155}\) Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Turkey for the Promotion and Protection of Investments (United Kingdom/Turkey BIT 1991), Article 6(1) *similar to footnote 148*.

\(^{156}\) Agreement between the Republic of Hungary and the Republic of Azerbaijan for the Promotion and Reciprocal Protection of Investments (Hungary/Azerbaijan BIT 2007), Article 13(2)(a) and 13(2)(b) (“(a) Nothing in this Agreement shall be construed to prevent a Contracting Party from adopting or maintaining measures that restrict transfers where the Contracting Party experiences serious balance of payments difficulties, or the threat thereof, and such restrictions are consistent with paragraph b. (b) Measures referred to in paragraph a shall be equitable, neither arbitrary nor unjustifiably discriminatory, in good faith, of limited duration and may not go beyond what is necessary to remedy the balance of payments situation…”)

\(^{157}\) Agreement between the Republic of Hungary and the Hashemite Kingdom of Jordan for the Promotion and Reciprocal Protection of Investments (Hungary/Jordan BIT 2007), Article 13(2)(a) and (b) *identical to footnote 149*. 

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International Monetary Fund’s rules on transfer restrictions [e.g. Article 5(3) of the 2002 Netherlands/Yugoslavia BIT,\textsuperscript{158} Clause 1 of the Protocol to the 2003 Netherlands/Korea BIT,\textsuperscript{159} Article 7(1) of the 1985 Netherlands/Philippines BIT,\textsuperscript{160} Article 5(4) of the 1991 Netherlands/Jamaica BIT,\textsuperscript{161} Ad Article 5(a) of the Protocol to the 2002 Netherlands/Namibia BIT,\textsuperscript{162} Article 7 of the 1984 Netherlands/Sri Lanka BIT,\textsuperscript{163}].

A significant number of Canadian BITs appear to favor affording host States

\textsuperscript{158} Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Federal Republic of Yugoslavia (Netherlands/Yugoslavia BIT 2002), Article 5(3) (“A Contracting Party may adopt or maintain measures inconsistent with its obligations under paragraph 1 of this Article in the event of serious balance-of-payments and external financial difficulties or threat thereof. Such measures: a) shall be consistent with the Articles of Agreement of the International Monetary Fund; b) shall not exceed those necessary to deal with the circumstances described in this paragraph; and c) shall be temporary and shall be eliminated as soon as conditions permit.”)

\textsuperscript{159} Agreement on the Promotion and Protection of Investments between the Government of the Kingdom of the Netherlands and the Government of the Republic of Korea (Netherlands/Korea, Republic of BIT 2003) Protocol Clause 1 similar to footnote 151.

\textsuperscript{160} Agreement between the Kingdom of the Netherlands and the Republic of the Philippines for the Promotion and Protection of Investments (Netherlands/Philippines BIT 1985), Article 7(1) (“Each Contracting Party shall in respect of investments permit nationals of the other Contracting Party the unrestricted transfer in freely convertible currency of their investments and of the earnings from it to the country designated by those nationals, subject to the right of the former Contracting Party to impose equitably and in good faith such measures as may be necessary to safeguard the integrity and independence of its currency, its external financial position and balance of payments, consistent with its rights and obligations as a member of the International Monetary Fund.”)

\textsuperscript{161} Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and Jamaica (Netherlands/Jamaica BIT 1991), Article 5(4) (“Each Contracting Party retains the right not to apply the provisions of paragraphs 1 and 2 of this Article to the item mentioned under paragraph 1(f) of this Article in cases of exceptional balance of payments difficulties and where large sums are involved. The exercise of this right shall be subject to the following conditions: i) it may be used for a limited period only, and only to the extent necessary; ii) it shall be exercised on a basis of non-discrimination; iii) at the request of the other Contracting Party there shall be prompt and adequate consultations on the measures taken in exercise of the right referred to in this paragraph; (iv) transfer of a minimum of thirty-three and one-third percent a year is guaranteed.”).

\textsuperscript{162} Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Namibia (Netherlands/Namibia BIT 2002), Protocol Ad Article 5(a) (“In case of serious balance of payments difficulties the Republic of Namibia may limit temporarily, for a maximum period of twelve months, the free transfer of capital pursuant to Article 5(g) only. These restrictions shall be imposed on an equitable, non-discriminatory and good faith basis. In case of such a delay in transfer, the investor shall be paid interest at a normal commercial rate on the amount concerned, from the day the transfer should have taken place until the day on which the transfer actually took place.”)

\textsuperscript{163} Agreement between the Kingdom of the Netherlands and the Democratic Socialist Republic of Sri Lanka for the Promotion and Protection of Investments (Netherlands/Sri Lanka BIT 1984), Article 7 similar to footnote 153.
more flexibility to respond to balance of payments crises [e.g. Article IX(3) of the 2010 Canada/Slovakia BIT, Article XVII(4) of the 2009 Canada/Latvia BIT and 2009 Canada/Romania BIT, Article IX(3) of the 2009 Canada/Czech Republic BIT, Article VII(2) of the 1991 Canada/Hungary BIT as well as the 1990 Canada/Poland BIT]; while Clause 6 of the Protocol to the 1991 United States/Sri Lanka BIT as well as several German BITs tend to contain specific language on restructuring payment terms [e.g. Clause 4 of the Protocol to the 1995 Germany/Ghana BIT, Clause 5 of the Protocol to the 1982 Germany/Lesotho

164 Agreement between the Government of Canada and the Slovak Republic for the Promotion and Protection of Investments, Article IX(3) similar to footnote 148.

165 Agreement between the Government of Canada and the Government of the Republic of Latvia for the Promotion and Protection of Investments (Canada/Latvia BIT 2009), Article XVII(4) similar to footnote 148.

166 Agreement between the Government of Canada and the Government of Romania for the Promotion and Reciprocal Protection of Investments (Canada/Romania BIT 2009), Article XVII(4) similar to footnote 148.

167 Agreement between Canada and Czech Republic for the Promotion and Protection of Investments (Canada/Czech Republic BIT 2009), Article IX(3) similar to footnote 148.

168 Agreement between the Republic of Canada and the Republic of Hungary for the Promotion and Reciprocal Protection of Investments (Canada/Hungary BIT 1991), Article VII(2) (“In cases where exceptional balance of payments difficulties exist, and then for a period not exceeding eighteen months, the contracting Party shall guarantee the transfer of any amount mentioned in paragraph 1 of this Article on a pro rata basis, provided that the total period for the transfer does not exceed five years.”)

169 Agreement between the Government of Canada and the Government of the Republic of Poland for the Promotion and Protection of Investments (Canada/Poland BIT 1990), Article VII(2) identical to footnote 155.

170 Agreement between the United States of America and the Democratic Republic of Sri Lanka Concerning the Encouragement and Reciprocal Protection of Investment (United States/Sri Lanka BIT 1991), Protocol Clause 6 (“6. With respect to Article IV, paragraph 1(e), a Party may, in the event of exceptional balance of payments difficulties and in consultation with the other Party, temporarily delay transfer of the proceeds from the sale or liquidation of an investment, but only on the following conditions: a) the transfer of such proceeds may be delayed for a period not to exceed three years from the date the transfer is requested; b) a minimum of thirty three and one third percent of the proceeds may be transferred each year; c) the Party availing itself of this provision shall ensure that the portion of the proceeds whose transfer is delayed can be invested in a manner that will preserve its real value free of exchange rate risk; d) this provision will be used only to the extent and for the time necessary to restore foreign exchange reserves to a minimally acceptable level; and e) the Party availing itself of this provision will ensure that investments under this Treaty are accorded treatment with respect to such transfers in a manner not less favorable than that accorded nationals or companies of third countries.”)

171 Treaty between the Federal Republic of Germany and the Republic of Ghana concerning the Encouragement and Reciprocal Protection of Investments (Germany/Ghana BIT 1995) Protocol Clause 4 (“In cases of exceptional balance of payments difficulties the period within which transfers have to be completed may be extended to a maximum of three months. The Contracting Party taking such
Article 5(2) of the 1985 Germany/Saint Lucia BIT, Article 5(b) of the 1990 Germany/Swaziland BIT, Clause 5(c) of the Protocol to the 1994 Germany/Namibia BIT, Clause 5 of the Protocol to the 1986 Germany/Nepal BIT, Clause 4(c) of the Protocol to the 1981 Germany/Bangladesh BIT]. In contrast, Article 6(4) of the 1999 Portugal/Mexico BIT as well as some Chinese BITs pose few restrictions on host States’ possible balance of payments measures

measure shall ensure that it is carried out in a non-discriminatory manner and is no broader in scope or duration than absolutely necessary.”)

Agreement between the Kingdom of Lesotho and the Federal Republic of Germany concerning the Encouragement and Reciprocal Protection of Investments (Germany/Lesotho BIT 1982), Protocol Clause 5 (“Insofar as necessitated by extreme balance of payments difficulties, either Contracting Party may, on the decision of the competent organ, restrict for a limited period the transfer of the proceeds of liquidation in the event of the sale of the whole or any part of the investment. In any case an annual minimum transfer of 20 percent of the proceeds of liquidation is guaranteed.”)

Treaty between St. Lucia and the Federal Republic of Germany concerning the Encouragement and Reciprocal Protection of Investments (Germany/Saint Lucia BIT 1985), Article 5(2) (“In the event of exceptional balance of payments difficulties the transfer of the proceeds from liquidation may be restricted to annual instalments of at least 20 percent so that transfer will be completed within a maximum period of five years from the date of liquidation.”)

Treaty between the Federal Republic of Germany and the Kingdom of Swaziland concerning the Encouragement and Reciprocal Protection of Investments (Germany/Swaziland BIT 1990), Article 5(b), similar to footnote 152.

Treaty between the Federal Republic of Germany and the Republic of Namibia concerning the Encouragement and Reciprocal Protection of Investments (Germany/Namibia BIT 1994), Protocol Clause 5(c) (“In the case of exceptional balance of payments difficulties, the Government of the Republic of Namibia is entitled, for a maximum of three years, to limit the free transfer of the proceeds from the sale or liquidation of an investment of the nationals or companies of the other Contracting Party and to prescribe transfer by instalments. At the investor’s request, amounts not transferred shall be paid into an account in convertible currency and shall accrue interest at the rate quoted on the international market for the currency concerned.”)


Agreement between the Federal Republic of Germany and the People’s Republic of Bangladesh concerning the Encouragement and Reciprocal Protection of Investments, Protocol Clause 4(c) (“In the event of exceptional balance of payments difficulties the transfer of the proceeds from liquidation may be restricted to annual instalments of at least 20 percent so that the transfer will be completed within a maximum period of five years from the date of liquidation.”)

Agreement between the Portuguese Republic and the United Mexican States on the Reciprocal Promotion and Protection of Investments (Portugal/Mexico BIT 1999), Article 6(4) (“In case of serious balance of payments difficulties or the threat thereof, each Contracting Party may temporarily restrict transfers, provided that such a Contracting Party implements measures or a programme in accordance with the International Monetary Fund’s standards. This restriction would be imposed on an equitable, non-discriminatory and in good faith basis, and may not go beyond what is necessary to remedy the balance of payments situation.”)
[e.g. Article 7(4) of the 2004 China/Uganda BIT,\textsuperscript{179} Article 6(2) of the 2004 Finland/China BIT,\textsuperscript{180} Article 8(3) of the 1986 China/Sri Lanka BIT,\textsuperscript{181} Article 8(5) of the 2008 China/Mexico BIT\textsuperscript{182}].

**Czech BITs** focus on assessing restrictive measures from international standards of non-discrimination, equitableness, and good faith rather than specific contours of restrictions [e.g. Article 6(4) of the 1998 Czech Republic/Costa Rica BIT,\textsuperscript{183} Clause 3 of the Protocol to the 1995 Czech Republic/Philippines BIT,\textsuperscript{184} Article 6(5) of the 2002 Czech Republic/Mexico BIT,\textsuperscript{185}]. Quite similarly, **Italian**

\textsuperscript{179} Agreement between the Government of the Republic of Uganda and the Government of the People’s Republic of China concerning Reciprocal Protection of Investments (China/Uganda BIT of 2004), Article 7(4) (“In case of serious balance of payments difficulties and external financial difficulties or the threat thereof, each contracting party may temporarily restrict transfers, provided that this restriction: i) shall be promptly notified to the other party; ii) shall be consistent with the articles of agreement with the International Monetary Fund; iii) shall be within an agreed period; iv) would be imposed in an equitable, non-discriminatory and in good faith basis.”)

\textsuperscript{180} Agreement between the Government of the Republic of Finland and the Government of the People’s Republic of China for the Encouragement and Reciprocal Protection of Investments (Finland/China BIT 2004), Article 6(2) (“A Contracting Party may, in exceptional balance of payments difficulties, exercise through equitable, non-discriminatory and good faith basis regulatory measures in accordance with time limits specified by the IMF in such situations and through powers conferred by law.”)

\textsuperscript{181} Agreement between the Government of the People’s Republic of China and the Government of the Democratic Socialist Republic of Sri Lanka on the Reciprocal Promotion and Protection of Investments (China/Sri Lanka BIT 1986), Article 8(3) (“Without prejudice to paragraph 1 of this Article, each Contracting Party may in exceptional balance of payments difficulties exercise effectively and in good faith and for a limited period of time, powers conferred by its laws.”)

\textsuperscript{182} Agreement between the Government of the People’s Republic of China and the Government of the United Mexican States on the Promotion and Reciprocal Protection of Investments (China/Mexico BIT 2008), Article 8(5) \textit{similar to footnote 179}.

\textsuperscript{183} Agreement between the Czech Republic and the Republic of Costa Rica for the Promotion and Reciprocal Protection of Investments (Czech Republic/Costa Rica BIT 1998), Article 6(4) (“Each Contracting Party shall be entitled, under circumstances of exceptional or serious balance of payments difficulties, to limit transfers temporarily, on a fair and non-discriminatory basis, and in accordance with criteria accepted by international organizations of which both Contracting Parties are members. Limits on transfers adopted or maintained by a Contracting Party under this paragraph shall be notified promptly to the other Contracting Party.”)

\textsuperscript{184} Agreement between the Czech Republic and the Republic of the Philippines for the Promotion and Reciprocal Protection of Investments (Czech Republic/Philippines BIT 1995), Protocol Clause 3 (“With respect to Transfers (Article VI) it is the understanding of the Contracting Parties that the provisions of this Article shall not prevent either Contracting Party from taking temporary measures, applied on an “erga omnes” basis, which are necessary to solve the balance of payments difficulties and are in accordance with the provisions of the international agreements to which both of the Contracting Parties adhere.”)

\textsuperscript{185} Agreement between the Czech Republic and the United Kingdom on the Promotion and Reciprocal Protection of Investments (Czech Republic/Mexico BIT 2002), Article 6(5) (“In case of serious balance of payments difficulties or threats thereof, each Contracting Party may temporarily restrict transfers
BITs do not specify the exact terms of what should comprise host States’ restrictions to protect their balance of payments position, other than to prescribe that such measures should conform to international legal standards of equitability, non-discrimination, and good faith [e.g. Article 6(1)(c) of the 1993 Jamaica/Italy BIT, Article VI(4) of the 2004 Italy/Yemen BIT, Article VI(4) of the 2004 Italy/Nicaragua BIT, Article 7(3) of the 2003 Spain/Namibia BIT, as well as a substantial number of Mexican BITs [e.g. Article 9(4) of the 2005 Australia/Mexico BIT, Article 7(6) of the 1998 Austria/Mexico BIT, Article 6(6) of the 1998 Belgium-Luxembourg Economic Union/Mexico BIT, Article 6(5) of the 2000 Denmark/Mexico BIT, provided that such a Contracting Party implements measures or a programme in accordance with recognized international standards. These restrictions would be imposed on an equitable, non-discriminatory and in good faith basis.

186 Agreement between the Government of Jamaica and the Government of the Italian Republic on the Promotion and Protection of Investments (Jamaica/Italy BIT 1993), Article 6(1)(c) (“the proceeds of the total or partial sale or liquidation by winding up or otherwise, of an investment; provided that, in cases where the proceeds constitute large sums and in periods of exceptional balance of payments difficulties, the transfer of a minimum of 33 1/3 % guaranteed over a period of three years at the relevant rate of interest…”).

187 Agreement between the Government of the Italian Republic and the Government of the Republic of Yemen on the Promotion and Protection of Investments (Italy/Yemen BIT 2004), Article VI(4) (“In the event that, due to very serious balance of payments problems, one of Contracting Party were to temporarily restrict transfer of funds, these restrictions shall be applied to the investments related to this Agreement, only if the Contracting Party implements the relevant recommendations adopted by the International Monetary Fund in the specific case. These restrictions shall be adopted on an equitable and non-discriminatory basis and in good faith.”)

188 Agreement between the Government of the Italian Republic and the Government of the Republic of Nicaragua on the Promotion and Protection of Investments (Italy/Nicaragua BIT 2004), Article VI(4) similar to footnote 187.

189 Agreement between the Kingdom of Spain and the Republic of Namibia on the Promotion and Reciprocal Protection of Investments (Spain/Namibia BIT 2003), Article 7(3) similar to footnote 170.

190 Agreement between the Government of Australia and the Government of the United Mexican States on the Promotion and Reciprocal Protection of Investments (Australia/Mexico BIT 2005), Article 9(4) similar to footnote 187.

191 Agreement between the United Mexican States and the Republic of Austria on the Promotion and Protection of Investments (Austria/Mexico BIT 1998), Article 7(6) similar to footnote 186.

192 Agreement between the United Mexican States and the Belgo-Luxemburg Economic Union on the Reciprocal Promotion and Protection of Investments (Belgium-Luxemburg Economic Union/Mexico BIT 1998), Article 6(6) similar to footnote 187.
Article 7(4) of the 1999 Finland/Mexico BIT, \(^{194}\) Article 7(4) of the 2000 Greece/Mexico BIT, \(^{195}\) Article 8(4) of the 2007 India/Mexico BIT, \(^{196}\) Article 6(4) of the 2005 Iceland/Mexico BIT, \(^{197}\) Article 6(4) of the 1999 Italy/Mexico BIT, \(^{198}\) Protocol to the 2000 Republic of Korea/Mexico BIT, \(^{199}\) Ad Article 4 of the Protocol to the 1998 Netherlands/Mexico BIT, \(^{200}\) Article 6(4) of the 2000 Sweden/Mexico BIT, \(^{201}\) Article 8(3) of the 2006 Trinidad and Tobago/Mexico BIT, \(^{202}\) Article 8(4) of

\(^{193}\) Agreement between the Government of the United Mexican States and the Government of the Kingdom of Denmark concerning the Promotion and Reciprocal Protection of Investments (Denmark/Mexico BIT 2000), Article 6(5) similar to footnote 187.

