Introduction

Periodic efforts to negotiate binding multilateral rules governing foreign investment have caught the attention of the wider public – albeit usually when these efforts have failed. In 1998, negotiations at the Organization for Economic Cooperation and Development (OECD) collapsed after concerns began to be raised about the impact of the proposed rules upon domestic policymaking in sensitive areas such as culture and the environment. More recently, at the 2003 Ministerial Conference of the World Trade Organization (WTO) in Cancun Mexico, efforts to launch negotiations on investment as part of the Doha round of trade negotiations were opposed by dozens of developing countries. And since Cancun, the European Commission (EC) - which negotiates on behalf of the United Kingdom (UK) and the other European Union (EU) member-states at the WTO - has retracted its demand that investment need form part of the Doha round of negotiations; however, the EC continues to champion optional investment negotiations on a plurilateral basis, amongst a sub-group of willing WTO members. This more limited agenda has also met with opposition from many WTO members, and various non-governmental development campaigners, who warn that such an agreement would entail serious costs for poorer countries, for little clear benefit, and might simply be a stalking horse for a more ambitious agreement at a later date.¹ For its part, the UK has reportedly diverged from the EC’s position on investment, arguing that it would be better to remove investment from the WTO agenda altogether.²
Thus, as the likelihood of multilateral investment negotiations recedes, it becomes even more important to focus attention upon the UK’s extensive and growing catalogue of bilateral agreements. These treaties were designed in an effort to protect foreign investors from egregious or arbitrary treatment at the hands of a foreign state. However, litigation under bilateral investment treaties has increased sharply worldwide in the last half-decade - with investors putting the agreements to a range of unanticipated uses – including claims that a wide range of government policies, including health, environmental and tax measures, may violate the treaty provisions. While considerable legal uncertainty surrounds such claims – with many of them still in the process of being resolved by international tribunals – it is apparent that the treaties may harbour wide and potentially serious implications for sustainable development.

In its original formulation by the UN’s Brundtland Commission, sustainable development was described as ‘development that meets the needs of the present without compromising the ability of future generations to meet their own needs.’ While economic growth constitutes an essential driver of sustainable development, so too does the capacity of governments to regulate that economic activity so as to minimize its environmental externalities and maximize its contribution to the alleviation of poverty and the improvement of livelihoods.

Recently, the UK Department of Trade and Industry has hailed foreign direct investment for its capacity to contribute to economic growth, and ‘thus to the achievement of the Millennium Development Goals’. Nevertheless, emerging evidence casts doubt on the claim that investment treaties play an important role in stimulating those desired investment flows. At the same time, as noted above, concerns are emerging that common treaty provisions could interfere, in some instances, with government’s ability to tax and regulate investment so that it can be harnessed to sustainable development.

Despite the fact that questions are emerging about the policy implications of these bilateral treaties, the UK Foreign & Commonwealth Office (FCO) indicates that it has no current plans to amend these agreements so as to address such concerns. Likewise, while the UK Government has insisted that any multilateral investment negotiations should guarantee the ability of developing countries ‘to negotiate whatever exceptions and safeguards they feel necessary’, the FCO signals that it has no intention of adjusting its negotiating policy at the bilateral level. This is highly significant given that the bilateral arena is where further binding investment rules are likely to be concluded for the foreseeable future.

This paper offers an overview of the UK Investment Promotion and Protection Agreements program, including a survey of its origins and the standard treaty provisions. It highlights concerns which first emerged under similar investment rules contained in the North American Free Trade Agreement (NAFTA), and subsequently under other bilateral treaties – namely, that treaty rules may be used to claim compensation for damages arising out of environmental, health or other forms of government regulation which impact negatively upon foreign investors. This paper offers a cataloguing of known disputes under the UK’s IPPAs, and highlights several of the procedural and substantive concerns which suggest that the broader pattern of investment treaty arbitration could open up certain unexpected liabilities for host governments – both in the developing and developed world.

### History and Contents of UK Treaty Program

The UK Investment Promotion and Protection Agreement (IPPA) programme dates to the early-1970s and owes its inspiration to earlier national treaty programme pioneered by European nations such as Germany and Switzerland, as well as the 1962 Organization of Economic Co-operation and Development (OECD) Draft Convention on the Protection of Foreign Property. The treaties were a response on the part of a number of Western capital-exporting nations to a series of developments including: a wave of nationalizations of foreign investments in the developing and post-colonial world; increasingly charged political rhetoric, particularly in the UN General Assembly as to the third world’s sovereign right to nationalize foreign property; and an ongoing disagreement as to the applicable international law standards related to compensation in the event of such property dispossession. British industry played a leading role in advising the FCO on the design of the treaty template which was then put to partners throughout the developing world.

