

# Handbook on Obligations in International Investment Treaties



**Asia-Pacific  
Economic Cooperation**

APEC Committee on Trade  
and Investment (CTI)

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# Key Messages

- \* Foreign investment can be an important source of economic growth, bringing additional capital, technology, and know-how.
- \* To encourage and protect foreign investment, governments conclude international investment treaties, which prohibit unfair, discriminatory, or expropriatory measures towards foreign investors.
- \* If any part of the government – at the central, regional, or local level – violates any obligation contained in an investment agreement, a foreign investor may be able to sue the host economy in international arbitration.
- \* Investment arbitration claims are expensive to defend and may result in very large monetary awards against the host economy.
- \* When exercising government functions, you may have no way to know that a protected foreign investor will be affected by your decision or act.
- \* It is important to familiarize yourself with, and always act with, awareness of the state's international investment treaties.
- \* Consult the “Checklist for Decision Making” in this Handbook for guidance.



**Please note that this Handbook is not a substitute for specialized legal advice.**

Should you have any questions or concerns about how the obligations described in this Handbook apply to your day-to-day work or in your interactions with an individual investor, you should seek specialized legal advice as early as possible.

# Introduction

This Handbook provides an overview of the obligations contained in international investment treaties and the risks that a government faces in the event its officials violate those obligations. The Handbook takes a practical approach, addressing key concepts through a Question & Answer format and the provision of practical examples. There is a “Checklist for Decision Making” to assist in giving these concepts meaning in the day-to-day work of government. This Handbook is intended to provide information to government officials at all levels and in all branches (executive, legislative, judicial) that will help them avoid violating international investment obligations and potentially triggering an international investment dispute.

**Please note that this Handbook is not a substitute for specialized legal advice.** Instead, it is intended that the contents of this Handbook will allow officials to better understand the types of obligations they may be subject to and when to seek specialist legal advice in specific cases. Note that the timing of any request for specialized legal advice depends on the circumstances of each case and the level of experience of each decision-maker. However, it is always preferable that legal advice be sought before a matter is so advanced that irreparable damage has been done either to the interests of the government, or to the rights of the individuals concerned.



# The Importance of Compliance with International Investment Obligations

Foreign investment can be found in virtually every sector of the economy and foreign investors interact directly and indirectly with officials at all levels of government, and across all government branches.

All APEC economies have entered into binding investment treaty commitments. These treaties generally apply to the actions of all government entities, regardless of the level of government (central, regional, local) and regardless of the governmental branch (executive, legislative, and judicial).



Violations of an investment treaty are a serious matter. If a government entity takes a measure contrary to the obligations contained in an investment treaty, that action can generate costly liability for the government. This could potentially require the payment of millions of dollars in compensation, damage the state's reputation as a good place to invest, and limit the state's ability to attract foreign investment in the future.

To ensure that government actions are consistent with its investment treaty obligations, it is essential for government officials at all levels and in all branches of government to:

- \* be aware of the government's investment treaty obligations;
- \* understand how treaty obligations relate to domestic policy making and implementation; and
- \* ensure there is timely communication and consultation within government regarding the application of these obligations to decisions regarding individual investors and investments.



# Foreign Investment and its Role in the Economy

## WHAT IS FOREIGN INVESTMENT?

In general terms, foreign investment involves a person or legal entity from one economy making an investment in another economy that involves a transfer of funds or capital into the economy in which the investment is made.

## WHY DO HOST ECONOMIES TRY TO ATTRACT FOREIGN INVESTMENT?

Foreign investment can be a source of economic growth and development. Under certain circumstances, foreign investment can involve not only the introduction of capital into the host economy, but also new technology, best business practices and know-how. Foreign investment can serve to strengthen export potential, create local employment, stimulate competition in the domestic economy, and promote modernization.

## HOW DO FOREIGN INVESTORS DECIDE WHERE TO MAKE AN INVESTMENT?

There are many different factors that affect where foreign investors decide to make investments. While commercial factors tend to be most important, foreign investors are also likely to consider other factors, such as the ease of doing business, available infrastructure, and the legal system of the economy in which the investment is made.

## HOW MUCH FOREIGN INVESTMENT IS THERE IN APEC?

Estimated flows of foreign direct investment (FDI) into APEC economies in 2018 amounted to USD \$838 billion and outward flows amounted to USD \$521 billion. During the same period, estimated levels of inward and outward FDI stocks in APEC economies each amounted to approximately USD \$17 trillion.<sup>1</sup>