\(^{194}\) Agreement between the Government of the Republic of Finland and the Government of the United Mexican States on the Promotion and Reciprocal Protection of Investments (Finland/Mexico BIT 1999), Article 7(4) similar to footnote 187.

\(^{195}\) Agreement between the Government of the United Mexican States and the Government of the Hellenic Republic on the Promotion and Reciprocal Protection of Investments (Greece/Mexico BIT 2000), Article 7(4) similar to footnote 186.

\(^{196}\) Agreement between the United Mexican States and the Government of the Republic of India on the Promotion and Reciprocal Protection of Investments (India/Mexico BIT 2007), Article 8(4) contains some more extensive language than those in most of the other Mexican BITs. (*4. In the event of serious balance of payments and external financial difficulties or threat thereof, a Contracting Party may adopt or maintain restrictions on payments or transfers related to investments, which shall: a) be consistent with the Articles of Agreement of the International Monetary Fund; b) avoid unnecessary damage to the commercial, economic, and financial interest of the investor of the other Contracting Party; c) not exceed those necessary to deal with the circumstances described in this paragraph; d) be temporary and be phased out progressively until the situation specified in this paragraph improves; e) be applied on an equitable, non-discriminatory and in a good faith basis; and f) be promptly notified to the other Contracting Party. The Contracting Party adopting any restrictions under this paragraph shall, upon request by the other Contracting Party, commence consultations with the latter in order to review the restrictions adopted by it.*"

\(^{197}\) Agreement between the Government of the United Mexican States and the Government of the Republic of Iceland on the Promotion and Reciprocal Protection of Investments (Iceland/Mexico BIT 2005), similar to footnote 187.

\(^{198}\) Agreement between the Government of the Italian Republic and the Government of the United Mexican States for the Promotion and Mutual Protection of Investments (Italy/Mexico BIT 1999), Article 6(4).

\(^{199}\) Agreement between the Government of the United Mexican States and the Government of the Republic of Korea for the Promotion and Reciprocal Protection of Investments (Republic of Korea/Mexico BIT 2000), Protocol similar to footnote 187.

\(^{200}\) Agreement on Promotion, Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the United Mexican States (Netherlands/Mexico BIT 1998), Protocol Ad Article 4, similar to footnote 187.

\(^{201}\) Agreement between the Government of the Kingdom of Sweden and the Government of the United Mexican States concerning the Promotion and Reciprocal Protection of Investments (Sweden/Mexico BIT 2000), Article 6(4) similar to footnote 187.

\(^{202}\) Agreement between the Government of the United Mexican States and the Government of the Republic of Trinidad and Tobago on the Promotion and Reciprocal Protection of Investments (Trinidad and Tobago/Mexico BIT 2006), Article 8(3) similar to footnote 187.
the 2006 United Kingdom/Mexico BIT,\textsuperscript{203} all contain similar formulations of balance of payments measures provisions as those found in the Italian BITs. Finally, in contrast to most of the BITs surveyed here, it is noticeable that most \textbf{Australian BITs} confine their treaty language to simply recognizing States’ inherent rights, “in exceptional balance of payments difficulties, to exercise equitably and in good faith powers conferred by its law”,\textsuperscript{204} to restrict outgoing capital transfers. What is starkly evident from the IIAs surveyed here is that the provisions on balance of payments measures often make no reference to the host State’s social protection objectives as the bases for policy flexibility needed to meet balance of payments or financial crises. The ultimate legality of capital transfer restrictions is made to depend only on compliance with payment restructuring terms; international standards of equitableness, non-discrimination, and good faith; and consistency with the IMF Articles of Agreement.

The foregoing discussion of substantive standards highlight several IIA design issues for States seeking to maintain policy flexibility to meet social protection objectives. First, none of these substantive standards appear to have been formulated to date with sufficient particularity to acknowledge that host States’ social protection duties warrant some degree of foreseeable policy flexibility in the interpretation of these IIA standards. Second, host States that indeed attempt interpretations of these IIA standards to argue for policy flexibility tend to do so long after controversies arise during the investor-State dispute settlement process, and on a piecemeal basis before different arbitral tribunals, each of whom can extrapolate different valences of

\textsuperscript{203} Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United Mexican States for the Promotion and Reciprocal Protection of Investments (United Kingdom/Mexico BIT 2006), Article 8(4) \textit{similar to footnote 187}.

\textsuperscript{204} See 1992 Australia/Indonesia BIT, Article VII(1); 1994 Australia/Lao People’s Democratic Republic, Article 9(1).
meaning for the same IIA standard in distinct cases. Third, none of the IIA substantive standards examined here fully capture the point that host States will very likely have continuing *dynamic* (and not static) international obligations to respect, protect, and fulfill economic, social, and cultural rights, and as such, retaining policy flexibility should be seen likewise as a matter of international legal obligation. Under the present formulations of substantive standards in the IIA, it is difficult to reach well-justified interpretations that fully acknowledge host States’ international economic, social, and cultural obligations as part of the corpus of investment obligations. If an IIA’s substantive standards were to be framed purposely to permit evolutionary interpretation, there can be little danger of heightening regulatory risk if all IIA parties can mutually and transparently anticipate host States’ needs for continuing policy flexibility to meet both IIA obligations as well as social protection obligations in international law. The intention to permit an evolutionary interpretation of IIA standards must be clearly discernible from the “generic” quality of the terms used in those IIA standards. Although there is to date thin investment arbitral practice that admits evolutionary interpretations of IIA standards, as will be discussed in Part II of this Article, future IIA design could deliberately provide for evolutionary interpretation in conformity with limitations set under international jurisprudence. The International Court of Justice has already discussed possibility that treaty drafters purposely allow for evolutionary interpretation of treaty terms in its 2009 Judgment in the Dispute regarding Navigational and Related Rights (Costa Rica v. Nicaragua).206

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205 See Mondev International Ltd v. United States, Award, ICSID Case No. ARB(AF)/99/2, 11 October 2002, para. 123 (in relation to the fair and equitable treatment standard in NAFTA Article 1105(1)).

206 Dispute regarding Navigational and Related Rights (Costa Rica v. Nicaragua), Judgment, I.C.J. Articles 2009, para. 66: “where the parties have used generic terms in a treaty, the parties necessarily having been aware that the meaning of the terms was likely to evolve over time, and where the treaty has been entered into for a very long period or is of ‘continuing duration’, the parties must be presumed, as a general rule, to have intended those terms to have an evolving meaning.” The Court has previously accepted evolutionary interpretation of treaties in Legal Consequences for States of the
C. Paradoxes in the Treatment of Regulatory Risk: Fair and Equitable Treatment (FET) and Indirect Expropriation Standards

Investors share responsibility with host States to conduct a complete due diligence that covers all foreseeable regulatory risks. The ad hoc Committee in *MTD Equity Sdn Bhd and MTD Chile SA v. Chile* stressed this particular point when it denied a petition for annulment of an arbitral award, in a case that had involved an investment project that was initially authorized by one government agency, but subsequently found to be inconsistent with the national government’s urban development policy.\(^{207}\) The Committee found no basis to annul the arbitral tribunal’s decision, which had allocated responsibility equally to both the host State (for breaching the fair and equitable treatment standard) as well as to the investor-claimants (for failing to protect themselves from business risks inherent in the investment), observing that in this particular case, “a foreign investor failed to complete due diligence on a matter fundamental to the investment. Land-use control is a core concern for the State…Whatever contracts foreign investors may make with the owners of rural land cannot be allowed to disrupt the due application of the law of the host State, nor should the vagueness inherent in such treaty standards as ‘fair and equitable treatment’ allow international tribunals to second-guess planning decisions duly made (as the decisions here were made) in accordance with that law.”\(^{208}\) To this end, investors and host States must cooperate to ensure transparency of regulations and regular information flows, especially between government agencies of the same State.

\(^{207}\) *MTD Equity Sdn Bhd and MTD Chile SA v. Chile*, Decision on Annulment, ICSID Case No. ARB/01/7, 16 February 2007.

\(^{208}\) Id. at footnote 207, para. 107.
It should stand to reason that regulatory risk must be assessed from the joint perspective of investors as well as host States. However, tribunals have not always taken this approach. Rather, when a host State’s regulatory change is alleged to breach an IIA standard, arbitral scrutiny has more often proven to be predominantly focused on the host State’s conduct, with a seemingly greater presumptive burden assumed against the host State. In his Separate Opinion in *International Thunderbird Gaming Corporation v. Mexico*, arbitrator Thomas W. Wälde emphasized that because the fundamental function of international investment law is to “promote foreign investment by providing effective protection to foreign investors exposed to the political and regulatory risk of a foreign country in a situation of relative weakness”, the general rule of thumb developed in arbitral jurisprudence is thus:

“…in case of doubt, the risk of ambiguity of a governmental assurance is allocated rather to the government than to a foreign investor and that the government is held to high standards of transparency and responsibility for the clarity and consistency in its interaction with foreign investors. If official communications cause, visibly and clearly, confusion or misunderstanding with the foreign investor, then the government is responsible for proactively clarifying its position. The government cannot rely on its own ambiguous communications, which the foreign investor could and did justifiably rely on, in order to later retract and reverse them – in particular in change of government situations… Investors need to rely on the stability, clarity and predictability of the government’s regulatory and administrative messages as they appear to the investor when conveyed – and without escape from such commitments by ambiguity and obfuscation inserted into the commitment identified subsequently and with hindsight…”

Even the test for determining the reasonableness of a regulatory change appears to focus mainly on host State conduct. According to the arbitral tribunal in *AES Summit Generation Limited and AES-Tisza Erőmű Kft v. Hungary* (a case

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210 Id. at footnote 209, paras. 4 and 5 of Separate Opinion of Thomas W. Wälde. Italics added.

involving alleged breaches of the Energy Charter Treaty after Hungary implemented regulatory pricing changes) the test for determining whether a regulatory change is an unreasonable or discriminatory measure amounting to a breach of the ECT has two elements: “the existence of a rational policy; and the reasonableness of the act of the state in relation to the policy.” A rational policy exists where it “is taken by a state following a logical (good sense) explanation and with the aim of addressing a public interest matter”, while the reasonableness of the challenged measure can be established through “an appropriate correlation between the state’s public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented.” Nowhere does this test consider the extent, if any, to which an investor could (and should) have anticipated, foreseen, or mitigated the regulatory risk.

The most interesting paradox in how arbitral tribunals treat and view regulatory risk can be seen from cases involving a host State’s regulatory measure that, on the one hand, is alleged to constitute indirect expropriation, and on the other, also purportedly amounts to a violation of the fair and equitable treatment standard. Based on its survey of arbitral practices, a 2012 Article of the United Nations Conference on Trade and Development (UNCTAD) derives four cumulative elements to determine the existence of indirect expropriation: 1) an act attributable to the host State; 2) interference with property rights or other protected legal interests; 3) of such degree that the relevant rights or interests will lose all or most of their value.

212 Id. at footnote 211, at para. 10.3.7.
213 Id. at footnote 211, at para. 10.3.8.
214 Id. at footnote 211, at para. 10.3.9.
or the owner is deprived of control over the investment; 4) even though the owner retains the legal title or remains in physical possession. 216 States cannot be deemed to have committed indirect expropriation when, “in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.” 217 Otherwise stated, if a host State can show that it implemented a regulatory change in good faith, in a non-discriminatory way, and purely for public welfare purposes, arbitral tribunals must regard any deprivation that may be incurred by an investor as a result of said regulatory change as simply a non-compensable regulatory taking or lawful exercise of police power by the host State. 218

The effect of a regulatory change (e.g. whether indirect expropriation or non-compensable regulatory taking) can be the basis for a separate breach of an IIA’s fair and equitable treatment (FET) standard, specifically where the FET standard is understood to grant “protection of the legitimate expectations of investors arising from a government’s specific representations or investment-inducing measures”. 219 A 2012 UNCTAD Article on the fair and equitable treatment standard cautions that this concept of extending protection to investors’ legitimate expectations through the FET standard “is an arbitral innovation. When economic, regulatory or other conditions general or specific to the investment undergo changes negatively affecting the investment’s value, they may be seen as a breach of legitimate expectations prevailing

216 Id. at footnote 215, p. 12.
at the time the investment is made. While in principle the concept of legitimate expectations may well have a place within fair and equitable treatment, its thoughtless application, looking at the issues at hand from the perspective of the investor only, runs the risk that the true purpose of the FET provision in IIAs will be lost under the weight of investor concerns alone.”\footnote{220} This “arbitral innovation” also explains why it is “inappropriate” to invoke the same police powers of the host State (which is the accepted exception to indirect expropriation claims) as a defense against breach of the FET standard. The arbitral tribunal in 	extit{Suez and ors v. Argentina}\footnote{221} provided a starkly tautological explanation for the seeming “inappropriateness” of the police powers defense:

“148. The police powers doctrine is a recognition that State have a reasonable right to regulate foreign investments in their territories even if such regulation affects property rights. In effect, the doctrine seeks to strike a balance between a State’s right to regulate and the property rights of foreign investors in their territory. \textit{However, the application of the police powers doctrine as an explicit, affirmative defense to treaty claims other than for expropriation is inappropriate}, because in judging those claims and applying such principles as full protection and security and fair and equitable treatment, both of which are considered in subsequent sections of this Decision, a tribunal must take account of a State’s reasonable right to regulate. \textit{Thus, if a tribunal finds that a State has violated treaty standards of fair and equitable treatment and full protection and security, it must of necessity have determined that such State has exceeded its reasonable right to regulate.} Consequently, for that same tribunal to make a subsequent inquiry as to whether that same State has exceeded its legitimate police powers would require that tribunal to engage in an inquiry it has already made. In short, a decision on the application of the application of the police powers doctrine in such circumstance would be duplicative and therefore inappropriate.”\footnote{222}

The discussion above anchors the alleged inappropriateness of the police powers defense to non-expropriation claims on a \textit{non sequitur}. It assumes that the tribunal’s finding on FET \textit{inevitably} considers the \textit{independent} and \textit{separate}}
international law defense of police powers doctrine. While this defense is admittedly irrelevant to an IIA breach where it is asserted as a matter of domestic law, it is nonetheless relevant to consider it as a separate principle under general international law in the process of determining whether a breach of a primary norm (e.g. the non-expropriation standard in the IIA, such as the FET standard) exists in the first place. There cannot be any logical duplication in the sense argued by the Suez tribunal, because the police powers doctrine is not an element of the FET standard and as such, is posited as an entirely separate and independent defense under international law.

More importantly, it should be emphasized that the “arbitral innovation” which supplied the “legitimate expectations” content to the FET standard is itself dependent on the concept of regulatory risk. If a tribunal were indeed to construct a fictive account of what an investor’s “legitimate expectations” supposedly were at the time of the establishment of an investment, the same tribunal must also consider that investor’s risk assessment as part of that retroactive assessment. The tribunal cannot afford to be selective, and equate the stipulated contractual value of the investment

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224 See SEDCO v. NIOC, Interlocutory Award No. ITL 55-129-3, 28 October 1985, 9 Iran-US Claims Tribunal Articles 248, at 275 (“...it is an accepted principle of international law that a State is not liable for economic injury which is a consequence of bona fide ‘regulation’ within the accepted police power of States.”) Id. at footnote 215, pp. 79-80:

“...Although there is no universally accepted definition, in a narrow sense, this doctrine covers State acts such as: (a) forfeiture or a fine to punish or suppress crime; (b) seizure of property by way of taxation; (c) legislation restricting the use of property, including planning, environment, safety, health, and the concomitant restrictions to property rights; (d) defence against external threats, destruction of property of neutrals as a consequence of military operations and the taking of enemy property as part payment of reparation for the consequences of an illegal war (citing IAN BROWNLEE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, Oxford University Press 2008, p. 532)... in present times, the police powers must be understood as encompassing a State’s full regulatory dimension. Modern States go well beyond the fundamental functions of custody, security and protection. They intervene in the economy through regulation in a variety of ways: preventing and prosecuting monopolistic and anticompetitive practices; protecting the rights of consumers; implementing control regimes through licenses, concessions, registers, permits and authorizations; protecting the environment and public health; regulating the conduct of corporations; and others. An exercise of police powers by a State may manifest itself in adopting new regulations or enforcing existing regulations in relation to a particular investor.”
merely to the investor’s “legitimate expectations”. After all, the stipulated contract value of an investment is jointly determined by the host State and the investor – it is therefore relevant for an arbitral tribunal to inquire as to the extent by which both parties conducted due diligence in their assessment of regulatory risk. If the arbitral tribunal finds that a regulatory change did not constitute indirect expropriation but merely a non-compensable regulatory taking pursuant to the host State’s police powers – which are part of the regulatory risks of that investment – it strains credibility that the tribunal would then disregard its own assessment of regulatory risk when it comes to its fictive reconstruction of the investor’s “legitimate expectations” supposedly protected by the FET standard. If the investor’s “legitimate expectations” are accepted as a form of content for the FET standard, it is germane to the tribunal’s inquiry to look into how the investor assessed the regulatory risks at the time of the establishment of the investment, and in particular, whether the investor prudently ascertained when, and under what circumstances, the police powers doctrine under both international law (and not just the host State’s domestic law) could possibly apply to the contemplated investment.