All IPPAs share a core set of disciplines, but closer scrutiny does reveal certain differences from country to country, as well as over time. Broadly speaking, the treaties provide investors with compensation in the event of nationalization, expropriation and other equivalent measures; guarantee certain minimal standards such as entitlement to ‘fair and equitable treatment’ and ‘full protection and security’; offer some protection against losses in the event of conflict or war; affirm the right to repatriate profits and other returns; and guarantee treatment in line with that accorded by the host state to investors of its most-favored nation or to the host state’s own nationals. Several of these provisions are spelled out in more detail in later sections of this paper.
The UK treaties tend to cover a broad range of investments (including movable and immovable property, shares, debt instruments, intellectual property rights and business concessions), and offer their protection to any foreign national or firm (typically defined by incorporation under the laws in any part of the home state) operating in the territory of the other country. As a rule, the treaties stipulate that investments will need to be made in accordance with the host state’s laws – which reserves to the host a right to screen incoming investments. However, once a foreign investor has ‘established’ an investment in the other state’s territory, then it will enjoy the rights and protections set out in the relevant IPPA.

Although the treaties protect investment which is established in the host’s territory, increasing doubt is cast upon the ability of the treaties to stimulate new investments. A study by World Bank economist Mary-Hallward Driemeier, and featured in the Bank’s 2003 Global Economic Prospects report, suggests that ‘Countries that had concluded a [Bilateral Investment Treaty] BIT were no more likely to receive additional FDI than were countries without such a pact.’ Such findings cast doubt on what was viewed as an important premise during the drafting of the IPPA program, namely, in the words of Lord Shawcross, ‘... that the capital importing countries in return for agreeing to abide by the generally recognized procedures of international law, will receive more private investment and with the capital, the benefits of the technical and commercial skills which go with them than would otherwise be the case.’

While increased investment flows may often prove illusory, the investor protections have proven anything but. The treaty rules are binding under international law upon the two parties to the agreement, and investors can employ a powerful arbitration mechanism to allege breaches of the treaty rules, and request compensation for losses arising from these breaches. Rarely will this path to arbitration require that the foreign investor first exhaust domestic legal remedies. This stands in contrast to other forms of international legal remedies, including under the European Convention on Human Rights, where claimants must begin in local courts, unless prevented from doing so. While UK citizens alleging mistreatment at the hands of their own government must join the queue in local courts, foreign business interests may have recourse to a form of international arbitration which has been described even by sympathetic commentators as a form of ‘private justice in the service of merchants’.

This form of ‘private justice’ represents a notable contrast from WTO practice (where recourse to that organization’s powerful dispute settlement procedures is reserved for WTO member states, not private actors) and from most other international economic treaties, which generally allow only State-to-State dispute settlement. And in recent years, specialized arbitration institutions handling these types of claims have reported a steady increase in the number of such disputes. A major stimulus for this surge in investor-state arbitration has been the experience of foreign investors under the NAFTA, which incorporates BIT-style investment rules, and which has seen a series of high-profile investor claims mounted against one or another of the NAFTA Governments.

**NAFTA Generates Attention for Investment Rules**

When in 1996 the Government of Canada introduced a law which would have banned the import and inter-provincial trade in a controversial gasoline additive, MMT, the sole producer and importer of that additive, the US-based Ethyl Corporation took refuge in protections contained in NAFTA’s investment chapter. Ethyl signaled its intent to arbitrate the matter, and its legal claim alleged damages of 200 million US dollars. ‘Having expropriated the investment of Ethyl Corp,’ the company warned, ‘the Government of Canada must pay compensation.’

Ethyl’s claim shone a spotlight on the hitherto-ignored investment provisions of the NAFTA, and the case set off alarm bells when the Government of Canada reached a settlement with the investor: agreeing to withdraw its proposed ban on MMT, issue a letter of apology and award $13 million US in compensation to the company.

Critics lamented this turn of events, warning that the NAFTA threatened to transform the environmental movement’s cherished ‘polluter pays’ principle’ into a ‘pay the polluter principle’. For its part, The Ethyl Corporation maintained that the Government of Canada had lacked sufficient evidence of MMT’s inimical health and environmental impacts, and had wrongly chosen to use a trade ban to accomplish what health and environmental regulation could not justify.

The Ethyl arbitration served to galvanize the attention of the international bar – pointing to the potential utility of the NAFTA’s investor rules for challenging a broad range of government measures which allegedly harmed the investments of foreign operators. And, following the Ethyl case, a string of multi-million dollar NAFTA arbitration claims were mounted by foreign investors, against everything from alleged denial of justice at the hands of a Mississippi jury to the alleged expropriation of a US-based mining operation by virtue of newly introduced regulations requiring the back-filling and restoration of certain sensitive areas subject to open-pit cyanide gold mining.
With most of these claims still before tribunals, it too early to generalize about the precise policy implications of the NAFTA investor provisions; many lawyers – including arbitrators charged with interpreting the agreements - concede that the import of the vaguely-worded treaty rules are not well fleshed out, and will vary depending upon the facts of a given claim.\(^{17}\) In the mean time, because standard bilateral investment treaties contain many of the same provisions as those found in the NAFTA, foreign investors are dusting off the NAFTA’s obscure cousins, and using them in an effort to challenge objectionable government treatment. Some of the questions which the treaties raise are set out in subsequent sections.