Interestingly, an arbitral tribunal’s recent attempt to further delineate and refine the concept of “legitimate expectations” in relation to the FET standard may provide one way to disentangle the Gordian knot over how to consider regulatory risk for both indirect expropriation claims as well as FET claims. In its 2011 Award in *El Paso Energy International Company v. Argentina*, the tribunal conceded that “[t]here can be no legitimate expectation for anyone that the legal framework will remain unchanged in the face of an extremely severe economic crisis. No reasonable investor can have such an expectation unless very specific commitments have been

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made towards it or unless the alteration of the legal framework is total.”226 The El Paso tribunal went on to explain:

“A reasonable general regulation can be considered a violation of the FET standard if it violates a specific commitment towards the investor. The Tribunal considers that a special commitment by the State towards an investor provides the latter with a certain protection against changes in legislation, but it needs to discuss more thoroughly the concept of ‘specific commitments’. In the Tribunal’s view, no general definition of what constitutes a specific commitment can be given, as all depends on the circumstances. However, it seems that two type of commitments might be considered ‘specific’: those specific as to their addressee and those specific regarding their object and purpose.

First, in order to prevent a change in regulations being applied to an investor or certain behavior of the State, there can indeed exist specific commitments directly made to the investor – for example in a contract or in a letter of intent, or even through a specific promise in a person-to-person business meeting – and not simply general statements in treaties or legislation which, because of their nature of general regulations, can evolve. The important aspect of the commitment is not so much that it is legally binding – which usually gives rise to the same sort of responsibility if it is violated without a need to refer to FET – but that it contains a specific commitment directly made to the investor, on which the latter has relied.

Second, a commitment can be considered if its precise object was to give a real guarantee of stability to the investor. Usually general texts cannot contain such commitments, as there is no guarantee that they will not be modified in due course. However, a reiteration of the same type of commitment in different types of general statements could, considering the circumstances, amount to a specific behavior of the State, the object and purpose of which is to give the investor a guarantee on which it can justifiably rely.”227

Following the El Paso tribunal’s reasoning, there could thus be a different estimation of regulatory risk that applies when a host State’s exercise of police powers (under both domestic and recognized international law) causes economic injury to an investment, as opposed to the estimation of regulatory risk that applies when a host State makes a “specific commitment” not to disturb the regulatory framework governing an investment. Arguably, a “specific commitment” partakes of

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226 Id. at footnote 225, para. 374. Italicics added.

227 Id. at footnote 225, paras. 375-377.
an extraordinary host State guarantee that should diminish the regulatory risk of an investment.

The main difficulty with the attempted differentiation in *El Paso* is how it introduces even more subjectivities to an inherently subjective “arbitral innovation” (e.g. the protection of the investor’s “legitimate expectations” through the FET standard). How would an arbitral tribunal find the bright line between a non-compensable regulatory taking, and compensation awarded for breach of the FET standard when an investor’s “legitimate expectations” arising from a “specific commitment” are supposedly violated? Does the investor’s regulatory risk analysis at the time of the establishment of the investment materially differentiate between possible economic injuries to the investment arising from regulatory changes that may be the product of a State’s exercise of police powers, as opposed to those possible regulatory changes that arise despite amorphously determined “specific commitments”? The only way to prevent the blurring overlap between the contemplated regulatory risks at the time of establishment of the investment, would be to show that “specific commitments” necessarily include the host State’s commitment not to exercise the sovereign police powers at any time during the life of the investment.

Arbitral jurisprudence involving regulatory changes fail to show any such nuanced differentiation that recognizes the reality of regulatory risk assessment from the joint perspective of both the investor and the host State. As the following awards show, what occurs frequently is that an arbitral tribunal that dismisses an indirect expropriation claim on the ground that the regulatory change is a lawful exercise of the State’s police power, would nonetheless subsequently rule that the regulatory change still violates the investor’s “legitimate expectations” in a way that breaches
the FET standard. The detrimental consequence to this inconsistency is that the “fair market value” compensation denied for an indirect expropriation claim, would be awarded in full, nevertheless, as reparations in the form of compensation for the alleged simultaneous breach of the FET standard.\footnote{\textsuperscript{228}}

1. \textit{Sempra Energy International v. Argentina}\footnote{\textsuperscript{229}}

The investor in this case alleged specific reliance conditions\footnote{\textsuperscript{230}} offered by various legislative and regulatory enactments (e.g. the 1991 Convertibility Law, the 1992 Gas Law and implementing regulations in Gas Decree 1738/92, and the Standard Gas Transportation License under Decree 2255/92 which included applicable basic Rules, an “Information Memorandum” concerning the privatization of the former State-owned transportation and distribution company Gas del Estado, and a “Pliego” explaining the bidding rules and pertinent contractual arrangements).\footnote{\textsuperscript{231}} The investor alleged that measures adopted by the Argentine government during the 2000-2002 financial crisis violated these conditions and specific commitments, breaching the 1991 Argentina-United States BIT, including among others indirect expropriation and the FET standard.\footnote{\textsuperscript{232}}

Among its conclusions, the tribunal found that the Argentine government did

\footnote{\textsuperscript{228}} See Diane A. Desierto, \textit{ICESCR Minimum Core Obligations and Investment: Recasting the Non-Expropriation Compensation Model during Financial Crises}, George Washington International Law Review (Fall 2012).

\footnote{\textsuperscript{229}} \textit{Sempra Energy International v. Argentina}, Award, ICSID Case No. ARB/02/16, 18 September 2007.

\footnote{\textsuperscript{230}} Id. at footnote 229, para. 85: “85. …these conditions included: “(i) a license for a term of 35 years, with a possible 10-year extension; (ii) the calculation of tariffs in U.S. dollars and their semiannual adjustment according to changes in the US Producer Price Index (PPI); (iii) a commitment that there would be no price freeze applicable to the tariff system and, if one was imposed, that the licensee had a right to compensation; (iv) the commitment that the license would not be amended by the Government, in full or in part, except with the prior consent of the licensee; (v) a commitment not to withdraw the license except in case of specific breaches listed; and (iv) the principle of indifference in respect of subsidies granted by the Government so that the distributor’s income would not be altered.”

\footnote{\textsuperscript{231}} Id. at footnote 229, at paras. 82-84.

\footnote{\textsuperscript{232}} Id. at footnote 229, at paras. 94-95.
not commit indirect expropriation, as it was not shown that the challenged regulatory changes resulted in substantial loss of control over the business operation or “virtual annihilation” of the value of the business.\footnote{Id. at footnote 229, paras. 283, 285: 283. The question of indirect or creeping expropriation requires a more complex assessment. The Tribunal has no doubt about the fact that such expropriation can arise from many kinds of measures, and that these have to be assessed by their cumulative effects. Yet, in this case, the Tribunal is not convinced that such has happened either….
285. Many of the measures discussed in the instant case have had a very adverse effect on the conduct of the business concerned. This is, however, again a question that the Treaty addresses in the context of other safeguards for protecting the investor. A finding of indirect expropriation would require more than adverse effects. It would require that the investor no longer be in control of its business operation, or that the value of the business has been virtually annihilated. This is not the case in the present dispute.”} Significantly, the tribunal considered the asserted damage to the investor’s legitimate expectation, but ultimately did not accept it as a less stringent standard to establish indirect expropriation.\footnote{Id. at footnote 229, para. 288: “Legitimate expectation is also an issue which the parties have discussed, and is subject to protection under broadly conceived treaty standards and international law. This does not mean, however, that this right will operate to make the test for indirect expropriation less stringent.”}

The tribunal proceeded to hold that the Argentine government did indeed violate the FET standard under the treaty.\footnote{Id. at footnote 229, para. 304: “Even assuming that the Respondent was guided by the best of intentions, what the Tribunal has no reason to doubt, there has here been an objective breach of the fair and equitable treatment due under the Treaty. The Tribunal thus holds that the standard established by Article II(2)(a) of the Treaty has not been observed, to the detriment of the Claimant’s rights.”} While it conceded the imprecision of the FET standard,\footnote{Id. at footnote 229, para. 296.} it surprisingly defined a particular function of the FET standard that was nowhere borne out by the text of the treaty or any of its \textit{travaux preparatoires}:

“It follows that it would be wrong to believe that fair and equitable treatment is a kind of peripheral requirement. To the contrary, \textit{it ensures that even where there is no clear justification for making a finding of expropriation, as in the present case}, there is still a standard which serves the purpose of justice and can of itself redress damage that is unlawful and that would otherwise pass unattended. Whether this result is achieved by the application of one or several standards is a determination to be made in the light of the facts of each dispute. \textit{What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought}
It must also be kept in mind that on occasion the line separating the breach of the fair and equitable treatment standard from an indirect expropriation can be very thin, particularly if the breach of the former standard is massive and long-lasting. In case of doubt, however, judicial prudence and deference to State functions are better served by opting for a determination in the light of the fair and equitable standard. This also explains why the compensation granted to redress the wrong done might not be too different on either side of the line.”

Clearly, the Sempra tribunal took it upon itself to assign a “catch-all” function to the FET standard – one that ensured compensation at the same or approximate level as that awarded for indirect expropriations could be awarded for a breach of a non-expropriation standard such as the FET standard. This arbitral policy is itself its own dangerously unique innovation – as discussed elsewhere, there has never been any automatic or substantial equivalence under international law between compensation under the general law of international responsibility (which is the standard of compensation for breaches of non-expropriation standards in an IIA) and compensation for direct or indirect expropriations. Compensation under the general law of international responsibility is not meant to be punitive, and looks toward the equitable outcome given the conduct of both the injured and the injuring State.

It was thus problematic that the Sempra tribunal deliberately chose to collapse these distinct concepts of compensation, merely because “it might be very difficult to distinguish the breach of fair and equitable treatment from indirect expropriation or other forms of taking and it is thus reasonable that the standard of reparation might be

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237 Id. at footnote 229, paras. 300 and 301. Italics added.


the same.” The tribunal then went on to assign “fair market value” as the standard of compensation, since it thought it was a “commonly accepted standard of valuation and compensation” and it was, in any case, the value defined in the treaty for expropriation claims. The tribunal ordered payment of compensation in the amount of US$128,250,462 (broken down into the equity value loss, loss on the December 2001 loss, unpaid PPI adjustments, and non-payment of subsidies), plus interest – an amount considerably less than the investor’s claim for US$ 350 million in damages to its total investment. In any event, the Sempra tribunal clearly omitted any consideration for how the investor and the host State’s joint regulatory risk assessment at the time of the establishment of the investment could have affected degree and nature of the investor’s “legitimate expectations” during a financial crisis.

2. Enron Corporation and Ponderosa Assets, LP v. Argentina

240 Id. at footnote 229, paras, 402-403:

“402. Article IV of the Treaty establishes the standard for the determination of compensation. ‘Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.’

403. It must be noted that this provision addresses specifically the case of expropriation which the Tribunal has concluded has not taken place in the present case. The Treaty does not specify the damages to which the investor is entitled in case of breach of the Treaty standards different from expropriation. Although there is some discussion about the appropriate standard applicable in such a situation, several awards of arbitral tribunals dealing with similar treaty clauses have considered that compensation is the appropriate standard of reparation in respect of breaches other than expropriation, particularly if such breaches cause significant disruption to the investment made. In such cases, it might be very difficult to distinguish the breach of fair and equitable treatment from indirect expropriation or other forms of taking and it is thus reasonable that the standard of reparation might be same.

241 Id. at footnote 229, para. 404: “Fair market value is thus a commonly accepted standard of valuation and compensation. In the present case, the Claimant made its investment in Argentina in 1996 and increased it over the years. The Tribunal is of the view that fair market value would be the most appropriate standard to apply in this case to establish the value of the losses, if any, suffered by the Claimant as a result of the Treaty breaches which occurred, by comparing the fair market value of the companies concerned with and without the measures adopted by Argentina in January 2002.”

242 Id. at footnote 229, paras. 92, 482, 486.

As with Sempra, the gas transportation and distribution investor in this case relied on virtually the same conditions established under the regulatory and legislative enactments of the Argentine Government. Enron likewise alleged injury from the regulatory changes wrought by certain Argentine measures during the 2000-2002 financial crisis. In almost identical language as that used by the Sempra tribunal, the arbitral tribunal in Enron denied the existence of indirect expropriation as substantial deprivation did not occur in the sense required under the concept of indirect expropriation – “[n]othing of the sort has happened in the case of TGS or CIESA or any of the related companies, so much so that the Claimants’ interests in these companies have been freely sold and included in complex transactions…”

The Enron tribunal also found that Argentina had violated the FET standard in Article II(2)(a) of the 1991 Argentina-US BIT. Inferring from the text of this treaty’s Preamble (e.g. “fair and equitable treatment of investment is desirable in order to maintain a stable framework for the investment and maximum effective use of economic resources”), the Tribunal concluded that “a key element of fair and equitable treatment is the requirement of a ‘stable framework for the investment’, which has been prescribed by a number of decisions.” What was “essential”, in the view of the Tribunal, was that the expectations of the foreign investor derive “from the conditions that were offered by the State to the investor at the time of the investment and that such conditions were relied upon by the investor when deciding

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244 Id. at footnote 243, paras. 41-44.
245 Id. at footnote 243, paras. 87-89.
246 Id. at footnote 243, paras. 244-246.
247 Id. at footnote 243, para. 268.
248 Id. at footnote 243, para. 259.
249 Id. at footnote 243, para. 260.
to invest.”

Similar to the Sempra tribunal’s findings, the Enron tribunal found that “it was in reliance upon the conditions established [by Argentina] in the regulatory framework for the gas sector that Enron embarked on its investment in TGS. Given the scope of Argentina’s privatization process, its international marketing, and the statutory enshrinement of the tariff regime, Enron had reasonable grounds to rely on such conditions.”

One gets a sharp impression from the Tribunal’s discussion that regulatory risks indeed materialized due to the violation of those specific conditions: “[w]here there was certainty and stability for investors, doubt and ambiguity are the order of the day. The long-term business outlook enabled by the tariff regime has been transformed into a day-to-day discussion about what comes next.”

The Enron tribunal likewise relied on an imprecise determination of compensation for the breach of the FET standard. While the investor-claimants pegged their damages to around US$ 543 Million, the ultimate compensation award issued by the Tribunal was for US$106.2 Million plus interest. The Enron tribunal freely acknowledged that it was faced with the problem of “whether a standard mainly related to expropriation, such as fair market value, can be applied to situations not amounting to expropriation”, but that it was purposely applying fair market value due to the “cumulative nature of the breaches that have resulted in a finding of liability.”

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250 Id. at footnote 243, para. 262.
251 Id. at footnote 243, para. 265.
252 Id. at footnote 243, para. 266.
253 Id. at footnote 243, para. 351.
254 Id. at footnote 243, para. 453.
255 Id. at footnote 243, para. 362.
256 Id. at footnote 243, para. 363.
devaluation or the risk of tariff freeze and pesification” could not have been factored into the assessment of the country risk premium, as such measures were “separately and specifically protected under the Regulatory Framework.”

The Tribunal adopted the fair market value standard in determining compensation, but also included within this standard “the measure of [the investment’s] future prospects”.

3. CMS Gas Transmission Company v. Argentina

CMS also involved a dispute arising from the impact of Argentine governmental measures on the privatized gas transportation sector governed by specific regulatory commitments. The investor argued that its decision to invest in the gas transportation sector was made “in reliance on the Argentine Government’s promises and guarantees, particularly those that offered a real return in dollar terms and the adjustment of tariffs according to the US PPI [Producer Price Index]…it invested almost US $175 million in the purchase of shares in TGN…TGN invested more than US $1 billion in the renovation and expansion of the gas pipeline network.”

For the investor, these acts along with other injurious measures taken by the Argentine Government during its 2000-2002 financial crisis, constituted a series of investment treaty breaches – expropriation, the fair and equitable treatment standard, non-discrimination standard, prohibitions against transfer restrictions, and the umbrella clause. Among its defenses, Argentina argued that the “transportation and distribution of gas is a national public service which must take into account particular needs of social importance. To this end, the Government is under an

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257 Id. at footnote 243, para. 378.
258 Id. at footnote 243, para. 384.
259 CMS Gas Transmission Company v. Argentina, Award, ICSID Case No. ARB/01/8, 12 May 2005.
260 Id. at footnote 259, paras. 53-67.
261 Id. at footnote 259, para. 68.
262 Id. at footnote 259, para. 88.
obligation to ensure the efficient operation of the service and must control the implementation of the contract, including the alternative of amendment or unilateral termination. Thus, the regulation of tariffs is a discretionary power of the Government insofar as it must take social and other public considerations into account.”

The CMS tribunal found that the investor possessed a “right to tariff calculations in dollars”, and a “right to adjustment of tariffs in accordance with the US PPI”, especially since it had been these specific guarantees that “attracted hundreds of companies to the country with investments over 10 billion dollars.” The legal framework governing the privatization of this sector was designed “to guarantee the stability of the tariff structure and the role calculation in dollars and the US PPI adjustment played therein.”

Upon a review of the facts and submissions of the parties, the CMS Tribunal held that there was no expropriation of the investment as there had not been any substantial deprivation of such investment. It found, on the other hand, that Argentina breached the fair and equitable treatment standard – a treaty standard that the Tribunal held to be “inseparable from stability and predictability”. In the Tribunal’s view, “a stable legal and business environment is an essential element of fair and equitable treatment.” In any event, the Tribunal contended that this interpretation “is not different from the international law minimum standard and its evolution under customary law.” While the Tribunal further declined to hold

263 Id. at footnote 259, para. 93.
264 Id. at footnote 259, para. 137.
265 Id. at footnote 259, para. 161.
266 Id. at footnote 259, paras. 263-264.
267 Id. at footnote 259, para. 276.
268 Id. at footnote 259, para. 274.
269 Id. at footnote 259, para. 284.
Argentina liable for alleged investment treaty breaches on arbitrariness and discrimination, it did find that the umbrella clause was breached “to the extent that legal and contractual obligations pertinent to the investment have been breached”. The cumulative nature of the treaty breaches, in the Tribunal’s view, warranted its resort to the fair market value standard in determining compensation, notwithstanding the absence of a finding of expropriation in this case. Argentina was held liable for US $ 133.2 million plus interest.

4. BG Group PLC v. Argentina

The British investor in this case was a shareholder in a natural gas distribution company incorporated in Argentina (MetroGas), who asserted that it had relied upon the Argentine regulatory framework established during the privatization process in the early 1990s – the Gas Law, the Gas Decree, and the MetroGas License for natural gas distribution. Similar to other tribunals that dealt with the impact of Argentine measures taken during its 2000-2002 financial crisis, the BG Tribunal did not find that Argentina committed expropriation, especially since “the impact of Argentina’s measures had not been permanent on the value of BG’s shareholding in MetroGas. It might well be that the measures adopted by Argentina were severe causing a fluctuation of BG’s investment during the crisis. However, MetroGas’ business never halted, continues to operate, and has an asset base which is recovering.” While the BG Tribunal found that Argentina did not breach the full protection and security

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270 Id. at footnote 259, para. 295.
271 Id. at footnote 259, para. 303.
272 Id. at footnote 259, para. 410.
273 Id. at footnote 259, para. 472.
275 Id. at footnote 274, paras. 1 and 27.
276 Id. at footnote 274, para. 270.
standard and the non-discrimination standard, it found that Argentina breached the reasonableness standard as well as the international minimum standard/fair and equitable treatment standard when it “fundamentally modified the investment Regulatory Framework, which…provided for specific commitments that were meant to apply precisely in a situation of currency devaluation and cost variations”.

The BG Tribunal awarded total damages to the claimant in the amount of about US$ 185 million plus interest, legal fees, and costs of the arbitration. The investor had claimed US$ 238.1 million, equivalent to “the loss in the fair market value of its investment in MetroGas”. The Tribunal stressed that it was “disinclined to automatically import [the fair market value] standard from Article 5 of the BIT [the provision on expropriation]”, but held this standard “is nonetheless available by reference to customary international law.” Significantly, the Tribunal did not indicate if the supposed “customary international law” standard on “fair market value” that it identified was derived from state practice involving breaches of international obligations that did not involve expropriation or any form of unlawful takings. Rather, the Tribunal simply transposed the compensation principle defined under the 1928 Chorzów Factory case decided by the Permanent Court of International Justice – a case that precisely involved the expropriation of a factory in Upper Silesia – as the standard for assessing compensation for non-expropriation breaches of the investment treaty in the present case.

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277 Id. at footnote 274, paras. 328 and 360.
278 Id. at footnote 274, para. 346.
279 Id. at footnote 274, para. 310.
280 Id. at footnote 274, para. 467.
281 Id. at footnote 274, para. 414.
282 Id. at footnote 274, para. 422.
283 Id. at footnote 274, paras. 423-429.
5. *LG & E Energy Corporation and ors v. Argentina*\(^ {284}\)

The claimants-investors in this case have shareholding interests in three local gas distribution companies created and existing under the laws of Argentina, holding gas distribution licenses issued by the Argentine Government.\(^ {285}\) The *LG & E* tribunal found that the regulatory framework involved four specific guarantees to investors in the gas transport and distribution centers: 1) tariffs would be “calculated in US dollars before conversion into pesos”; 2) tariffs would be “subject to semi-annual adjustments according to the US Producer Price Index (PPI)”; 3) tariffs were to “provide an income sufficient to cover all costs and a reasonable rate of return”; and 4) the tariff system “would not be subject to freezing or price controls without compensation”.\(^ {286}\) The *LG & E* Tribunal found that Argentina did not commit expropriation directly or indirectly as a result of the measures taken during the 2000-2002 financial crisis,\(^ {287}\) and that such measures did not violate the investment treaty prohibition against arbitrariness.\(^ {288}\) However, the tribunal held that Argentina violated the fair and equitable treatment standard, noting that while “certain political and social realities…may have influenced the Government’s response to the growing economic difficulties”, Argentina “went too far by completely dismantling the very legal framework constructed to attract investors.”\(^ {289}\) Argentina was also deemed to have acted discriminatorily by “suspend[ing] PPI adjustments for the gas industry two years before enacting the Emergency Law” contrary to other public utility

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\(^ {284}\) *LG&E Energy Corporation and ors v. Argentina*, Decision on Liability, ICSID Case No. ARB/02/1, 3 October 2006.

\(^ {285}\) Id. at footnote 284, para. 1.

\(^ {286}\) Id. at footnote 284, para. 119.

\(^ {287}\) Id. at footnote 284, paras. 189-200.

\(^ {288}\) Id. at footnote 284, paras. 161-163.

\(^ {289}\) Id. at footnote 284, para. 139.
In its Award of damages in 2007, the LG & E tribunal rightly acknowledged the differences between compensation awarded for expropriation, and compensation as a form of reparations for breach of other investment treaty provisions that do not involve expropriation. In particular, the tribunal noted that as the fair market value standard has already been deemed improper to measure compensation for unlawful expropriation, “it is a fortiori not appropriate for breaches of other Treaty standards.” The tribunal focused its analysis on the appropriate measure of compensation from a perspective of causality: “[t]he question is one of ‘causation’: what did the investor lose by reason of the unlawful acts?” It found that the measures resulted in a “significant decrease in the Licensees’ revenues that, in turn, has produced a decrease of dividends distributed to shareholders…the actual damage inflicted by the measures is the amount of dividends that could have been received but for the adoption of the measures.” The tribunal further declined to include lost future profits as part of its estimation of the quantum of compensation, finding that such future loss is “uncertain and any attempt to calculate it is speculative…Claimants have retained title to their investments and are therefore entitled to any profit that the investment generates and could generate in the future.”

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290 Id. at footnote 284, paras. 147-148.
292 Id. at footnote 291, paras. 35-38.
293 Id. at footnote 291, para. 38.
294 Id. at footnote 291, para. 45.
295 Id. at footnote 291, para. 48.
296 Id. at footnote 291, para. 90.
the investor for US$ 57.4 million plus compound interest.297

6. Azurix Corporation v. Argentina298

Azurix is the parent corporation of two subsidiary companies in Argentina that had concession rights for water distribution and sewage disposal management services for the Province of Buenos Aires in Argentina.299 Azurix argued that Argentina violated the Argentina-US bilateral investment treaty because of various actions and omissions of the Province and other instrumentalities “that resulted in the non-application of the tariff regime of the Concession for political reasons; the Province did not complete certain works that were supposed to remedy historical problems and were to be transferred to the Concessionaire upon completion; that the lack of support for the concession regime prevented [the concession operator] from maintaining financing for its Five Year Plan; that in 2001, the Province denied that the canon was recoverable through tariffs; and that ‘political concerns were always privileged over the financial integrity of the concession’.”300

The Azurix Tribunal did not find expropriation in this case, since “the impact on the investment attributable to the Province’s actions was not to the extent required to find that, in the aggregate, these actions amounted to an expropriation.”301 However, it found that Argentina, through the actions or omissions of the Province of Buenos Aires, breached the fair and equitable treatment standard,302 the treaty

297 Id. at footnote 291, para. 115.
298 *Azurix Corporation v. Argentina*, Award, ICSID Case No. ARB/01/12, 23 June 2006.
299 Id. at footnote 298, paras. 38-42.
300 Id. at footnote 298, para. 43.
301 Id. at footnote 298, para. 322.
302 Id. at footnote 298, paras. 358-378.
The tribunal took the view that “compensation based on the fair market value of the Concession would be appropriate, particularly since the Province has taken it over. Fair market value has been defined as ‘the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.” Azurix was awarded compensation in the amount of over US $ 165 million plus compounded interest.

**7. Suez and ors v. Argentina**

The investors-claimants in this case were the major shareholders in an Argentine company that held the concession for water distribution and waste water treatment in the Province of Santa Fe in Argentina. Claimants alleged breaches of the Argentina-France bilateral investment treaty provisions on expropriation, fair and equitable treatment, and full protection and security, arising from measures taken by the Argentine government during the 2000-2002 financial crisis leading up to the Province of Santa Fe’s termination of the concession.

The Suez tribunal rejected the claim of expropriation because the claimants had not been deprived of their property rights through the challenged measures. It

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303 Id. at footnote 298, para. 393.
304 Id. at footnote 298, para. 408.
305 Id. at footnote 298, para. 424.
306 Id. at footnote 298, para. 442.
307 *Suez and ors v. Argentina*, Decision on Liability, ICSID Case No. ARB/03/17, 30 July 2010.
308 Id. at footnote 307, para. 1.
309 Id. at footnote 307, para. 116.
310 Id. at footnote 307, paras. 135-145.
noted in obiter dictum that “States have a legitimate right to exercise their police powers to protect the public interest”.\textsuperscript{311} However, the Suez tribunal was quick to declare that police powers doctrine is an “inappropriate” affirmative defense for non-expropriation treaty claims, since a tribunal can be assumed to have “taken account of a State’s reasonable right to regulate” in judging those claims.\textsuperscript{312} Notably, the Suez tribunal did not indicate what its factual or legal bases were for making such an assumption.

The Tribunal further declined to find that the full protection and security clause had been breached, since this provision referred mainly to the protection of investors and investments primarily from physical injury, and not to encompass “the maintenance of a stable legal and commercial environment.”\textsuperscript{313} On the other hand, the Tribunal held that Argentina violated the fair and equitable treatment standard, through the “Province’s actions in refusing to revise the tariff according to the legal framework of the Concession and in pursuing the forced renegotiation of the Concession Contract contrary to that legal framework”, the fact that “Argentina failed to exercise due diligence in certain elements of its treatment of the Claimants’ investments”, ultimately frustrating the “legitimate expectations” of the investor-claimants in this case.\textsuperscript{314} The decision on damages for breach of fair and equitable treatment and costs were deferred to a subsequent proceeding.\textsuperscript{315}

8. Total SA v. Argentina\textsuperscript{316}

The investor in this case owned shares in Argentine gas transportation

\begin{itemize}
  \item \textsuperscript{311} Id. at footnote 307, para. 147.
  \item \textsuperscript{312} Id. at footnote 307, para. 148.
  \item \textsuperscript{313} Id. at footnote 307, para. 173.
  \item \textsuperscript{314} Id. at footnote 307, paras. 227 and 228.
  \item \textsuperscript{315} Id. at footnote 307, para. 248.
  \item \textsuperscript{316} Total SA v. Argentina, Decision on Liability, ICSID Case No. ARB/04/1, 21 December 2010.
\end{itemize}
companies that held licenses for rendering gas transportation utilities in northern and central Argentina for 35 years, renewable for a further ten years.\textsuperscript{317} Total claimed that its investment decision was based on the specific commitments and guarantees provided in the Gas Regulatory Framework governing the concession.\textsuperscript{318} Total asserted that the emergency measures enacted by Argentina during the 2000-2002 financial crisis “completely destroyed”\textsuperscript{319} that regulatory framework.

The Total Tribunal did not find that the challenged measures amounted to expropriation, and that furthermore, these measures did not breach the non-discrimination provision in the investment treaty.\textsuperscript{320}

However, some of the challenged Argentine measures were still deemed to breach the fair and equitable treatment standard. In parsing this standard, the Tribunal carefully delineated the kind of legitimate expectations protected under the fair and equitable treatment standard in an investment treaty: “[i]n the absence of some ‘promise’ by the host State or a specific provision in the bilateral investment treaty itself, the legal regime in force in the host country at the time of making the investment is not automatically subject to a “guarantee” of stability merely because the host country entered into a bilateral investment treaty with the country of the foreign investor. The expectation of the investor is undoubtedly “legitimate”, and hence subject to protection under the fair and equitable treatment clause, if the host State has explicitly assumed a \textit{specific legal obligation for the future}, such as by contracts, concessions or stabilisation clauses on which the investor is therefore

\textsuperscript{317} Id. at footnote 316, para. 41.
\textsuperscript{318} Id. at footnote 316, paras. 47-59.
\textsuperscript{319} Id. at footnote 316, para. 68.
\textsuperscript{320} Id. at footnote 316, paras. 199, 217-218.
entitled to rely as a matter of law.”321 The Tribunal went on to distinguish the kind of regulation that leads to a justifiable reliance or guarantee of stability to the investor, the serious infringement of which results in a violation of the fair and equitable treatment standard:

“Indeed, the most difficult case is (as in part in the present dispute) when the basis of an investor’s invocation of entitlement to stability under a fair and equitable treatment clause relies on legislation or regulation of a unilateral and general character. In such instances, investor’s expectations are rooted in regulation of a normative and administrative nature that is not specifically addressed to the relevant investor. This type of regulation is not shielded from subsequent changes under the applicable law. This notwithstanding, a claim to stability can be based on the inherently prospective nature of the regulation at issue aimed at providing a defined framework for future operations. This is the case for regimes, which are applicable to long-term investments and operations, and/or providing for “fall backs” or contingent rights in case the relevant framework would be changed in unforeseen circumstances or in case certain listed events materialize. In such cases, reference to commonly recognized and applied financial and economic principles to be followed for the regular operation of investments of that type (be they domestic or foreign) may provide a yardstick. This is the case for capital intensive and long term investments and operation of utilities under a license, natural resources exploration and exploitation, project financing or Build Operate and Transfer schemes. The concept of “regulatory fairness” or “regulatory certainty” has been used in this respect. In the light of these criteria when a State is empowered to fix the tariffs of a public utility it must do so in such a way that the concessionaire is able to recover its operations costs, amortize its investments and make a reasonable return over time, as indeed Argentina’s gas regime provided.

On the other hand, the host State’s right to regulate domestic matters in the public interest has to be taken into consideration as well. The circumstances and reasons (importance and urgency of the public need pursued) for carrying out a change impacting negatively on a foreign investor’s operations on the one hand, and the seriousness of the prejudice caused on the other hand, compared in the light of a standard of reasonableness and proportionality are relevant. The determination of a breach of the standard requires, therefore, “a weighing of the Claimant’s reasonable and legitimate expectations on the one hand and the Respondent’s legitimate regulatory interest on the other.” Thus an evaluation of the fairness of the conduct of the host country towards an investor cannot be made in isolation, considering only their bilateral relations. The context of the evolution of the host economy, the reasonableness of the normative changes challenged and their

321 Id. at footnote 316, para. 117. Italics added.
appropriateness in the light of a criterion of proportionality also have to be taken into account…”

Applying the foregoing calibration of the fair and equitable treatment standard and the inherent right of a State to regulate for the public interest, the Total Tribunal found that not all of the Argentine measures breached the fair and equitable treatment standard. It decided to separate the quantification of damages for this particular breach (applicable to damage to its shareholder value in the Concessionaire, investment in power generation, and investments in exploration and production of hydrocarbons) to a subsequent phase of the proceedings.

9. Impregilo SpA v. Argentine Republic

Impregilo is one of the partners of an international consortium that had been awarded concessions by the Province of Buenos Aires for the operation of water and sewerage services in a concession area covering seven municipalities in Argentina. Impregilo challenged various measures taken by the Argentine Government originating from the 2000-2002 financial crisis, which had steadily encroached on its rights under the concession until the termination of the Concession Agreement. Impregilo contended that the Argentine Government breached the Argentina-Italy bilateral investment treaty provisions on expropriation, fair and equitable treatment, non-discrimination, full protection and security, and the umbrella clause.

The Impregilo Tribunal held that the Argentine measures did not amount to

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322 Id. at footnote 316, paras. 122-123. Italics added.
323 Id. at footnote 316, paras. 182-183, 346, 444, 455, 461.
325 Id. at footnote 324, paras. 13-14.
326 Id. at footnote 324, paras. 20-48.
327 Id. at footnote 324, paras. 192-209.
direct or indirect (creeping) expropriation,\textsuperscript{328} but did amount to a breach of the fair and equitable treatment standard.\textsuperscript{329} Significantly, the Tribunal emphasized that “the legitimate expectations of foreign investors cannot be that the State will \textit{never} modify the legal framework, especially in times of crisis, but certainly investors must be protected from \textit{unreasonable modifications} of that legal framework.”\textsuperscript{330} Contractual rights are not to be equated to legitimate expectations, since the FET standard is not meant to stand as an umbrella clause.\textsuperscript{331} The Tribunal thus focused on the treatment afforded to the concessionaire to which the investor was a shareholder, to determine if the “alleged contractual breaches…could affect Argentina’s responsibility under the BIT because they were a misuse of public power or reveal a pattern directed at damaging [the concessionaire] and indirectly, Impregilo, as one of its shareholders.”\textsuperscript{332} On the facts, the Tribunal found that none of the alleged contractual breaches triggered Argentina’s responsibility under the investment treaty, and that neither was there any evidence of “a pattern of acts by State entities aimed at causing damage to Impregilo as investor.”\textsuperscript{333} What ultimately became determinative of the breach of the fair and equitable treatment standard was the “disturbance of the equilibrium between rights and obligations in the concession…essentially due to measures taken by the Argentine legislator”, and Argentina’s failure to “effectively restore an equilibrium on a new or modified basis” or “to create for [the concessionaire] a reasonable basis for pursuing its tasks as concessionaire which had

\textsuperscript{328} Id. at footnote 324, para. 283.
\textsuperscript{329} Id. at footnote 324, para. 331.
\textsuperscript{330} Id. at footnote 324, para. 291. Italics added.
\textsuperscript{331} Id. at footnote 324, para. 293.
\textsuperscript{332} Id. at footnote 324, para. 299.
\textsuperscript{333} Id. at footnote 324, para. 309.
been negatively affected by the emergency legislation.”  

In determining the compensation to be awarded for breach of the FET standard, the Tribunal noted that both the concessionaire and the Province of Buenos Aires “have a shared responsibility for the failure of the concession”, and as such, damages should be based on a “reasonable estimate of the loss that may have been caused to Impregilo.” The Tribunal found that the compensation to be awarded should only be based “only on the capital contribution made by Impregilo”, particularly as Impregilo had not been able to show whether the concession was likely to have been profitable if there had been no interference by the Argentine legislator and public authorities. Impregilo was awarded US $ 21.294 million plus compound interest at 6% until date of payment.


The American investor-claimant in this case owned direct and non-controlling shareholdings in several Argentine companies engaged in energy generation, hydrocarbon, electricity, and distribution services in Argentina. The claimant alleged Argentina’s violations of the Argentina-United States bilateral investment treaty, as a result of the measures it had taken during the 2000-2002 financial crises, as well as tax issues (such as claims related to export duties established by the Emergency Law and deductions on income tax).  