**Disputes are Proliferating, but the Precise Extent is Unknown**

For many years, observers had tended to view the UK programme’s success primarily in terms of its role as a ‘deterrent’ to nationalization or other egregious interference with an investment - rather than through the actual use of the treaties by investors in formal legal contexts.\(^{18}\) And during the first two decades of that programme there had been only a single arbitration mounted by a UK investor against a host state.\(^{19}\) However, in the last decade, the author is aware of at least ten arbitrations which have been mounted by UK investors against countries which include Guyana, Hungary, Egypt, Argentina, and Russia (see box 1). More than half of these claims have been mounted in the last two years, which is in line with broader trends which have seen record numbers of bilateral investment treaties registered.\(^{20}\)

However, a full accounting of these types of international disputes – let alone an analysis of their policy implications - is impossible due to the peculiar rules under which arbitrations are handled. The treaties may provide several different arbitral avenues for aggrieved investors and not all of these require that arbitrations be publicly disclosed, let alone open to the public or the media.\(^{21}\) This is problematic given that investment treaty cases against sovereign governments may centre upon matters of serious public consequence, and harbour significant implications for the public purse. Indeed, on occasion, arbitral tribunals have acknowledged the ‘undoubtedly public interest’ in the subject matter of some of these investor-state disputes.\(^{22}\) Nevertheless, the rules of arbitration prevent tribunals from opening proceedings to the public, in the absence of the consent of the two parties – or even, in the case of some rules, to acknowledge the very existence of an arbitration. With these serious limitations borne in mind, the following information about investor claims under UK IPPAs may well represent only the visible portion of a larger legal iceberg.

### Known Disputes under UK IPPAs

As far as can be gathered, the UK has yet to face an IPPA claim by a foreign investor. However, at least ten claims have been mounted by UK investors against foreign governments. Simply because a dispute is known to have been brought to arbitration does not guarantee that information about that case will be made public. In the case of one claim by a UK-incorporated financial services firm against Russia, following that nation’s financial crisis and restructuring of its domestic bond obligations in 1998, all that is known is that a claim was mounted at the Stockholm Arbitration Institute and that the Russian Government settled the suit for an undisclosed sum.\(^{23}\)

By contrast, a claim launched by Booker plc, a subsidiary of the UK-based Big Food Group, against Guyana in 2001, attracted a rare degree of publicity in

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**Box One: List of known arbitrations under UK IPPAs**

**i) Settled or abandoned claims**

- Russian Financial Crisis case, registration date unknown
- Booker PLC. v. Guyana (ICSID) registered in 2001
- AES v. Hungary (ICSID) (BIT and ECT) registered in 2001

**ii) Concluded**

- AAPL v. Sri Lanka (ICSID) registered in 1987
- Wena Hotels v. Egypt (ICSID) registered in 1998
- William Nagel v. Czech Republic (ICSID) registered in 2002

**iii) Pending**

- JacobsGibb Ltd. v. Jordan (ICSID) registered in 2002
- Joy Mining Machinery Ltd v. Egypt (ICSID) registered in 2003
- National Grid v. Argentine Republic (UNCITRAL) registered in 2003
- British Gas v. Argentine Republic (UNCITRAL) registered in 2003
- AWG group plc v Argentine Republic (UNCITRAL) registered in 2003
the UK press. The case related to debts long-ago incurred by Guyana due to its 1976 expropriation of a sugar plantation. Although Guyana had come to terms with the investor, and had paid annual compensation installments for many years, the two sides agreed a temporary lull in the payments, whilst Guyana considered a re-privatization of its sugar industry. When the country opted against privatization, Booker plc renewed its compensation claims, seeking 11 million US dollars and a further 8 million in interest; after a period of fruitless negotiation, the investor submitted the dispute to a World Bank arbitration facility using Guyana's consent to arbitration contained in the UK-Guyana IPPA.

This arbitration was roundly criticized by debt campaign group, Jubilee Research, which warned that the demands for compensation could complicate Guyana's qualification for debt relief under an International Monetary Fund (IMF) scheme. Jubilee noted that relief from multilateral and bilateral creditors hinged upon Guyana's ability to secure similar concessions from its commercial creditors (including Booker plc). Following a spate of embarrassing publicity, the company agreed to abandon its arbitration.

In recent months, several UK-incorporated firms have launched IPPA claims against Argentina for losses arising out of the emergency measures taken by the Government during its financial crisis. Along with a number of foreign-owned operators of privatized utilities, these UK firms object to strict measures put into place by Argentina, which have, on the one hand, removed the one-to-one peg between the US Dollar and the Argentine Peso, and, at the same time, refused to let utility tariffs charged to customers rise in order to stem increasing losses from payment received in highly-devalued pesos. Interviews with one lawyer representing certain foreign investors against Argentina suggest that these firms contend that the Government's measures, when they lead to significant financial loss, are equivalent to expropriation in line with the definition used in an earlier NAFTA ruling: 'covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.'

Other cases launched by UK-incorporated firms have seen successful damages claims mounted in the case of outright deprivation of an investment due to violence or military conflict. While another UK IPPA claim brought to the Stockholm Arbitration Institute against the Czech Republic resulted in a ruling in favor of the Czech Government. That case saw an investor allege that the Czech authorities had reneged on a promise to award him a GSM mobile phone license. According to sources familiar with the arbitration, the tribunal ruled that the alleged agreement between the investor and the Czech authorities did not constitute an investment under the relevant IPPA, and the tribunal dismissed the claim in its entirety. However, the award has not been disclosed by the parties – so a careful review of the case is not possible.

Indeed, a number of the claims discussed in this section have been settled, discontinued, resolved under confidential terms or are still pending – as such they do not serve to clarify many of the more sensitive concerns which are emerging under this type of investment treaty arbitration. Rather, it can be expected that they are the vanguard of a wider number of such cases which will appear in the coming years.

Looking beyond the known claims under UK IPPAs to the broader universe of claims under the more than 2000 known bilateral treaties, two things can be stated with certainty. First, it is clear that BITs may be used by foreign investors in virtually any economic sector – unless that sector is expressly carved out of the treaty. The author is aware of arbitrations relating to investments in the following sectors: television and radio broadcasting, waste management, banking, insurance, water and sanitation provision, electricity generation, and the building of university and medical facilities.

Second, while the UK does not appear to have been the target of a foreign investor lawsuit under any of its IPPAs, this is unlikely to remain the case. As a number of developing countries become significant capital exporters, they are more likely to avail themselves of investment treaty protections to challenge treatment at the hands of Western governments. The UK Government should note that foreign investors in private finance initiative (PFI) projects, or in other privatized services (e.g. rail service operators) would enjoy rights under relevant IPPAs to bring claims in the event of a conflict with the government or its authorities. Moreover, in cases where an investor hails from a nation which has not concluded an IPPA with the UK, foreign investors may be able to incorporate in a home-state-of-convenience in order to avail themselves of an investment treaty in place between that state and the UK.

In other words, the UK should expect that foreign firms looking to invest in the UK, but not hailing from a home state which has an IPPA with the UK (a group which includes most developed nations), may seek to channel that investment through an intermediary country which has an IPPA with the UK. Accordingly, the threat of arbitration appears much more likely than it had been when these agreements were first introduced – and when they were thought to represent
a largely unidirectional tool for UK investors confronting obstacles in the developing world. At the same time, as arbitrations under these treaties begin to proliferate, questions are being raised about the suitability of arbitration as a mechanism for resolving such disputes. Indeed, the Australian government resolutely opposed the inclusion of such an investor-state mechanism in the investment rules which were recently negotiated with the United States as part of a broader free trade agreement, although Australia has signed up many developing countries to such a process through its own programme of bilateral investment treaties, it balked at providing such an avenue to litigation-savvy US investors.\(^\text{35}\)

While this marks a notable retreat, there remains a possibility that US investors might be able to avail themselves of investor-state arbitration against Australia, by virtue of incorporating subsidiaries in a territory which does have a full investment treaty with Australia, and channelling investment through that subsidiary. Indeed, US investors in India are known to have adopted this tactic in order to avail themselves of investment treaties concluded by India with Mauritius.\(^\text{36}\) By the same token, the UK should note that its own treaties might expose it to arbitration not only from investors of its numerous developing country treaty-partners, but also from developed-country investors, investing in the UK via a developing country. Given the likelihood that investor-state arbitration will remain a viable (and increasingly visible) avenue of recourse for foreign investors with claims against the UK, it is important to look more closely at this process of dispute settlement.

**Uncertainty Engendered by the Use of Investor-State Arbitration**

For foreign investors, arbitration of disputes can be a highly-attractive proposition, particularly where local courts are corrupt or unreliable. In contrast to local court rulings, arbitral awards are enforceable in many jurisdictions - including in territories where a host government may have funds - thanks to international conventions such as the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, this method of alternative dispute resolution which was designed primarily for commercial disputes, typically involving two business entities, is proving rather ill-suited to the resolution of investment treaty disputes between investors and host governments.