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334 Id. at footnote 324, paras. 330-331.  
335 Id. at footnote 324, para. 378.  
336 Id. at footnote 324, paras. 381 and 380.  
337 Id. at footnote 324, Part VI(E).  
339 Id. at footnote 338, paras. 7-13.  
340 Id. at footnote 338, paras. 294-295.
measures were reasonable and not arbitrary,\textsuperscript{341} did not amount to expropriation,\textsuperscript{342} and likewise did not constitute \textit{de jure or de facto} discrimination\textsuperscript{343} against the investor. However, the \textit{El Paso} Tribunal did find that there was a “cumulative” impact of the challenged measures that “was a total alteration of the entire legal setup for foreign investments”, that could also be viewed in the aggregate as “creeping violations” of the fair and equitable treatment standard.\textsuperscript{344} While it accepted that “legitimate and reasonable expectations” could be considered to determine any possible breach of the FET standard, the Tribunal nonetheless took pains to explain that such expectations: 1) “can be breached even in the absence of subjective bad faith”\textsuperscript{,}\textsuperscript{345} 2) “result from a confrontation of the objective expectations of investors \textit{and} the right of the State to regulate”;\textsuperscript{346} and 3) “necessarily vary with the circumstances”.\textsuperscript{347}

In the view of the Tribunal, the FET standard implies that there is “no unreasonable or unjustified modification of the legal framework”\textsuperscript{348} and “no modification of the legal framework when contrary specific commitments have been made towards the investor”.\textsuperscript{349} The quantum of compensation for breach of this standard, according to the Tribunal, would still be the “fair market value” standard, comparing the fair market value of the investment with and without the challenged Argentine measures.\textsuperscript{350} The investor was ultimately awarded compensation of US $

\begin{footnotes}
\item\textsuperscript{341} Id. at footnote 338, paras. 319-325.
\item\textsuperscript{342} Id. at footnote 338, paras. 297-299.
\item\textsuperscript{343} Id. at footnote 338, paras. 305-316.
\item\textsuperscript{344} Id. at footnote 338, paras. 517-519.
\item\textsuperscript{345} Id. at footnote 338, para. 357.
\item\textsuperscript{346} Id. at footnote 338, para. 358.
\item\textsuperscript{347} Id. at footnote 338, paras. 359-363.
\item\textsuperscript{348} Id. at footnote 338, paras. 365-374.
\item\textsuperscript{349} Id. at footnote 338, paras. 375-379. Italics added.
\item\textsuperscript{350} Id. at footnote 338, paras. 702-704.
\end{footnotes}
43.03 million plus compounded interest.\textsuperscript{351}

The foregoing summaries of arbitral awards involving the Argentine financial crisis of 2000-2002 highlight several paradoxes on regulatory risk discussed in this Part I. For one, under the definition of regulatory risk adopted in this Article (“the risk that regulatory agencies will change policy decisions”), arbitral tribunals do not appear to differentiate from regulatory risk attendant to the ordinary business cycle, vis-à-vis regulatory risk arising from exogenous macroeconomic crises or price shocks in the host State. While some tribunals have considered that the State’s “right to regulate” might also extend to responding to difficult economic situations, they have not triangulated the impact that regulatory risk may play in both investor and host State expectations of compensation for non-expropriation breaches of the investment treaty. The easy transposition of the “fair market value” standard (and based on perfectly competitive market conditions at that) to determine compensation for breaches of the fair and equitable treatment standard is likewise perplexing from the standpoint of regulatory risk. It can make little difference to an investor’s regulatory risk assessment at the time of establishment of the investment that a host State’s exercise of police powers will be acceptable for expropriation, \textit{but not} for all other treaty breaches.

If the purpose of the due diligence process is to enable the investor to accurately assess the risks to the investment (and in a way that more realistic “pricing” of the desired returns or yields from the investment that the investor rightly expects in exchange for letting a host State use its capital), it should suffice for estimation purposes that both the investor and the host State identify the likelihood of the State’s use of its police powers to meet economic crises. Such being the case, it

\textsuperscript{351} Id. at footnote 338, para. 752.
might also be possible that the ultimate value of the investment could already have a "mark-up" that purposeful reflects a higher regulatory risk premium to satisfy the investor’s fear of loss from this kind of risk. Despite the proliferation of the “arbitral innovation” of the “legitimate expectations of the investor” as the proxy variable for determining any breach of the fair and equitable treatment standard, it is highly interesting that none of the tribunals to date have begun to approach the complex issues of regulatory risk in the determination of investor compensation. Part II proceeds to sketch various proposals for reconsidering regulatory risk assessment in light of host States’ continuing social protection obligations under the International Covenant on Economic Social and Cultural Rights.

II. MANAGING REGULATORY RISK FROM SOCIAL PROTECTION MEASURES

A. The ICESCR and its Institutional Enforcement

There are currently 160 States Parties to the International Covenant on Economic Social and Cultural Rights (ICESCR), as well as 70 State signatories. ICESCR obligations are binding and actionable norms of international law, comprising both positive rights owed to individuals as well as negative prohibitions upon States. A State’s obligations under the ICESCR apply both territorially and extraterritorially. In its Wall Advisory Opinion the International Court of Justice did

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354 See Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory, Advisory Opinion, I.C.J. Articles 2004, paras. 112, 131, 133-134.

355 AUDREY CHAPMAN AND SAGE RUSSELL (EDS.), CORE OBLIGATIONS BUILDING A FRAMEWORK FOR ECONOMIC, SOCIAL AND CULTURAL RIGHTS (Intersentia, 2002).
not restrict the scope of application of the ICESCR by a State merely to its own
territory, recognizing that the ICESCR “applies both to territories over which a state
party has sovereignty and to those over which that state exercises territorial
jurisdiction”.

A year later in its Judgment in Democratic Republic of Congo v. Uganda, the Court further stressed the extraterritorial application of international human rights instruments, saying that these “are applicable in respect of acts done by
a state in the exercise of its jurisdiction outside its own territory, particularly occupied
territories.”

International law scholars accept the extraterritorial application of the
ICESCR to “individuals and groups within a state’s territory and to those individuals
who are subject to a state’s jurisdiction.”

There are material differences between the modes of State compliance with
the ICESCR, as opposed to the International Covenant on Civil and Political Rights
(ICCPR). While Article 2(1) of the ICCPR makes it the “undertaking” of each State
Party “to respect and to ensure to all individuals within its territory and subject to its
jurisdiction the rights recognized in the present Covenant”, Article 2(2) of the
ICCPR affords each State Party discretion on how to implement the ICCPR: “where
not already provided for by existing legislative or other measures, each State Party to
the present Covenant undertakes to take necessary steps, in accordance with its
constitutional processes and with the provisions of the present Covenant, to adopt

356 Id. at footnote 354, at para. 112.
such laws as may be necessary to give effect to the rights recognized in the present
Covenant.”\textsuperscript{360} On the other hand, the ICESCR contains a progressive and dynamic
general obligation for its State Parties “to take steps, individually and through
international assistance and cooperation, economic and technical, to the maximum of
its available resources, with a view to achieving progressively the realization of the
rights recognized in the present Covenant by all appropriate means, including
particularly the adoption of legislative measures.”\textsuperscript{361} The Committee on Economic
Social and Cultural Rights (hereafter, “the Committee”) explains this fundamental
general obligation under the ICESCR as one that:

“provides for progressive realization and acknowledges the constraints due
to the limits of available resources, it also imposes various obligations
which are of immediate effect….while the full realization of the relevant
rights may be achieved progressively, steps towards that goal must be
taken within a reasonably short time after the Covenant’s entry into force
for the States concerned. Such steps should be deliberate, concrete and
targeted as clearly as possible towards meeting the obligations
recognized in the Covenant….While each State party must decide for itself which
means are the most appropriate under the circumstances with respect to
each of the rights, the ‘appropriateness’ of the means chosen will not
always be self-evident…Among the measures which may be considered
appropriate, in addition to legislation, is the provision of judicial remedies
with respect to rights which may, in accordance with the national legal
system, be considered justiciable….Other measures which also be
considered ‘appropriate’ for the purposes of article 2(1) include, but are
not limited to, administrative, financial, educational, and social
measures.”\textsuperscript{362}

ICESCR obligations thus differ markedly from ICCPR obligations, in that
ICESCR obligations have an inherently \textit{evolutionary} and \textit{dynamic} substantive content
arising from their “progressive realization”. The Committee further explains:

\textsuperscript{360} ICCPR Article 2(2).
\textsuperscript{361} International Covenant on Economic, Social and Cultural Rights, Article 2(1), GA res. 2200A
(XXI), 21 UN GAOR Supp. (No. 16) at 49, UN Doc. A/6316 (1966), 993 U.N.T.S. 3. [hereafter,
“ICESCR”]
\textsuperscript{362} Committee on Economic Social and Cultural Rights, General Comment 3 (The nature of States
parties obligations (Art. 2, para. 1 of the Covenant), 12/14/1990, paragraphs 1, 2, 4, 5, and 7 available at
http://www.unhchr.ch/tbs/doc.nsf/(Symbol)/94bd6af59b43a424c12563ed0052b664?Opendocument
(last accessed 10 October 2012).
“the concept of ‘progressive realization’ constitutes a recognition of the fact that full realization of all economic, social and cultural rights will generally not be able to be achieved in a short period of time. In this sense the obligation differs significantly from that contained in article 2 of the International Covenant on Civil and Political Rights which embodies an immediate obligation to respect and ensure all of the relevant rights. Nevertheless, the fact that realization over time, or in other words progressively, is foreseen under the Covenant should not be misinterpreted as depriving the obligation of all meaningful content. It is on the one hand a necessary flexibility device, reflecting the realities of the real world and the difficulties involved for any country in ensuring full realization of economic, social and cultural rights. On the other hand, the phrase must be read in the light of the overall objective, indeed the raison d’être, of the Covenant which is to establish clear obligations for States parties in respect of the full realization of the rights in question. It thus imposes an obligation to move as expeditiously and effectively as possible towards that goal. Moreover, any deliberately retrogressive measures in that regard would require the most careful consideration and would need to be fully justified by reference to the totality of the rights provided for in the Covenant and in the context of the full use of the maximum available resources.”

Most importantly, ICESCR obligations have an “obligatory baseline” consistent with this specialized treaty’s raison d’être – otherwise known as the “minimum core content” of ICESCR rights that States are required to respect, protect, and fulfill even during economic emergencies or despite resource constraints. In the words of the Committee, it is “of the view that a minimum core obligation to ensure the satisfaction of, at the very least, minimum essential levels of rights is incumbent upon every State party”, and that this minimum core obligation would in any event “also take account of resource constraints applying within the country concerned…In order for a State party to be able to attribute its failure to meet at least its minimum core obligations to a lack of available resources it must demonstrate that every effort has been made to use all resources that are at its disposition in an effort to satisfy, as a matter of priority, those minimum obligations.” The minimum core content or minimum core obligations of the ICESCR ultimately refer to essential levels “without

363 Id. at footnote 362, para. 9. Italics added. Underscoring in the original.
364 Id. at footnote 362, para. 10.
which a right loses its substantive significance as a human right”, thus yielding an “absolute international minimum”, applicable “whatever the State’s level of development and resources” since the ICESCR minimum core obligation entails “the basic level of sustenance necessary to live in dignity…the base-line below which all States must not fall, and should endeavor to rise above.”

The Committee’s General Comments thus far have clarified the minimum core content of the right to food, the right to health, the right to social security, the right to water, among others. These Comments provide useful guidelines and benchmarks for States not just in their country Reporting duties to the Committee, but also for undertaking their ongoing and regular national assessments of the “minimum core content” of ICESCR protection. Relatively recent academic literature also offers guidance on quantitative


367 CESC R General Comment 12 [The right to adequate food (art. 11)], 1999, para. 17. See also Rolf Künnemann, The Right to Adequate Food: Violations Related to its Minimum Core Content, pp. 161-183 in AUDREY CHAPMAN AND SAGE RUSSELL (EDS.), CORE OBLIGATIONS: BUILDING A FRAMEWORK FOR ECONOMIC, SOCIAL AND CULTURAL RIGHTS (Intersentia, 2002).

368 CESC R General Comment 14 [The right to the highest attainable standard of health (article 12 of the International Covenant on Economic, Social and Cultural Rights)], para. 43. See also Audrey R. Chapman, Core Obligations Related to the Right to Health, pp. 185-215 in AUDREY CHAPMAN AND SAGE RUSSELL (EDS.), CORE OBLIGATIONS: BUILDING A FRAMEWORK FOR ECONOMIC, SOCIAL AND CULTURAL RIGHTS (Intersentia, 2002).


370 CESC R General Comment No. 15 [The right to water (arts. 11 and 12 of the International Covenant on Economic, Social and Cultural Rights)], 2002, para. 37.

371 On the persuasive weight of the Articles and recommendations of the human rights treaty bodies, see Philip Alston, The Historical Origins of the Concept of ‘General Comments’ in Human Rights Law, p. 763 in L. BOISSON DE CHAZOURNES AND V. GOWLAND DEBBAS (EDS.), THE INTERNATIONAL LEGAL SYSTEM IN QUEST OF EQUITY AND UNIVERSALITY; LIBER AMICORUM GEORGES ABI-SAAB (2001); Markus Schmidt, United Nations, pp. 391-432, at 408-409 in DANIEL MOECKL, SANGEETA SHAH, AND SANDESH SIVAKUMARAN, INTERNATIONAL HUMAN RIGHTS LAW (Oxford University Press, 2010) (“…general comments and recommendations offer extremely helpful interpretative guidance to states and other stakeholders….While not legally binding, general comments and recommendations are frequently invoked by states and complainants in the context of Reporting and complaints procedures, and sometimes by national courts in their judgments. They have been called a new species of soft law.”)
measurements, analytical indicators, and empirical methodologies to determine the “minimum core obligation” of ICESCR rights, considering the peculiar resource constraints, governmental capabilities, and population needs unique to various States Parties.  

Finally, it should also be noted that the compliance mechanisms in the ICESCR primarily depend on the periodic and dialogic State Reporting process administered by the Committee. The Committee is the primary authoritative body of experts mandated to assist the United Nations Economic and Social Council with monitoring States’ compliance with the ICESCR. Apart from the State Reporting process, an individual complaints procedure was established in December 2008, through the Optional Protocol to the International Covenant on Economic, Social and

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Cultural Rights ("Optional Protocol to the ICESCR"). The Optional Protocol to the ICESCR empowers the Committee to request urgent interim measures from a State Party “as may be necessary in exceptional circumstances to avoid possible irreparable damage to the victim or victims of the alleged violations”.

After examination of the individual communication, the Committee could transmit its views to the State Party concerned for its consideration and action. Significantly, the Optional Protocol to the ICESCR confers authority to the Committee to conduct confidential inquiries on alleged grave or systematic violations by a State Party of Covenant rights, and thereafter transmitting findings and recommendations to the State Party concerned.

Finally, the Optional Protocol to the ICESCR enables an inter-State communications procedure where a State Party can invite the attention of another State Party to the fulfillment of ICESCR obligations, culminating with the issuance of a Committee Article on the disputed matter.

As seen from the foregoing, the dynamic and evolutionary nature of ICESCR obligations introduces complexity to the assessment of a State’s compliance (or non-compliance) with the ICESCR. The complexity does not, however, make ICESCR obligations indeterminate, or incapable of application to specific facts. (As the International Court of Justice demonstrated in the Wall Advisory Opinion, it is entirely possible to identify breaches of the ICESCR that engage a State’s international

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376 Id. at footnote 375, Art. 5.

377 Id. at footnote 375, Arts. 7-8.

378 Id. at footnote 375, Art. 11.

379 Id. at footnote 375, Art. 10.
When assessing regulatory risk within these States, it is impossible to overlook their continuing and dynamic obligations under the ICESCR to adapt statutes, administrative regulations, and other forms of legislation to continue to satisfy not just the minimum core content of the ICESCR but to “progressively realize” ICESCR rights given a State’s resource constraints. For this reason, there may be more policy uncertainty (and in turn, higher expectations of regulatory risk) expected from a State that is far from achieving even the minimum core content or obligatory baseline of the ICESCR. In those situations, it may well be the case that authoritative decision-makers of a State could be expected to prioritize the minimum social protection and economic rights guarantees under the ICESCR. Precisely because a State’s fiscal decisions directly determine the degree of compliance with the ICESCR, the corresponding policy uncertainty bears upon regulatory risk.

B. ICESCR-based social protection adjustments to investment due diligence

In its March 2012 Note, the Investment Climate Department of the World Bank Group Reported that “political risk is investors’ top concern over the medium term…[in part] due to recent global developments, with investor perceptions of political risk heightened by issues like terrorist threats, economic crises, and developing countries’ desire to control their natural resources and civil societies.” These new manifestations of political risk are consistent with the broad definition of

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political risk as “risks associated with business or investment in a country which would not be present in another country with a more stable and developed business and economic climate and regulatory regime.”\textsuperscript{382} Significantly, aspects of political risk such as regulatory and policy uncertainty, have been found to be the “most serious constraints on doing business in developing countries...[a] business environment characterized by constant policy surprises and reversals, unclear property rights, and uncertain contract enforcement is likely to deter investment and result in poor economic performance.”\textsuperscript{383}

Basic due diligence processes in foreign investment usually involve examining commercial and administrative laws, regulations, and procedures likely to affect an investment. One law firm describes “country diligence” for the purchase of oil and gas assets in foreign countries as a process that requires “interviewing for local law expertise”, “obtain[ing] a copy of the host country’s Foreign Investment Law”, and “obtain[ing] a copy of the law establishing the host country business entities.”\textsuperscript{384} Beyond this traditional scope of the foreign investment due diligence process, however, some scholars have proposed reforms that would include host States’ international human rights commitments in the due diligence review to be


conducted jointly by the investor with the host State. While it might seem at first glance that a State’s human rights commitments appear tangential to a foreign investor’s due diligence concerns, the effect of these competing commitments on the degree of policy uncertainty to be expected from the host State makes these commitments significant for an investor’s regulatory risk analysis.

An investor that seeks to ascertain the likelihood or probability that a host State would change the regulatory, administrative, or legislative framework at any point during the life of an investment must necessarily identify and anticipate the nature of the host State’s long-term commitments to social protection obligations under the ICESCR. It may be reasonable to expect that a host State that fails to meet its minimum core obligations under the ICESCR during economic crises, would conceivably prioritize such obligations over that of its obligations to investors (and thus possibly increase its default risk towards the latter). As emphasized in 2012 by Ariranga Pillay, the Chairperson of the Committee on Economic, Social and Cultural Rights, policy changes to implement the ICESCR should be expected during economic crises:

“The Committee has observed over recent years the pressure on many States Parties to embark on austerity programmes, sometimes severe, in the face of rising public deficit and poor economic growth. Decisions to adopt austerity measures are always difficult and complex, and the Committee is acutely aware that this may lead many States to take decisions with sometimes painful effects, especially when these austerity measures are taken in a recession….