Because treaty arbitrations are not handled by a single international institution the process of dispute settlement can yield overlapping or even conflicting interpretations of treaty rules. In strict legal terms, a given tribunal's decision (or award) is binding only on the two parties to the arbitration. Although it is widely conceded that earlier awards will be highly persuasive for future tribunals, there is no requirement that tribunals follow the lead of earlier tribunals. Matters are further complicated by the fact that individual shareholders in a given investment may be able to mount separate treaty claims - each of which could be resolved by a separate tribunal. As a result, international tribunals may operate in parallel, and ultimately hand down awards which diverge from - or even flatly contradict – each other. This has already occurred in one notable instance where two related treaty claims were brought by a European broadcasting firm and its chief US shareholder against the Czech Republic.\(^\text{37}\) The disputes arose out of alleged actions and omissions on the part of the Czech Government and its media regulation agency, which were said to have violated many of the substantive provisions contained in investment treaties concluded by the Czech Government with the Netherlands and the United States.\(^\text{38}\)

Following an examination of the cases by two separate international tribunals, these bodies would issue – within 10 days of one another – awards which reached essentially contradictory conclusions. One tribunal held that the Czech Republic had committed no significant violations of the Czech Republic's investment treaty commitments, whilst a second tribunal found multiple violations and awarded an unprecedented damages award amounting to 350 million US dollars with interest. Arbitration can be relied upon to resolve a dispute, but it may not be relied upon to resolve like cases in a like manner. This shortcoming has led arbitrators to question the ‘legitimacy’ of the current dispute settlement system under these treaties – with one expressing the fear that the process was in danger of becoming a legal ‘casino’.\(^\text{39}\)

While this arbitral casino could be an especially inhospitable environment for those nations with meager bankrolls, it should be noted that even OECD nations, like the Czech Republic, have found that a single treaty award can have enormous repercussions. After losing one of the two aforementioned claims, the public sector deficit of the Czech Republic was effectively doubled – and the government was forced to consider a variety of solutions to compensate the affected investor, including an increase in value added tax on goods and services.\(^\text{40}\)

Of course, it is far from certain that a given investment treaty claim will succeed, and those which do may well succeed for good reasons, such as malfeasance, abuse or other mistreatment perpetrated by a host government. Nevertheless, the untransparent and uncertain process by which arbitration takes place does not provide sufficient public confidence given the
Expropriation and the Right to Regulate Inward Investment

It is virtually standard for investment treaties to include provisions which set out the terms under which governments may nationalize, expropriate or take measures equivalent to expropriation of property. For a long time, the expropriation language was deemed relatively uncontroversial and appeared to prohibit both outright takings of property, as well as so-called creeping expropriation (i.e. where a series of government measures serve to deprive an investor of their investment). More recently, questions have been raised as to whether governments may in fact owe a duty to compensate foreign investors where a government has exercised its regulatory powers over an investor or changed a policy – leading to some losses – or where a government has acted for protective purposes (e.g. banning a product which poses a public health threat). For example, recent cases under the NAFTA have seen investors challenge bans or restrictions on the use of agrochemicals (lindane) or controversial gasoline additives (MTBE), while recent BIT cases have seen investors in the water and sewage services industry or natural gas transportation business challenge their treatment at the hands of tax, regulatory or administrative authorities.41

Without prejudging the merits of the cases alluded to above, it bears notice that extremely sensitive regulatory questions may be resolved through investment treaty arbitration. For example, in one of the water services arbitrations alluded to above, it is known that the investor and the government have fallen out over a range of sensitive administrative and regulatory questions including ‘the method for measuring water consumption, the level of tariffs for customers, the timing and percentage of any increase in tariffs, the remedy for non-payment of tariffs, the right of (the investor) to pass-through to customers certain taxes and the quality of the water delivered’.42

Nevertheless, it remains unclear in this and other cases to what extent rules on expropriation will apply to what is known as a state’s exercise of its ‘police powers’ under international law.43 To date, arbitrations have yet to delineate a clear boundary between compensable expropriations and legitimate exercises of a state’s powers to regulate. Several tribunals have shown a troubling predilection for focusing upon the extent of impact upon the affected investor, rather than the purpose underlying the impugned government measures.44 However, in at least one instance, a tribunal has affirmed that some category of ‘valid governmental activity’, for example, certain forms of taxation, environmental regulation or zoning decisions will not be deemed to be an expropriation.45

With a growing number of other claims pending, some governments have recognized that further steps may need to be taken in order to reduce the uncertainty in this area. For example, the United States has begun to insert language into new investment rules, in an effort to clarify that ‘except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation.’46 However, the FCO dismisses any need to underscore a host government’s right to regulate in such contexts, on the rather puzzling grounds that they have had no ‘expressions of concern from business regarding this area’.47

Likewise, the FCO indicates that it has no plans to clarify that tax measures imposed by host states are not generally understood to constitute expropriation. Yet, as matters now stand, treaties are subject to some ambiguity as to what level of taxation might be construed as an expropriation. As one tax lawyer observes ‘it is not necessary to establish a total deprivation or abandonment of an investment in order to demonstrate expropriation’; the difficulty comes in drawing the line between legitimate taxation and expropriation.48 Some governments have responded to uncertainty in this area through more careful and detailed drafting of investment treaties. For instance, the Government of Japan has developed extensive treaty language which clarifies that the imposition of taxes ‘does not generally constitute expropriation’ and that ‘A taxation measure will not be considered to constitute expropriation where it is generally within the bounds internationally recognized tax policies and practices.’49 By contrast, however, UK IPPAs are silent on this question – giving no special guidance to tribunals which might be confronted with investor claims that a given tax measure is ‘equivalent to expropriation’. The UK Treasury ought to countenance the possibility that excessively high taxes imposed upon a foreign investor could give rise to a challenge under any of its stable of IPPAs, as some investment lawyers have cautioned.50

Ultimately, foreign investment is most likely to contribute to sustainable development in contexts where governments are free to regulate and/or tax that investment so that it can be harnessed to domestic
policy objectives such as social services, environmental protection, poverty-alleviation or the provision of other public goods – at the same time that investors enjoy sufficient certainty that they can invest under predictable terms. While such a balancing-act is difficult to sustain in the abstract, it is the case that treaty-language clarifying a government’s right to regulate could serve to thwart a certain category of capricious litigation, and to ensure that host governments (particularly those in the less developed countries) are not scared away from exercising legitimate forms of government oversight, for fear of costly international lawsuits.

Transfers of capital

It is common for investment treaties to guarantee to foreign investors the right to transfer capital related to their investments out of the host territory. Indeed, few rights are as essential to investors as the ability to repatriate profits and returns from an investment (including upon its sale or liquidation). Often, however, UK IPPAs will subject this right of transfer to certain exceptions in the case of a serious balance-of-payments or other financial difficulty in the host state. Exact formulations of this exception differ from treaty to treaty, with many insisting that some forms of transfers (e.g. profits) not be subject to any limitations, at the same time as other proposed transfers (e.g. sums generated by a sale or liquidation of the investment) may be transferred in smaller amounts over a prescribed time period.

From about 1991, however, it became exceedingly rare for UK treaties to permit any sort of restrictions upon transfers in the event of financial or economic difficulties. Interestingly, this policy appears not to have changed even after a series of international financial crises served to rehabilitate somewhat the case for the use of limited capital controls in certain grave economic crises.

Moreover, UK treaty policy seems to be at odds with policy at the European level which recognizes that restrictions on transfers may be necessary in extreme circumstances; for example, EC Treaty rules which safeguard the right of the European Council of Ministers (on advice of the European Central Bank) to restrict transfers where capital movements might jeopardize the European Economic or Monetary Union. Indeed, the very absence of such safeguard provisions in certain investment treaties concluded by accession candidates to the EU has led the European Commission to push for amendment to those treaties before those countries accede to the EU.

In September of 2003, the European Commission and the United States signed a memorandum of understanding, which sought to address EC concerns over a series of investment treaties concluded by the US with eight central and eastern European nations, including Poland, the Czech Republic and Bulgaria. Notably, the Commission and the United States failed to agree upon amendments to the transfer provisions - seemingly because the US fears that any changes to its BITs would put US investors at a disadvantage compared with other investors from third countries who retain investment treaties with existing EU member-states, (and which treaties may impose no restrictions upon capital transfers). Nevertheless, the two parties undertook to consult further on the matter.

Whatever the outcome of the EC-US consultations, the controversy has highlighted the fact that a number of BITs concluded by existing EU member-states - including virtually all of the UK’s post-1990 IPPAs – accord little flexibility to developing countries in the event of financial crises, and furthermore, appear to be out of line with EU legal practice in this regard.

Non-Discrimination amongst Domestic and Foreign Investors

The UK’s IPPAs typically guarantee ‘national treatment’ and ‘most-favored nation treatment’ (MFN). In practice, this means that foreign investors and their investments will be treated in a manner which is not less favorable than the treatment accorded to the UK’s own domestic investors and investments, or the treatment reserved for the investors and investments of any third state. As noted earlier, this promise is reserved for investments at the post-establishment stage – that is to say, those which have already entered the country according to any conditions which may be set out in the treaty.

Several potential implications for sustainable development can be glimpsed here.

In the debate at the World Trade Organization over a prospective investment agreement, a number of developing countries have expressed a desire to retain the ability to favor local enterprises in some circumstances. Indeed, the UK Government went further in a June 2003 briefing on the WTO negotiations, where it noted that ‘developing countries should be able to negotiate whatever exceptions and safeguards they feel necessary.’