Economic and financial crises, and a lack of growth, impede the progressive realization of economic, social and cultural rights and can lead


386 Id. at footnote 362.
to retrogression in the enjoyment of those rights. The Committee realizes that some adjustments in the implementation of some of these Covenant rights are at times inevitable. States Parties, however, should not act in breach of their obligations under the Covenant.

...the Committee emphasizes that any proposed policy change or adjustment [] has to meet the following requirements: first, the policy is a temporary measure covering only the period of crisis; second, the policy is necessary and proportionate, in the sense that the adoption of any other policy, or a failure to act, would be more detrimental to economic, social and cultural rights; third, the policy is not discriminatory and comprises all possible measures, including tax measures, to support social transfers to mitigate inequalities that can grow in times of crisis and to ensure that the rights of the disadvantaged and marginalized individuals and groups are not disproportionately affected; fourth, the policy identifies the minimum core content of rights, or a social protection floor, as developed by the International Labour Organisation, and ensures the protection of this core content at all times.”

Thus, to the extent that a host State’s continuing and dynamic commitments to comply with the ICESCR contributes to heightened policy uncertainty that could affect the investment, foreign investors would be well-advised to expand the scope of due diligence review, and concomitantly, the bases for assessing a State’s political or regulatory risks. Investors can obtain information on the ICESCR obligations assumed by States, as well as their degree of compliance with these obligations, from the publicly available and standardized periodic Articles submitted by States Parties to the Committee pursuant to the ICESCR monitoring process. Notably, within the same process, the Committee has enabled receipt of Articles and other information from non-governmental organizations (NGOs) to counterbalance and provide

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388 Economic and Social Council Resolution 1985/17 (which established the Committee on Economic Social and Cultural Rights), to assume the monitoring duties of the UN Economic and Social Council under Part IV of the ICESCR. See also Barbara von Tigerstrom, Implementing Economic, Social and Cultural Rights: The Role of National Human Rights Institutions, pp. 139-159 in ISFAHAN MERALI AND VALERIE OOSTERVELD (EDS.), GIVING MEANING TO ECONOMIC SOCIAL AND CULTURAL RIGHTS (University of Pennsylvania Press, 2001). See Article of the Secretary-General, Compilation of Guidelines on the Form and Content of Articles to be Submitted by States Parties to the International Human Rights Treaties, HRI/GEN/2/Rev. 6, 3 June 2009,
informational critiques on State Articles. Information sought by the Committee from the States Parties entails obtaining “detailed factual data”, such that the Committee regularly “meets with the representatives of the country after its review. During this meeting, which is open to the public, the [Committee] typically asks for further information or clarification.” Other international organizations and UN specialized agencies also regularly furnish information to the Committee to provide a broad-based view of a State Party’s compliance with various ICESCR rights.

The inclusion of the above data in the due diligence process is not in itself unusual, especially when taken alongside recent proposals for operationalizing “human rights risk assessments”:

“Taking a risk approach to human rights due diligence means answering the question ‘What is the actual, potential or perceived risk of company participation in human rights abuse in the country?’…The empirical work of risk assessment can be done through desktop research and by going to the field…[The] desk-top preparation phase serves as an initial scoping, looking for potential sources of risk. It looks at both the status of human rights in a particular country and at the status of human rights in the company’s operational environment. The objective is to establish good background information about the human rights situation relevant for the company’s operations and to identify priorities for deeper investigation…”

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389 See RICHARD PIERRE CLAUDE AND BURNS H. WESTON (EDS.), HUMAN RIGHTS IN THE WORLD COMMUNITY: ISSUES AND ACTION (3rd edition, University of Pennsylvania Press, 2006), at p 292; COMMITTEE ON ECONOMIC, SOCIAL AND CULTURAL RIGHTS: ARTICLE ON THE FORTY-SECOND AND FORTY-THIRD SESSIONS (United Nations Publications, 2010), at pp. 8-19 (on the overview of the working methods of the Committee in relation to the States Articles, receipt of information from sources other than States parties, Articles by non-Reporting State parties, adoption of concluding observations and general comments by the Committee).

390 DAVID P. FORSYTHE, ENCYCLOPEDIA OF HUMAN RIGHTS, VOL. I (Oxford University Press, 2009), at p. 93.

391 W. Benedek, The Normative Implications of Education for All (EFA): The Right to Education, pp. 295-312, at p. 307 in ABDULQAWI A. YUSUF (Ed.), STANDARD-SETTING IN UNESCO VOL. I: NORMATIVE ACTION IN EDUCATION, SCIENCE AND CULTURE (UNESCO Publishing/Martinus Nijhoff Publishers) (“UNESCO has a practice of assisting the CESC’s discussion of the education part of State Articles under the ICESCR through written comments or by being present in meetings as an observer…”). COMMITTEE ON ECONOMIC, SOCIAL AND CULTURAL RIGHTS: ARTICLE ON THE FORTY-SECOND AND FORTY-THIRD SESSIONS (United Nations Publications, 2010), at p. 165. Note, however, that the Committee has occasional problems, as with any UN treaty monitoring body, with non-submission of Articles or delayed Articles. See NIGEL D. WHITE, THE UNITED NATIONS SYSTEM: TOWARD INTERNATIONAL JUSTICE (Lynne Rienner Publishers, 2002), at p. 231.
Step 1: Read the international human rights Articles on the country available on the web and list what seem to be the most important human rights issues in the country…they will provide important information about the sources of human rights risk that the human rights community has been able to identify.

Step 2: Map or list the company’s operations, both underway and planned, in that country. Look for such internal documentation as country risk assessments, environmental and social impact assessments…

Step 3: Cross check 1 and 2 looking for obvious connections.

Step 4: Draw up a list of tentative risks, involving the nature of the harm and/or violation involved, the affected people, and potential connections to the company…

Step 5: Engage with relevant company personnel. Explain the objective of the assessment…

Step 6: Contact trusted external experts…Is a particular section of industry under particular scrutiny for some issues? …

Step 7: Prepare the staff of the company site for the visit…Especially in large companies, or where country managers or key managers at the corporate headquarters are skeptical, assume that it will take them time to adjust to the idea of human rights related assessments… Be sure to include those who may be in the field outside the head-office in the capital as they will be key to your access to field sites, local authorities, and possibly local communities…

Step 8: Speak with internal stakeholders. These include representatives of various departments in the company [which]…are directly tasked with functions which in fact help ensure respect for many key human rights. The purpose of these discussions is to understand the challenges that the company faces with regard to the human rights affected by their functions. This requires asking questions about potential harms…the level of control over these risks that the departments may have, the obstacles that some departments face in their human rights related efforts, etc…

Step 9: Speak with external stakeholders both in the capital, the region, and in the local footprint are of the company…Human rights risk assessments are not mechanical processes. It is very difficult to quantify human rights risk. Checklists or compliance questionnaires, while helpful as a starting point or as a cross-check, cannot capture the quality of the risk and, therefore, the range of potential mitigations. It seems likely that the single most effective way to identify, understand, and manage risks are through dialogue processes, such as stakeholder dialogue or the internal company risk workshop…

While numerous scholars have developed empirical methodologies for statistically estimating State compliance with the ICESCR using representative indicators and benchmarking, it must be noted that even the United Nations is itself already well into the process of establishing statistical and empirical databases to track States Parties’ compliance with the ICESCR. In 2006, the UN Office of the High Commissioner for Human Rights prepared a Article (“Indicators for monitoring compliance with international human rights instruments: a conceptual and methodological framework”) in response to the requests of chairpersons of the various human rights treaty bodies. The High Commissioner stressed the particular utility of setting up quantitative indicators for the task of treaty monitoring:

“…in the context of the ongoing reform of the treaty bodies in general, and the Reporting procedure in particular, it has been argued that the use of appropriate quantitative indicators for assessing the implementation of human rights – in what is essentially a qualitative and quasi-judicial exercise – could contribute to streamlining the process, enhance its transparency, make it more effective, reduce the Reporting burden and

393 See among others Edward Anderson, Using quantitative methods to monitor government obligations in terms of the rights to health and education, November 2008 unpublished paper, Center for Economic and Social Rights, available at http://www.cesr.org/downloads/Quantitative%20Methods%20for%20Measuring%20ESCR.pdf (last accessed 10 October 2012), at pp. 8-10 (which focuses more on a basic resource allocation framework and government obligations under the ICESCR, specifying policy variables such as taxation, subsidies, direct provision, and market regulation, as well as constraints such as the national budget); Gauthier de Beco, Human Rights Indicators for Assessing State Compliance for International Human Rights, 77 Nordic Journal of International Law 1-2 (2008), pp. 23-49 (which emphasizes that human rights indicators be used by treaty bodies, and identifies what kind of data sets would be required for such indicators); Robert E. Robertson, Measuring State Compliance with the Obligation to Devote Maximum Available Resources to Realizing Economic, Social and Cultural Rights, 16 Hum. Rts. Q. 693 (1994) (descriptively explaining resource allocation under the ICESCR, and how resource allocation ought to be measured from the vantage point of human resources, technological resources, information resources, natural resources, and financial resources); Sital Kalantry, Jocelyn E. Getgen, and Steven Arrigg Koh, Enhancing Enforcement of Economic, Social and Cultural Rights Using Indicators: A Focus on the Right to Education in the ICESCR, 32 Hum. Rts. Q. 2 (May 2010), 253-310 (which examines the specific treaty language, scope of the right, appropriate indicators to correlate with the state obligation, benchmarking progressive realization of the right, and identifying violations); Judith V. Welling, International Indicators and Economic, Social, and Cultural Rights, 30 Hum. Rts. Q. 4 (November 2008), 933-958 (identifying indicators from the ICESCR); Maria Green, What We Talk About When We Talk About Indicators: Current Approaches to Human Rights Measurement, 23 Hum. Rts. Q. 4 (Nov. 2001), 1062-1097.

above all improve follow-up recommendations and concluding observations, both at the committee, as well as the country, levels.”

The High Commissioner distinguished human rights “indicators” (e.g. “specific information on the state of an event, activity, or an outcome that can be related to human rights norms and standards, that address and reflect the human rights concerns and principles; and that are used to assess and monitor promotion and protection of human rights”), from “benchmarks” (e.g. “indicators that are constrained by normative or empirical considerations to have a predetermined value”), which the Committee on Economic, Social and Cultural Rights particularly favors. Indicators may be quantitative or qualitative. In defining the conceptual framework for human rights indicators, the High Commissioner drew attention to several methodological matters:

“First, there is a need to anchor indicators identified for a human right in the normative content of that right, as enumerated in the relevant articles of the treaties and related general comments of the committees. Secondly, it is necessary to reflect cross-cutting human rights norms or principles (such as non-discrimination and equality, indivisibility, accountability, participation and empowerment) in the choice of indicators. Thirdly, the primary focus of human rights assessment (and its value-added) is in measuring the effort that the duty-holder makes in meeting his/her obligations – irrespective of whether it is directed at promoting a right or protecting it. At the same time, it is essential to get a measure of the ‘intent or acceptance of’ human rights standards by the State party, as well as the consolidation of its efforts, as reflected in appropriate ‘outcome’ indicators. While such a focus recognizes an implicit linkage between the intent of a State party, its efforts in meeting those commitments and the consolidated outcomes of those efforts, the linkage may not always translate into a direct causal relationship between indicators for the said three stages in the implementation of a human right. This is because human rights are indivisible and interdependent such that outcomes and the efforts behind the outcomes associated with the

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395 Id. at footnote 394, at para. 3.

396 Id. at footnote 394, para. 7.

397 Id. at footnote 394, para. 12.

398 Id. at footnote 394, para. 8.
realization of one right may, in fact, depend on the promotion and protection of other rights…such a focus in measuring the implementation of human rights supports a common approach to assessing and monitoring civil and political rights, as well as economic, social and cultural rights…the adopted framework should be able to reflect the obligation of the duty-holder to respect, protect, and fulfill human rights.”

The High Commissioner then laid out a sequence for developing the conceptual framework defining indicators for substantive human rights: 1) identifying the “attributes” of a right (“limited number of characteristic attributes that facilitate the identification of appropriate indicators for monitoring the implementation of the right”); 2) defining the configuration of structural indicators (e.g. “the ratification/adoptions of legal instruments and existence of basic institutional mechanisms deemed necessary for facilitating realization of the human right concerned”), process indicators (e.g. “relating State policy instruments to milestones that become outcome indicators, which in turn can be more directly related to the realization of human rights…State policy instruments refer to all such measures including public programmes and specific interventions that a State is willing to take in order to give effect to its intent/acceptance of human rights standards to attain outcomes identified with the realization of a given human right”), and outcome indicators (e.g. “attainments, individual and collective, that reflect the status of realization of human rights in a given context…often a slow-moving indicator, less sensitive to capturing momentary changes than a process indicator”); 3) developing sources and data-generating mechanisms (e.g. socio-economic and administrative

399 Id. at footnote 394, para. 13. Italics in the original.

400 Id. at footnote 394, at para. 14.

401 Id. at footnote 394, para. 17.

402 Id. at footnote 394, para. 18.

403 Id. at footnote 394, para. 19.
statistics, events-based data on human rights violations); for the selection of quantitative indicators (e.g. “relevant, valid and reliable”, “simple, timely and few in number”, “based on objective information and data-generating mechanisms”, “suitable for temporal and spatial comparison and following relevant international statistical standards”, and “amenable to disaggregation in terms of sex, age and other vulnerable or marginalized population segments”).

Using the structure-process-outcome indicators framework, the High Commissioner has since drawn up lists of illustrative indicators on civil and political rights as well as economic, social and cultural rights, and subjected such indicators to a comprehensive validation process before international experts, members of global academia, non-governmental organizations, international organizations, and national level policy makers. Among the ICESCR rights covered in the list of illustrative indicators are the right to the enjoyment of the highest attainable standard of physical and mental health, the right to adequate food, the right to adequate housing, the right to education, the right to social security, the right to work, and the right to non-discrimination and equality. The High Commissioner had also previously issued a Handbook for National Human Rights Institutions on the implementation of the ICESCR. Notably, in 2012, the Office of the UN High Commissioner for Human

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404 Id. at footnote 394, paras. 24 and 25.

405 Id. at footnote 394, para. 26.


407 Id. at footnote 406 (see Annexes to the Article).

Rights issued its consolidated volume, “Human Rights Indicators: A Guide to Measurement and Implementation”, which further developed the structure-process-outcome indicators conceptual framework for determining State compliance with international human rights treaties, particularly the ICESCR.

Thus, while it may be said that the foregoing efforts towards empirical, quantitative, and qualitative verification of State compliance with the ICESCR appear to be incipient, it cannot be denied that, for purposes of regulatory risk analysis and the foreign investment due diligence process, there is at the very least, a wealth of information from which investors and host States can draw information mutually transparent and reasonably grounded “expectations” regarding the likelihood of legislative, administrative, regulatory or policy changes ensuing from a host State’s continuing and dynamic commitments towards social protection under the ICESCR.

In establishing the foreign investment due diligence process, host States may additionally access the expertise and information available to the Committee on Economic, Social and Cultural Rights, particularly towards assisting in the design of ICESCR-based human rights impact assessments of prospective foreign investments. Finally, other recent innovations in the UN system point towards recommended revisions of the foreign investment due diligence process, such as the

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411 See Bruno Simma and Diane A. Desierto, Bridging the Public Interest Divide: Committee Assistance for Investor-Host State Compliance with the ICESCR, pp. 1-15 in ESSAYS IN HONOUR OF EIBE RIEDEL (FESTSCHRIFT) (Duncker-Humblot, Berlin, 2012).
2011 Principles for Responsible Contracts issued by the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, (which recommends human rights risk assessment specifically built into different phases of the investment contracting process), and the 19 December 2011 Article of Special Rapporteur Olivier De Schutter to the UN Human Rights Council (“Guiding Principles on Human Rights Impact Assessments of Trade and Investment Agreements”), which proposed a

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1. Project negotiations preparation and planning: The parties should be adequately prepared and have the capacity to address the human rights implications of projects during negotiations.

2. Management of potential adverse human rights impacts: Responsibilities for the prevention and mitigation of human rights risks associated with the project and its activities should be clarified and agreed before the contract is finalized.

3. Project operating standards: The laws, regulations, and standards governing the execution of the project should facilitate the prevention, mitigation and remediation of any negative human rights impacts throughout the life cycle of the project.

4. Stabilization clauses: Contractual stabilization clauses, if used, should be carefully drafted so that any protections for investors against future changes in law do not interfere with the State’s bona fide efforts to implement laws, regulations or policies in a non-discriminatory manner in order to meet its human rights obligations.

5. ‘Additional goods or service provision’: Where the contract envisages that investors will provide additional services beyond the scope of the project, this should be carried out in a manner compatible with the State’s human rights obligations and the investor’s human rights responsibilities.

6. Physical security for the project: Physical security for the project’s facilities, installations or personnel should be provided in a manner consistent with human rights principles and standards.

7. Community engagement: The project should have an effective community engagement plan through its life cycle, starting at the earliest stages.

8. Project monitoring and compliance: The State should be able to monitor the project’s compliance with relevant standards to protect human rights while providing necessary assurances for business investors against arbitrary interference in the project.

9. Grievance mechanisms for non-contractual harms to third parties: Individuals and communities that are impacted by project activities, but not party to the contract, should have access to an effective non-judicial grievance mechanism.

10. Transparency/Disclosure of contract terms: The contract’s terms should be disclosed, and the scope and duration of exceptions to such disclosure should be based on compelling justifications.”

distinct methodology for deriving treaty language that balances human rights protection with investment priorities. The Guiding Principles explicitly require host States to prepare human rights impact assessments to be used in the due diligence and negotiating process for concluding trade and investment agreements, built according to the principles of independence, transparency, and inclusive participation.\footnote{Id. at part IV, paras. 4.1 to 4.7.}

C. ICESCR as an interpretive device to an IIA

To reiterate, no IIA to date makes any explicit reference to the ICESCR as either an integral part of the IIA or its enumeration of applicable law. If the ICESCR were to be read into the substantive standards of an IIA as part of the primary norm on investment “treatment” applied to investors by host States (whether through the fair and equitable treatment standard, the national treatment standard, or the MFN treatment standard), the same can be done so only as a “relevant rule of international law applicable between the parties” under Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT).\footnote{Vienna Convention on the Law of Treaties, Article 31(3)(c).} Bruno Simma and Theodore Kill have previously argued in favor of a cautious use of this provision of the VCLT, showing that investment treaties enjoy the presumption of compliance with other relevant rules of international law, and that, when properly argued, international human rights norms in particular satisfy the test of “relevance” contemplated in this provision of the VCLT.\footnote{Bruno Simma and Theodore Kill, Harmonizing Investment Protection and International Human Rights: First Steps towards a Methodology, pp. 678-707 in CHRISTINA BINDER, ET AL., INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY: ESSAYS IN HONOUR OF CHRISTOPH SCHREUER (Oxford University Press, 2009).} This approach has not yet been tested in arbitral jurisprudence, particularly since few tribunals invoke VCLT Article 31(3)(c) to justify using human rights
treaties to interpret investment treaty standards. In its 2008 Decision on Jurisdiction and Admissibility, the arbitral tribunal in *Micula and ors v. Romania* invoked VCLT Article 31(3)(c) to support its additional consideration of Article 15 of the Universal Declaration of Human Rights, in the process of interpreting a BIT’s nationality requirements for investors.\(^4\)\(^1\) The *Saluka Investments v. Czech Republic* arbitral tribunal also depended upon VCLT article 31(3)(c), in order to take account of the customary international law principle “that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order.”\(^4\)\(^2\) While the *amici curiae* in *Biwater Gauff v. Tanzania* argued generally for a human rights-sensitive interpretation of a BIT, on the reasoning that “human rights and sustainable development issues are factors that condition the nature and extent of the investor’s responsibilities, and the balance of rights and obligations as between the investor and the host State,”\(^4\)\(^3\) the tribunal merely took the observation into consideration in its factual assessment of the investor’s acts and omissions, and not with respect to the interpretation of specific standards of the BIT.\(^4\)\(^5\) Insofar as the Reported arbitral awards arising from the 2001-2002 Argentine crisis are concerned,

\(^{417}\) *Micula and ors v. Romania*, Decision on Jurisdiction and Admissibility, ICSID Case No. ARB/05/20, 24 September 2008, at paras. 86-88.

\(^{418}\) *Saluka Investments BV v. Czech Republic*, Partial Award, PCA (UNCITRAL), 17 March 2006, at paras. 254-255:

> 254. The Tribunal acknowledges that Article 5 of the Treaty in the present case is drafted very broadly and does not contain any exception for the exercise of regulatory power. However, in using the concept of deprivation, Article 5 imports into the treaty the customary international law notion that a deprivation can be justified if it results from the exercise of regulatory actions aimed at the maintenance of public order. In interpreting a treaty, account has to be taken of ‘any relevant rules of international law applicable in the relations between the parties’ – a requirement which the International Court of Justice (ICJ) has held includes relevant rules of general customary international law.

> 255. It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner *bona fide* regulations that are aimed at the general welfare.”

\(^{419}\) *Biwater Gauff (Tanzania) Ltd. v. Tanzania*, Award and Concurring and Dissenting Opinion, ICSID Case No. ARB/05/22, 18 July 2008, at para. 380.

\(^{420}\) Id. at footnote 417 at para. 601.
Argentina’s arguments based on human rights norms appear to have been left undeveloped, and certainly did not employ the Simma-Kill methodology for invoking external rules through VCLT Article 31(3)(c). In any event, arbitral tribunals are loathe to invoke VCLT Article 31(3)(c) as a gateway for human rights treaty norms, in the absence of any perceived textual ambiguity. Using the ICESCR as an interpretive foil to an IIA standard requires meeting the threshold of the unitary system of interpretation under the Vienna Convention on the Law of Treaties.

Another way of using the ICESCR as an interpretive device to an IIA would be to accept that a host State’s good faith compliance with the ICESCR could be an equitable basis to temper compensation, especially for non-expropriation compensation that is usually not provided for under the text of the IIA. As discussed

421 CMS Gas Transmission Company v. Argentina, Award, ICSID Case No. ARB/01/8, 25 April 2005, paras. 114, 121 [“In this case the Tribunal does not find any such collision (between the Argentine Constitution and the arbitration. First because the Constitution carefully protects the right to property, just as the treaties on human rights do, and secondly because there is no question of affecting fundamental human rights when considering the issues disputed by the parties.], Siemens AG v. Argentina, Award and Separate Opinion, ICSID Case No. ARB/02/8, 6 February 2007, at para. 79 (“79. … In this respect, the Tribunal notes the reference made by Argentina to international human rights law ranking at the level of the Constitution after the 1994 constitutional reform and implying that property rights claimed in this arbitration, if upheld, would constitute a breach of international human rights law. This argument has not been developed by Argentina. The Tribunal considers that, without the benefit of further elaboration and substantiation by the parties, it is not an argument that, prima facie, bears any relationship to the merits of this case.”); Azurix Corporation v. Argentina, Award, ICSID Case No. ARB/01/12, 23 June 2006, at para. 261 (“261. The Respondent has also raised the issue of the compatibility of the BIT with human rights treaties. The matter has not been fully argued and the Tribunal fails to understand the incompatibility with the specifics of the instant case. The services to consumers continued to be provided without interruption by ABA during five months after the termination notice and through the new provincial utility after the transfer of service.”).

422 Berschader and Berschader v. Russian Federation, Award and Correction, SCC Case No. 080/2004, 21 April 2006, at para. 95; Azurix Corporation v. Argentina, Decision on Application for Annulment, ICSID Case No. ARB/01/12, 1 September 2009, at para. 90. Although note that tribunals, have sparingly resorted to VCLT Article 31(3)(c) as a means of treaty interpretation in other contexts that did not involve human rights assertions. See Yukos Universal Ltd. v. Russian Federation, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 227, 30 November 2009, paras. 260 and 309; Veteran Petroleum Ltd v. Russian Federation, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 228, 30 November 2009, paras. 260 and 309; Gulley Enterprises Ltd. v. Russian Federation, Interim Award on Jurisdiction and Admissibility, PCA Case No. AA 226, 30 November 2009, paras. 260 and 309; Kardassopoulos v. Georgia, Decision on Jurisdiction, ICSID Case No. ARB/05/18, 6 July 2007, paras. 207-208.
elsewhere, increased policy uncertainty owing to the dynamic nature of ICESCR obligations and State compliance thereto should be reflected in upward estimations of both the investment beta and the equity risk premium in a standard capital asset pricing model, thus resulting in a lower compensation value. Moreover, resort to the “fair market value” standard for determining compensation in non-expropriation breaches of an IIA is pure arbitral discretion: “[t]he customary rule of full compensation is of a very general nature and it does not offer a conceptual framework for the recovery of damages that would be comparable in specificity to the ‘value’ approach generally applicable in expropriation cases. Rather, it provides a general principle, according to which any loss suffered and established must be compensated in full. The generality of the customary rule provides tribunals with flexibility as to what the precise methodology for assessing damages should be in a specific case.”

The legal basis for awarding compensation for non-expropriation breaches of an IIA is ultimately, the law of compensation under the general law of international responsibility as codified under Article 36 of the ILC Articles on State Responsibility. This form of compensation is in no way intended to be punitive, exemplary, or expressive, and is in fact imposed on condition that such compensation must be equitably determined from the perspective of both the injuring party and the injured party: “[a]s to the appropriate heads of compensable damage and the principles of


424 Id. at footnote 423, at p. 142.

425 SERGEY RIPINSKY AND KEVIN WILLIAMS, DAMAGES IN INTERNATIONAL INVESTMENT LAW (BIICL, 2008), at pp. 90-91.

assessment to be applied in quantification, these will vary, depending upon the content of particular primary obligations, an evaluation of the respective behavior of the parties and, more generally, a concern to reach an equitable and acceptable outcome."\(^{427}\) Following these rules, it is not too surprising that in the 19 June 2012 Judgment of the International Court of Justice in *Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo) (Compensation owed by the Democratic Republic of the Congo to the Republic of Guinea)*\(^{428}\) – incidentally the only decision on compensation to date that the Court has issued in a case of diplomatic protection – the total compensation claim of US $11,590,148 (for mental and moral damage, injury to Mr. Diallo’s reputation, loss of earnings during detention and following his expulsion, material damage, and loss of potential earnings), was whittled down by the Court to an award of US $85,000 (for non-material injury suffered by Mr. Diallo) and US$10,000 (for material injury suffered by Mr. Diallo in relation to his personal property).\(^{429}\)

Most significantly, the *Diallo* Judgment on Compensation was an occasion for the Court to stress the rule that “[q]uantification of compensation for non-material injury rests on equitable considerations”,\(^ {430}\) in light of the practices of the Human Rights Committee, the African Commission on Human and Peoples’ Rights, arbitral tribunals and regional human rights courts such as the European Court of Human Rights and the Inter-American Court of Human Rights. Applying this recent


\(^{429}\) Id. at footnote 428, at paras. 10 and 61.

\(^{430}\) Id. at footnote 428, at para. 24. Italics added.
approach by the Court to the particular circumstances of an investor asserting non-material injuries arising from IIA standards *that do not involve expropriation* (such as the fair and equitable treatment standard), a host State’s good faith compliance with the ICESCR must be taken, at the very least, by the arbitral tribunal as a substantial equitable basis to prevent awarding compensation levels to an investor at the full “fair market value” ordinarily imposed by the IIA for direct or indirect expropriations. If the IIA is itself silent on the matter of compensation for breaches of non-expropriation standards in the IIA, it is not appropriate or consistent with the equitable process of determining compensation under the general law of international responsibility for the arbitral tribunal to summarily import the just compensation level of “full fair market value” that the States Parties merely intended for cases of direct or indirect expropriation.

A final way in which the ICESCR can be used as an interpretive device to an IIA is to re-examine the obligations of the home State of an investor. While most IIAs ordinarily will not contain substantive obligations of the home State in relation to regulating the conduct of its investor-nationals, it has been proposed that investor and home State obligations be included:

“….directly in the IIAs as opposed to leaving it up to the host country to regulate under its domestic legislation. An example of this is the proposal submitted by China, Cuba, India, Kenya, Pakistan and Zimbabwe in November 2002 to the WTO’s now-moribund Working Group on Trade and Investment (WGTI). In this proposal, these countries suggested that any discussion in the WTO on a multilateral framework on trade and investment should also look at ‘legally-binding measures aimed

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at ensuring corporate responsibility and accountability relating to foreign investors, including measures that clearly spell out investors’ obligations and the obligations of their home governments'. These countries stressed ‘the right of host members to regulate foreign investors and the need for foreign investors to undertake obligations in line with host members' interests, development policies and objectives’ and that investors ‘should strictly abide by all domestic laws and regulations in each and every aspect of the economic and social life of the host members in their investment and operational activities. Further, in order to ensure that the foreign investor meets its obligations to the host member, the cooperation of the home member’s government is often necessary, as the latter can, and should, impose the necessary disciplines on the investors. The home member’s government should therefore also undertake obligations, including to ensure that the investor’s behavior and practices are in line with and contribute to the interests, development policies and objectives of the host member.’

Some of the proposals include directly incorporating binding guidelines, standards, or verifiable benchmarks for human rights compliance by multinational enterprises, such as the OECD Guidelines for Multinational Enterprises as well as the UN Global Compact. The draft Norwegian Model BIT of 2007 attempted to introduce the concept of investor obligations and home State obligations in language that appeared non-binding, although an institutional avenue was opened through the establishment of a Joint Committee of the Contracting Parties, through which the States Parties could discuss these new obligations and mutually decide to amend the Agreement accordingly in the future. However, Norway subsequently revoked this draft Model BIT after much public criticism that the draft text had supposedly failed

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432 Id. at footnote 431 (Yu and Marshal), at p. 4.

433 Id. at footnote 431 (Muchlinski), at pp. 18-20.


Short of actual treaty practice indicating specific requirements imposed upon investors and their home States to ensure compliance with human rights obligations, the ICESCR may still be invoked independent of the IIA as against the home State that is a party to both the ICESCR and the IIA. As an ICESCR party, the home State is bound to ensure that its nationals do not act in ways that cause violations of the State’s fundamental obligations to ‘respect’, ‘protect’, and ‘fulfill’ ICESCR rights.\footnote{See ICESCR Article 2(1).}

In the investment context, home States may find guidance for implementing their fundamental general obligation under Article 2(1) ICESCR through the “UN ‘Protect, Respect and Remedy’ Framework for Business and Human Rights” (otherwise known as the “UN Framework”).\footnote{Article of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, “Protect, Respect and Remedy: A Framework for Business and Human Rights”, A/HRC/8/5, 7 April 2008, full text available at \url{http://www.Articles-and-materials.org/Ruggie-Article-7-Apr-2008.pdf} (last accessed 10 October 2012).} The UN Framework articulates three core principles arising from international human rights treaty practices: “the State duty to protect against human rights abuses by third parties, including business; the corporate responsibility to respect human rights; and the need for more effective access to remedies.”\footnote{Id. at footnote 437, p. 1.}

As an example of this Framework’s salience to investment processes, the Special Rapporteur drew attention to the role of “export credit agencies” (ECAs, which “finance or guarantee exports and investments in regions and sectors that may
be too risky for the private sector alone“439) as the frequent home State mechanism within investment contracting processes. ECAs, in the Special Rapporteur’s view, ought to have a significant role in ensuring due diligence on potential human rights impacts: “relatively few ECAs explicitly consider human rights at any stage of their involvement...a strong case can be made that ECAs, representing not only commercial interests but also the broader public interest, should require clients to perform adequate due diligence on their potential human rights impacts.”440 The recommended scope of due diligence to anticipate potentially adverse human rights impacts is described below:

“...The process inevitably will be inductive and fact-based, but the principles guiding it can be stated succinctly. Companies should consider three sets of factors. The first is the country contexts in which their business activities take place, to highlight any specific human rights challenges they may pose. The second is what human rights impacts their own activities may have within that context – for example, in their capacity as producers, service providers, employers, and neighbours. The third is whether they might contribute to abuse through relationships connected to their activities, such as with business partners, suppliers, State agencies, and other non-State actors. How far or how deep this process must go will depend on the circumstances.

For the substantive content of the due diligence process, companies should look, at a minimum, to the international bill of rights and the core conventions of the ILO, because the principles they embody comprise the benchmarks against which other social actors judge the human rights impacts of companies.”441

The Special Rapporteur further noted that human rights impact assessments can be linked with other forms of (company or regulatory) risk assessments, but in such cases should include “explicit references to internationally recognized human

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439 Id. at footnote 437, para. 39.

440 Id. at footnote 437, paras. 39-40.

441 Id. at footnote 437, at paras. 57 and 58. Italics added.
An appropriate due diligence process will not only ensure that the investor anticipates regulatory risk, but also avoids complicity in creating human rights-related harms. The 2011 Guiding Principles on Business and Human Rights further describes the appropriate contours of human rights due diligence:

“17. In order to identify, prevent, mitigate and account for how they address their adverse human rights impacts, business enterprises should carry out human rights due diligence. The process should include assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses and communicating how impacts are addressed. Human rights due diligence:

(a) Should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships;

(b) Will vary in complexity with the size of the business enterprise, the risk of severe human rights impacts, and the nature and context of its operations;

(c) Should be ongoing, recognizing that the human rights risks may change over time as the business enterprise’s operations and operating context evolve…

18. In order to gauge human rights risks, business enterprises should identify and assess any actual or potential adverse human rights impacts with which they may be involved either through their own activities or as a result of their business relationships. This process should:

(a) Draw on internal and/or independent external human rights expertise;

(b) Involve meaningful consultation with potentially affected groups and other relevant stakeholders, as appropriate to the size of the business enterprise and the nature and context of the operation…

19. In order to prevent and mitigate adverse human rights impacts, business enterprises should integrate the findings from their impact assessments across relevant internal functions and processes, and take appropriate action…”

442 Id. at footnote 437, at para. 61.
443 Id. at footnote 437, at para. 73.
While an ICESCR-adjusted due diligence process better enables the host State and the investor to assess and estimate the regulatory risks of a given investment project, there is little room within a foreign investment contract for the responsibility of the home State of the investor. For this reason, and to ensure that the home State of the investor can also be held to account, the ICESCR obligations assumed by the home State of the investor - and not just the host State of the investment – must be adequately reflected in the IIA to likewise ensure that the home State remains responsible for preventing possible ICESCR violations arising from investor conduct.

III. REGULATORY RISK ASSESSMENT FOR DIVERSE ASSETS

Apart from reforming the investment due diligence process to enable a more accurate assessment of the regulatory risks arising from host States continuing and dynamic substantive obligations under the ICESCR, it is also important to adjust the regulatory risk assessment process considering the risks attendant to the nature of the asset and how that will be affected under the assumption that the host State will continue implementing ICESCR obligations during the life of such an investment.

While “investment” holds numerous meanings in IIAs and may encompass various types of economic assets (physical infrastructure, financial assets, contract rights, among others), the extensive scope of the ICESCR means that it could potentially figure in just about any form of investment. The ICESCR provides for the right to work and to just and favourable work conditions, the right to form or join


446 ICESCR Article 6(1), Article 7.
trade unions and the right to strike, the right to social security, the right to an adequate standard of living (including adequate food, clothing and housing), the right to the enjoyment of the highest attainable standard of physical and mental health, right to education (including compulsory and freely available primary education, access to secondary and higher education), and the right to take part in cultural life and benefit from moral and material interests from any scientific, literary, or artistic production.