Virtually all IPPAs contain two standard exceptions to the grant of national treatment and MFN treatment which are designed to protect the host state’s ability to discriminate with respect to tax matters and to ensure that states need not pass along benefits flowing from their membership in a regional trade agreement or customs union (including membership in the EU).

However, at the bilateral level, the UK’s investment agreements rarely contain exceptions and safeguards
designed to introduce a degree of development-flexibility. Typically, rules on non-discrimination are comprehensive, reaching into all corners of the economy touched by foreigners. Only rarely, do the treaties set out economic sectors or activities which will be exempted from the reach of the non-discrimination obligation. One recent IPPA concluded with Vietnam is notable for the inclusion of an annex which sets out a variety of exceptions made by Vietnam with respect to the requirement that it accord national treatment to foreign investors; these include, among others, broadcasting; television; press; telecom services; banking services; insurance services; fisheries; and the exploitation of oil and gas. Another variation found in a small percentage of IPPAs is some exception for ‘special incentives’ or ‘government aids’ provided by a host state to its own nationals or companies in an effort to stimulate the creation of local industries. However, these types of exceptions are rare and there appears to have been an evolution in UK treaty practice over time, with fewer such exceptions having been entered in recent years.58

Given the broad reach of the non-discrimination obligation, and the scarcity of exceptions, both the UK and its treaty partners ought to note that a wide range of measures might be subjected to review under these treaties. Developing countries might find that they are unable to create special incentives or policies designed to encourage small and medium enterprises; while the UK might find that perceived discrimination in favor of UK firms could lead to legal challenge. For example, under the NAFTA, the Canadian Government has been confronted with a $160 million dollar claim alleging that Canada’s postal monopoly unfairly subsidizes a separate courier business to the detriment of US-based UPS which has significant investments in the Canadian market.59 It remains to be seen to what extent, the UK might be vulnerable to comparable claims alleging – to take one example - that the state-funded British Broadcasting Corporation unfairly subsidizes media ventures in new technological formats (e.g. the Internet or yet-to-be-invented media) which serve to disadvantage foreign players competing in those sectors of the UK economy. Certainly, the author is not aware of the UK having adopted language in any of its treaties comparable to that which Chile has included in a recent investment agreement with the United States: an exception noting that ‘government supported subsidy programs’ in the cultural industries (including television, radio, etc.) are not subject to the legal disciplines spelled out in the investment agreement.60

Of course, it is unclear how a tribunal would resolve a prospective claim against the UK for its subsidy of new forms of public media but it is important to point out that there is no obvious bar to such claims being mounted; nor do IPPAs contain treaty language designed to defend such subsidies from legal challenge under the treaty. This is not surprising. The very possibility of claims against the UK did not appear to have been countenanced seriously during the formative years of the IPPA program.61 But, as these agreements have now been confirmed to operate reciprocally, disciplining developed, as well as developing, countries, there may be a need to re-examine the UK’s negotiating template in light of this reality.

Given that sustainable development entails careful consideration for the needs of future generations, the emerging uncertainties under the UK IPPA program ought to be closely examined and monitored. As some governments have already learned, investment treaties are not as benign as had long been thought. While providing a useful bulwark for foreign investors, the agreements may circumscribe the power of governments in unanticipated respects and expose the government to serious financial liability. The concluding section offers some suggestions as to steps that might help to minimize the prospect that future generations will be saddled with unanticipated and potentially onerous liabilities with respect to its treatment of foreign investors.

Conclusions

As foreign investors have shown greater interest in these long-ignored investment agreements, a number of questions have come to the fore. While the system of dispute resolution under the agreements hinders a full accounting and analysis of investor-state claims, it is already clear that governments may find that certain policy measures imposed upon foreign investors – including most legislation, regulatory measures, administrative decisions and certain forms of taxation - may be challenged through binding arbitration under international law in the event that they appear to damage a foreign investor’s interests. Although the treaties were often concluded on the expectation that they would be rarely invoked – and serve only to stimulate new investment flows - in many instances closer to the opposite may have occurred. Studies have questioned the importance of BITs in stimulating new investment flows, at the same time that foreign investors have shown increased appetite for using investment treaties in an effort to challenge treatment which bears negatively upon their interests. While it bears repeating that investor protection represents a legitimate interest, it also must be noted that these treaties could, in some instances, protect rather too well – to the detriment of governments’ ability to regulate and govern investment so that it conforms to domestic developmental and environmental priorities.
By signing vast numbers of these agreements, governments have sailed quietly into uncharted legal territory and even OECD governments should be prepared for at least some legal challenges under these agreements. This will entail, among other things, careful monitoring of the emerging case-load, jurisprudence, and policy implications which are arising under these treaties. In turn, this may require improvements to the rules under which such arbitration takes place, so that the government and other interested parties can monitor and assess this burgeoning area of international law. The FCO has indicated that it would supply information about any arbitrations against the UK Government. However, in the absence of any binding requirement that such cases be publicly registered when they are launched, the public may be reliant upon the UK Government to acknowledge the very existence of a case, before any requests for detailed information would be forthcoming from the public. Other more troubling features of the arbitration process – from the in-camera nature of proceedings to the prospect for multiple tribunals to work at cross-purposes to each other – may only be rectified by amendment to existing treaties, by alterations to future ones, or design of permanent, standing international dispute resolution procedures.

Likewise, any clarification of substantive provisions, for example clearer statements that tax, environmental or health regulations rarely constitute expropriation – would need be undertaken by amendment to the treaty and revision of the template for future such agreements. With respect to developing countries, for which these treaties were more expressly designed, it should be expected that they will continue to face treaty challenges by UK-incorporated investors. Here, questions can be raised about the capacity of the poorest developing countries to defend against this type of specialized international arbitration, given the costs and uncertainty entailed by the process. It might be the case that the UK Government could look to capacity-building and technical assistance programs designed to educate officials in the least-developed countries about emerging treaty implications and strategies for winnowing out the more entrepreneurial of investor claims. At the same time, a more open and predictable method of dispute resolution would help observers to assess which claims may be justified by government malfeasance, corruption or other mistreatment - and which claims may pose worrying threats to a government’s ability to regulate for social, environmental or other important purposes. With many questions still to be resolved, it is already clear that the current process of dispute resolution which is opaque, decentralized and unpredictable, is proving inadequate as the potential stakes of investment treaty arbitration for sustainable development come into clearer focus.

Endnotes

3 UK Government Briefing on the proposed WTO Agreements on Investment and Competition, June 2003, available on Department of Trade and Industry Website at: www.dti.gov.uk/ewt/ukgovt.pdf; The UN’s Millennium Development Goals are discussed at: http://www.un.org/millenniumgoals/
4 Foreign & Commonwealth Office, Written Communication to Author, Jan.14, 2004
5 See UK Government Briefing on the proposed WTO Agreements on Investment and Competition, June 2003; FCO Written Communication to Author, Jan.14, 2004
7 Ibid.; investment treaties between OECD countries are exceedingly uncommon, due in part to a perception that the domestic legal systems of those countries would provide for adequate protection to inward investors.
8 80 of the UK’s 101 IPPAs were examined for the purposes of this briefing paper. A listing of all UK IPPAs is available on the website of the Department of Trade and Industry at: http://www.dti.gov.uk/ewt/investment.htm
9 In a few instances, this prerogative of the host state will be circumscribed by provisions which expressly set out the relevant procedures or laws governing entry. Meanwhile, a small number of UK IPPAs insert standstill language which stipulates that admission of investment will be in accordance with the laws “existing when this Agreement enters into force” – thereby prohibiting states from introducing more onerous admission regulations at a later date.
11 As quoted in Denza, at p. 911


18 Denza 1987

19 Asian Agricultural Products Limited (AAPL) v. Sri Lanka, Award and Dissenting Opinion of June 27, 1990, 6 ICSID Review - Foreign Investment Law Journal 526 (1991); the AAPL case was brought by a Hong Kong investor whose shrimp farm operation in Sri Lanka enjoyed the coverage of the UK treaty thanks to a 1981 extension of the treaty to cover Hong Kong.

20 The World Bank’s International Centre for Settlement of Investment Disputes (ICSID), a popular arbitral venue, has handled an ever-increasing volume of investment treaty arbitration; in 2003, the facility registered 29 investment treaty claims - up from 16 in 2002 and 13 in 2001.

21 These less-transparent avenues include arbitration under the 1976 UNCITRAL rules or those of the International Chamber of Commerce or Stockholm Chamber of Commerce.


23 Most information about this claim comes from the website of a law firm involved in the case, Freshfields Bruckhaus Deringer, see: http://www.freshfields.com/practice/arbitration/experience/idisputes.asp


29 Asian American Products Ltd. V. Republic of Sri Lanka, (Case No. ARB/87/3)


31 Ibid.


33 For example, the Kingdom of Spain has faced treaty claims from countries such as Argentina. See Emilio Agustin Maffezini v. Kingdom of Spain, case materials available at: http://www.worldbank.org/iccid/cases/awards.htm

34 The ability to incorporate in a third state and benefit from that state’s investment treaties will depend upon several factors, including how loose the definition of enterprise or investor. For example, many treaties simply require that a firm be legally incorporated in the putative “home” state, without any more exacting requirements. A Czech natural gas firm has been reported to have channelled its investment thru the UK in order that its investments in Pakistan will benefit from the UK-Pakistan IPPA (source: “Czech Company starts exploiting natural gas deposit in Pakistan”, By Thomas Franek, NTIS service, US Department of Commerce)


42 Compania de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic (ICSID Case No. ARB/97/3), Award of the Tribunal, Nov.21, 2000