A. Differentiating regulatory risk assessments for asset type

A host State’s obligation to “respect, protect, and fulfill” these rights under the ICESCR would necessarily have to differentiate between potential human rights impacts of a foreign direct investment (such as, for example, infrastructure, utilities, and mining operations of investors), as opposed to financial investments traded in the secondary markets. The regulatory risks affecting either type of investment would have to be assessed by also considering the possible impact of the host State’s continuing compliance with the ICESCR on the prospects of any future changes (if any) on the particular regulatory framework governing the kind of investment involved. Karl Sauvant has discussed the different regulatory risks that are emerging according to different types of investment assets:

“[m]uch of [] regulatory uncertainty and threat of FDI protectionism

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447 ICESCR Article 8.
448 ICESCR Article 9.
449 ICESCR Article 11.
450 ICESCR Article 12.
451 ICESCR Article 13.
452 ICESCR Article 15.
focuses on cross-border M&As, as greenfield FDI continues to be almost uniformly welcome, regardless of the type of investor that undertakes it...From a host country perspective, however, cross-border M&As do not add to its productive capacity (at least immediately), but merely represent a change in ownership from domestic to foreign hands. Moreover, such transactions are often accompanied by restructuring, typically implying job losses or the closing down of activities, in order to increase the efficiency of the assets involved, integrate them profitably into the new parent or simply assure their survival. A more cautious attitude toward cross-border M&As can therefore have a major impact on FDI flows. Caution can be heightened if the acquirers are private equity groups, are from emerging markets, or are state-controlled entities.”

Other types of investment assets for which Sauvant also identifies potential regulatory risk concerns include: 1) private equity acquisitions of assets “that have a strong social dimension...private equity groups are not regarded as strategic investors interested in, and bound to, the long-term economic development of a host country”; 2) equity acquisitions by emerging market companies in companies that perform sensitive public service or national security functions; and 3) equity acquisitions by sovereign wealth funds (“seen as potential threats and/or strategic competitors...a defensive reaction against the ‘new kids on the block’ can combine with national security concerns to provoke restrictive legislation and action”).

Furthermore, one can also expect differences in the methods of assessing or estimating regulatory risks, when the valuation process for investment also varies in suitability depending on the asset type. The “market or sales comparison approach”


454 Id. at footnote 453, p. 236.

455 Id. at footnote 453, p. 237.

456 Id. at footnote 453, pp. 238-239.
derives the estimated value of an investment in comparison with “similar businesses, business ownership interests, and securities that have been sold in the market. The three most important common sources of data used in the market approach are public stock markets in which ownership interests of similar businesses are traded, the acquisition market in which entire businesses are bought and sold, and prior transactions in the ownership of the subject business.”457 This method depends considerably on the reliability of comparator data – which may not necessarily be high when it comes to the assessment of regulatory conditions affecting the investment vis-à-vis those affecting the businesses to which the investment is compared. Very “unique” projects will make it difficult to aggregate the “suitable market price” if the project has a specific market that is not easily replicable in other jurisdictions.458

On the other hand, the “income approach” focuses on estimating the “expected future financial benefits and discounting them to present value”, which “considers income and expense data relating to the property being valued and estimates value through a capitalization process.”459 The main difficulty with this method lies with the choice of the discount rate,460 where the risk premium component (including country risk, political risk, regulatory risk) might not adequately capture the host State’s economic circumstances affecting the investment

457 Irmgard Marboe, Calculation of Compensation and Damages in International Investment Law (Oxford University Press, 2009), at p. 189.

458 Id. at footnote 457, at p. 190, para. 5.13.

459 Id. at footnote 457, at pp. 206-207.

460 Id. at footnote 457, at p. 24
enough to yield a reliable forecast. As has been rightly observed:

“For the selection of the discount rate it is important to identify the rates on alternative investments available to potential buyers or investors. The greatest difficulty lies in the comparability of the investment, in particular in terms of risk... An enterprise’s risk is usually divided into ‘systematic’ and ‘unsystematic’ (‘specific’ or ‘subjective’) risk. The former entails, for example, general economic conditions, environmental risks, political environment – thus generally events or problems that are equal for all businesses or for the entire industry. Examples of ‘unsystematic’ risks are risks specific to the company, such as the market position of the company... qualification of management, and the financial situation of the business.”

Further complications from the income approach arise if the valuation includes “future prospects” in relation to the investment contract, where “it has been suggested that in this case, the legitimate expectations of the investor should be taken into account.” As discussed in Part II, the estimation of such legitimate expectations often neglects to consider the investor’s counterpart expectations of regulatory risks, especially those arising from a host State’s continuing and dynamic obligations towards social protection under the ICESCR.

The third valuation approach, otherwise known as the “asset-based or cost approach”, refers to the estimation of the value of an investment “based on the market value of individual business assets less liabilities.” This approach does not appear be amenable to assessing regulatory risk and its potential role, if any, on the ultimate

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461 Id. at footnote 457, at pp. 228-232. See Diane A. Desierto, ICESCR Minimum Core Obligations and Investment: Recasting the Non-Expropriation Compensation Model during Financial Crises, 44 George Washington International Law Review 101 (2012). Note that while some valuation experts assess country risk as the premium over the “risk-free rate” to represent volatility differences between debt and equity markets, the reliability of this “risk-free rate” in an era of prolonged financial crises may be in serious doubt. See Black Rock Investment Institute, Sovereign Bonds: Reassessing the Risk-Free Rate, April 2011, available at https://www2.blackrock.com/webcore/litService/search/getDocument.seam?venue=PUB_IND&source=GLOBAL&contentId=1111135895 (last accessed 10 November 2012).

462 Id. at footnote 457, p. 246. Italics added.

463 Id. at footnote 457, at pp. 232-242, at 232.

464 Id. at footnote 457, at p. 268.
value of an investment, since the method behind this approach focuses on the valuation of discrete asset items, and thus does not lend itself to the analysis of intangible assets and other external impacts on the value of the investment entity as a whole.  

Finally, it must also be emphasized that the methods for estimating or assessing regulatory risks for financial investment assets expectedly differ with methods for assessing regulatory risks for foreign direct investments such as physical infrastructure or utilities operations in the host State. Risks in a financial investment asset are usually estimated within the standard Capital Asset Pricing Model (CAPM), which in its most basic form, is specified as:

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E(R_i) = R_F + \beta_i [E(R_M) - R_F]
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where \(E(R_i)\) is the estimated value of the capital asset, \(R_F\) is the risk-free rate, \(\beta_i\) is the investment beta, \(E(R_M)\) is the expected market return, and \([E(R_M) - R_F]\) is the equity market premium. The investment beta is intended to measure the “sensitivity (volatility) of the rate of return on an individual security (or a portfolio of securities) to general rates of return in the public stock markets.” The higher the investment beta, the more sensitive the value of the investment is to the price fluctuations of the overall market. An investment beta higher than 1.0 reflects greater uncertainty, causing the discount rate to increase, and ultimately decreases the present value of an investment. The equity market premium, on the other hand,

465 Id. at footnote 457, at p. 269, para. 5.276.

466 EDWIN J. ELTON, MARTIN J. GRUBER, STEPHEN J. BROWN, WILLIAM N. GOETZMANN, MODERN PORTFOLIO THEORY AND INVESTMENT ANALYSIS (John Wiley & Sons, 2009), at p. 332.

467 MARK KANTOR, VALUATION FOR ARBITRATION: COMPENSATION STANDARDS, VALUATION METHODS, AND EXPERT EVIDENCE (2008), at 164.

468 Id. at footnote 467, at 165.
“measure[s] the additional return the investor will require before investing in a portfolio that contains such an investment, as compared with the risk-free investment.” Variables that determine the equity risk premium have been identified to include: (1) investor risk aversion and consumption preferences, (2) the health and predictability of the overall economy, (3) information about firm earnings and cash flows, (4) illiquidity costs (or the costs of trading the asset), (5) catastrophic risk (e.g., “events that occur infrequently but can cause dramatic drops in wealth”), and (6) government policy, where uncertainty about government policy can translate into higher equity risk premiums. This last determinant of the equity risk premium on government policy is what will be particularly affected by policy uncertainty to be anticipated from a host State’s continuing and dynamic obligations under the ICESCR.

In contrast, foreign direct investment will additionally require examining industry-specific regulatory risks. In the context of the renewable energy sectors in the United States and Canada, Guy L.F. Holburn has argued that variables such as the “institutional structure of regulatory agencies” in the industry or sector, as well as the “degree of autonomy from elected political institutions”, will affect the level of regulatory risk since “regulators are more likely to resist political pressures”. On the other hand, specific environmental regulations (as well as future changes) can be expected to apply in particular to the mining industry as well as other forms of long-

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469 Id. at footnote 467, at 165.


471 Id. at footnote 4, at p. 1.
term infrastructure such as utilities and telecommunications. A host State’s continuing and dynamic obligations towards social protection under the ICESCR can be anticipated to play a significant role in the adaptation of industry-specific regulations. The regulatory risk estimation, in this case, should not be cabined into the CAPM but rather designed in a way that introduces other explanatory variables taking into account specific regulatory risks appertaining to the host State’s ICESCR compliance in relation to the industry.

The explication of new investment valuation or estimation models, taking into account a broader understanding of regulatory risks arising from ICESCR compliance at the macroeconomic level as well as ICESCR compliance necessitated at the industry level, comprise suggested areas for future research.

B. Normative Guidance for Risk Assessment: UN Principles and the UNCTAD Investment Policy Framework for Sustainable Development

When designing an appropriate regulatory risk assessment process within IIAs that takes into account a host State’s fundamental social protection obligations, it should be noted that normative guidance can be drawn from the UN Principles of Responsible Investment (hereafter, “UN Principles”) and the UNCTAD Investment Policy Framework for Sustainable Development (hereafter, “IPFSD”). The UN Principles constitute voluntary undertakings of institutional investors to incorporate environmental, social, and corporate governance issues into investment analysis, decision-making processes, ownership policies, and processes, and also encourages

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compliance Reporting in the implementation of the Principles.\textsuperscript{474} The IPFSD, on the other hand, is composed of Core Principles for investment policymaking for sustainable development, that are in turn fleshed out and applied through National Investment Policy Guidelines, and also serve as the conceptual foundation for policy options and recommendations for various elements in negotiating new IIAs.\textsuperscript{475}

While both the UN Principles and the IPFSD are recent initiatives, already efforts have commenced towards gathering baseline data to help determine investors’ compliance with the UN Principles and host States’ use of the IPFSD. In 2012, the Reporting Framework for the UN Principles was piloted to provide a set of standardized indicators “relevant and to the point for all investors, with separate pathways for direct and indirect investors and specific asset class supplements.”\textsuperscript{476} Some institutional investors have voluntarily made available their individual responses to the Reporting framework for the years 2008-2011, and the UN has made available aggregated data on these responses in annual Articles on Progress from 2007-2011.\textsuperscript{477} The data obtained under the Reporting Framework will be aggregated and finalized into a comprehensive database with the prescribed indicators for compliance measurement by October 2013. On the other hand, UNCTAD has opened various sections of the IPFSD (such as Policy Options for IIAs) for public comment and annotation, especially based on particular country experiences. A November 2012 article by John Kline noted the deficiency in the IPFSD as the lack of a “process implementation tool that can help evaluate the multiple, interactive, effects

\textsuperscript{474} Id. at footnote 473, Principles 1-6 of the UN Principles.

\textsuperscript{475} Id. at footnote 473, at pp. 7-9 of the IPFSD.

\textsuperscript{476} The process for the Reporting Framework on the UN Principles is described here: \url{http://www.unpri.org/Reporting/framework.php} (last accessed 10 October 2012).

\textsuperscript{477} For the links to the Articles, see \url{http://www.unpri.org/Reporting/result.php} (last accessed 10 October 2012).
of FDI proposal across economic, environmental, social, and governmental objectives”, recommending a quantitative and qualitative approach to evaluate the extent to which social and environmental regulations and the host State’s development priorities would be affected by proposed foreign direct investment. As UNCTAD garners more country responses on the IPFSD’s impact on national investment policy programming, it is hoped that the individual and aggregated data will be accessible for future research.

These examples are meant to illustrate that, for purposes of determining the regulatory risk of an investment, there are increasing data pools available regarding the host State’s social protection commitments and level of compliance. Future research would benefit from tracking these other normative and empirical sources.

CONCLUSION

“...an uncertainty which can by any method be reduced to an objective, quantitatively determinate probability, can be reduced to complete certainty by grouping cases. The business world has evolved several organization devices for effectuating this consolidation, with the result that when the technique of business organization is fairly developed, measurable uncertainties do not introduce into business any uncertainty whatever....the present and more important task is to follow out the consequences of that higher form of uncertainty not susceptible to measurement and hence to elimination. It is this true uncertainty which, by preventing the theoretically perfect outworking of the tendencies of competition, gives the characteristic form of "enterprise" to economic organization as a whole and accounts for the peculiar income of the entrepreneur.”

- Frank H. Knight, Risk, Profit, and Uncertainty (1921)

“The terms ‘certain’ and ‘probable’ describe the various degrees of rational belief about a proposition which different amounts of knowledge authorize us to entertain. All propositions are true or false, but the knowledge we have of them depends on our circumstances, and while it is often convenient to speak of propositions as certain or probable, this expresses strictly a relationship in which they stand to a corpus of knowledge...”


Regulatory risk inimitably involves forecasting the future decisions and policies of a State. There are numerous variables that can affect the trajectory of this particular risk in relation to the longer time horizons of investments as opposed to other commercial transactions. This Article acknowledges the significance of one such variable – policy uncertainty arising from the host State’s continuing and dynamic obligations under the ICESCR. It has attempted to show that the objective of achieving regulatory predictability and stability in modern IIAs need not rule out including dynamic and evolving host State obligations under the ICESCR when assessing regulatory risks. On the contrary, a more realistic estimation of regulatory risk requires factoring in sources of policy uncertainty that can already be detected at the time of the establishment of an investment. The host State’s continuing international obligations towards social protection under the ICESCR is particularly relevant to this analysis, because they involve legitimately competing demands on the State’s fiscal and economic resources during the life of an investment.

As this Article has shown, the compensability of breaches of IIAs that involve observable regulatory risks (e.g. the fair and equitable treatment standard vis-à-vis the indirect expropriation standard) has not been a consistent process of determination for arbitral tribunals in the investor-State dispute settlement process. Much of the arbitral jurisprudence generated thus far and identified in this Article reflect uneven conceptions of regulatory risk, and varying theories of how to determine a host State’s liability for compensation when such regulatory risks materialize. As seen in Part I, the underlying problems behind this inconsistency lie with the textual formulation of specific IIA provisions, as well as heterogeneous arbitral

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480 John Maynard Keynes, A Treatise on Probability (original publication 1921, reprint by Dover Publications 2004), at p. 4.
interpretations of such treaty language. Part II proposes measures to recast the estimation of regulatory risk by building in ICESCR compliance from the prism of IIA design and interpretation; reforming the due diligence process in foreign investment contracting to detect the structure-process-outcome illustrative indicators to determine the investment’s compliance with the ICESCR; amending the valuation process of compensation for non-expropriation standards to reflect the broader conception of regulatory risk arising from the policy uncertainty to be expected from ICESCR compliance; as well as exploring the potential role of the home State of the investor who is the counterparty to the IIA in ensuring ICESCR compliance in foreign investments covered by the IIA. Part III stresses the importance of differentiating regulatory risk assessment methods in light of the impact of ICESCR compliance obligations on the nature of the particular investment asset.

Regulatory predictability does not equate to static or frozen host State regulations, and investors cannot easily assume that legislation and regulations at the time of the establishment of an investment will remain, and be implemented in, completely the same manner, in perpetuity. The ordinary workings of government recognize adaptation, amendment, and change, and what is most important is to establish a legal framework within which the investor can adequately, sufficiently, and transparently track and predict such regulatory changes as would affect the investment.

It is for this reason that this Article invites attention to the fundamental design of IIAs as well as foreign investment contracts to capture the dynamic and continuing social protection obligations of host States under the ICESCR. It is submitted that the identification of regulatory risks, as well as the management of expectations of such risks, must be the collective and joint enterprise of the host State, the investor, as well
as the home State of the investor who is the Party to the IIA. While the information asymmetry on regulatory risks would probably lean more towards the host State who is expectedly privy to its own governmental policies, distribution programs, and fiscal priorities, this does not excuse the investor as well as its home State from active participation in the dialogue on monitoring and assessing regulatory risks, if only to avoid or mitigate damage or loss from such risks materializing in the future. As the arbitral tribunal in *Generation Ukraine v. Ukraine* rightly observed,

“Predictability is one of the most important objectives of any legal system...It would enhance the sentiment of respect for legitimate expectations if it were perfectly obvious why, in the context of a particular decision, an arbitral tribunal found that a governmental action or inaction crossed the line that defines acts amounting to an indirect expropriation. But there is no checklist, no mechanical test to achieve that purpose... The fact that an investment has become worthless obviously does not mean that there was an act of expropriation; investment always entails risk...”^481

Finally, this Article also aimed to demonstrate the critical role of the arbitral tribunal in the valuation process, in particular for investment losses arising from the materialization of regulatory risks. Where the regulatory risk arises from host State conduct that prohibitively creates moral hazards and incentivizes adverse selection, there can be no doubt that the ensuing breaches of the IIA towards the investor would indeed be compensable. The actual degree, however, of this compensability, must be scrupulously scrutinized. As shown in this Article, there has been a disquieting automatic tendency on the part of several arbitral tribunals to equate the fair market value of the investment as the level of compensation for breaches of the IIA that do not even amount to expropriation. Where policy uncertainty anticipated from ICESCR is properly managed and fused into the design of an IIA (as well as the

^481*Generation Ukraine v. Ukraine*, Award, ICSID Case No. ARB/00/9, 15 September 2003, paras. 20.29-20.30.
investment contract), dynamic host State regulations or policy flexibility to ensure continued social protection need not be prohibited or penalized *ex ante* as compensable breaches of an IIA. The regulatory risk premium cannot, and should not, be conservatively estimated when the investor has long been made aware of the host State’s continuing and dynamic obligations under the ICESCR, and corollarily, of the potential changes that ought to be anticipated for the regulatory framework of the investment in order to enable the host State to comply with such social protection obligations. Host States must likewise apprise investors of required compliance with the minimum core obligations under the ICESCR even during economic or financial crises. Where States Parties and investors have been transparently and timely informed of this continuing dimension of regulatory risk on the value of an investment, there can be no justifiable claim to compensation for losses arising from the materialization of ICESCR-adjusted regulatory risk.

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