# II

## International Investment Treaties and Claims by Foreign Investors

# II

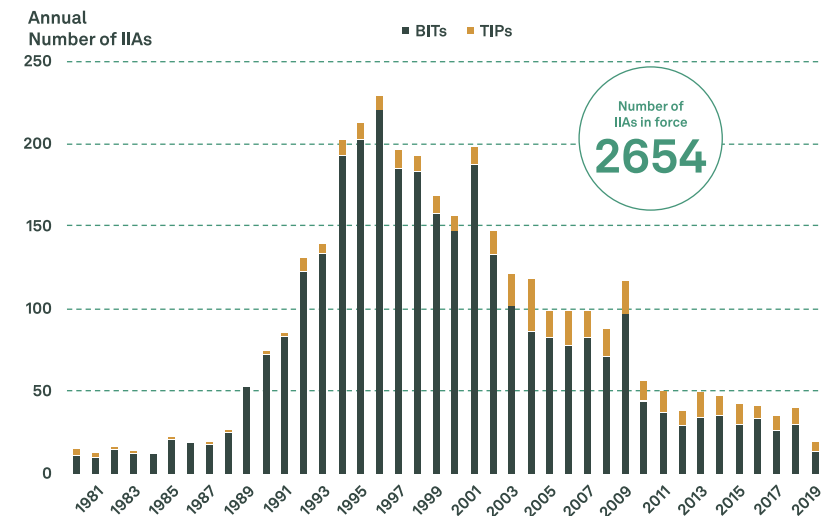
### WHAT ARE INTERNATIONAL INVESTMENT TREATIES?

An international investment treaty is a treaty concluded between economies (usually two, sometimes more) with the object of promoting and protecting foreign investment. These usually take the form of Bilateral Investment Treaties (BITs) or, increasingly, investment chapters found in Free Trade Agreements (FTAs).

Investment treaties do two things:

1. They create obligations for the government of the economy in which an investment is made (the “**host economy**”) to treat foreign investors according to particular standards which are set out in the treaty.
2. They **almost always** grant foreign investors the right to bring claims for compensation against the host economy for violation of the standards of treatment contained in the treaty.

There are presently over 2,500 investment treaties in force around the world. Every APEC economy has entered into at least one investment treaty.



Source: UNCTAD, World Investment Report 2020

## WHY DO ECONOMIES ENTER INTO INVESTMENT TREATIES?

The aim of investment treaties is twofold: (1) to help establish an investment climate that will attract foreign investment and encourage its establishment in the host economy and (2) to protect outward investors in foreign markets.

## WHAT ARE THE OBLIGATIONS OF THE HOST ECONOMY UNDER AN INVESTMENT TREATY?

Each investment treaty is different, but there are similarities among almost all of them. Generally, the substantive obligations of the host economy include:

- A. Requirement of “non-discrimination”
- B. Requirement of “fair and equitable” treatment
- C. Requirement to provide “full protection and security”
- D. Prohibition against illegal expropriation
- E. Obligation to “observe undertakings”
- F. Guarantee of free transfer of funds related to investments

Examples of what these obligations require and how they can apply in the day-to-day operation of government are provided below (Section IV - Obligations under Investment Treaties).

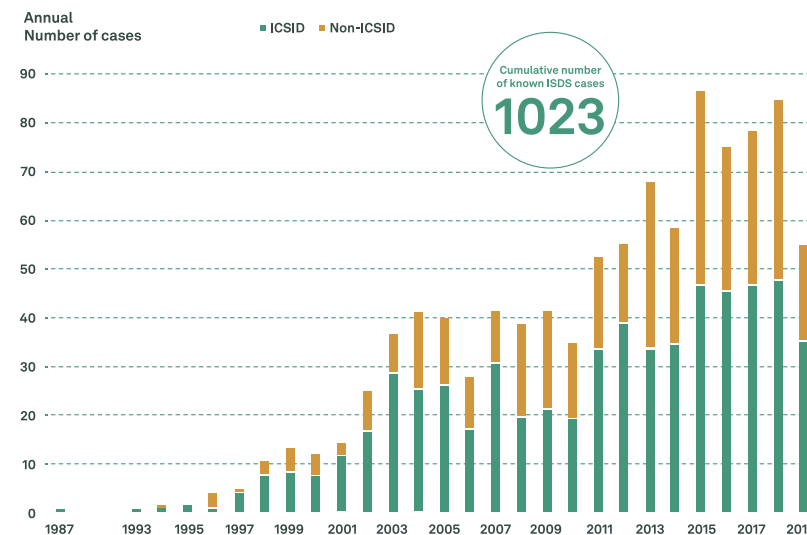


## WHAT HAPPENS IF THERE IS A DISPUTE BETWEEN A FOREIGN INVESTOR AND THE HOST ECONOMY ABOUT THE OBLIGATIONS UNDER AN INVESTMENT TREATY?

Investment treaties almost always contain a mechanism for the binding resolution of disputes between protected foreign investors and the host economy. If the investor believes that the host economy has not treated it in accordance with the treaty, the investor may bring a claim for monetary damages against the host economy using the treaty’s dispute resolution mechanism. This typically involves use of an independent arbitral tribunal.

## ARE INVESTOR CLAIMS UNDER INVESTMENT TREATIES COMMON?

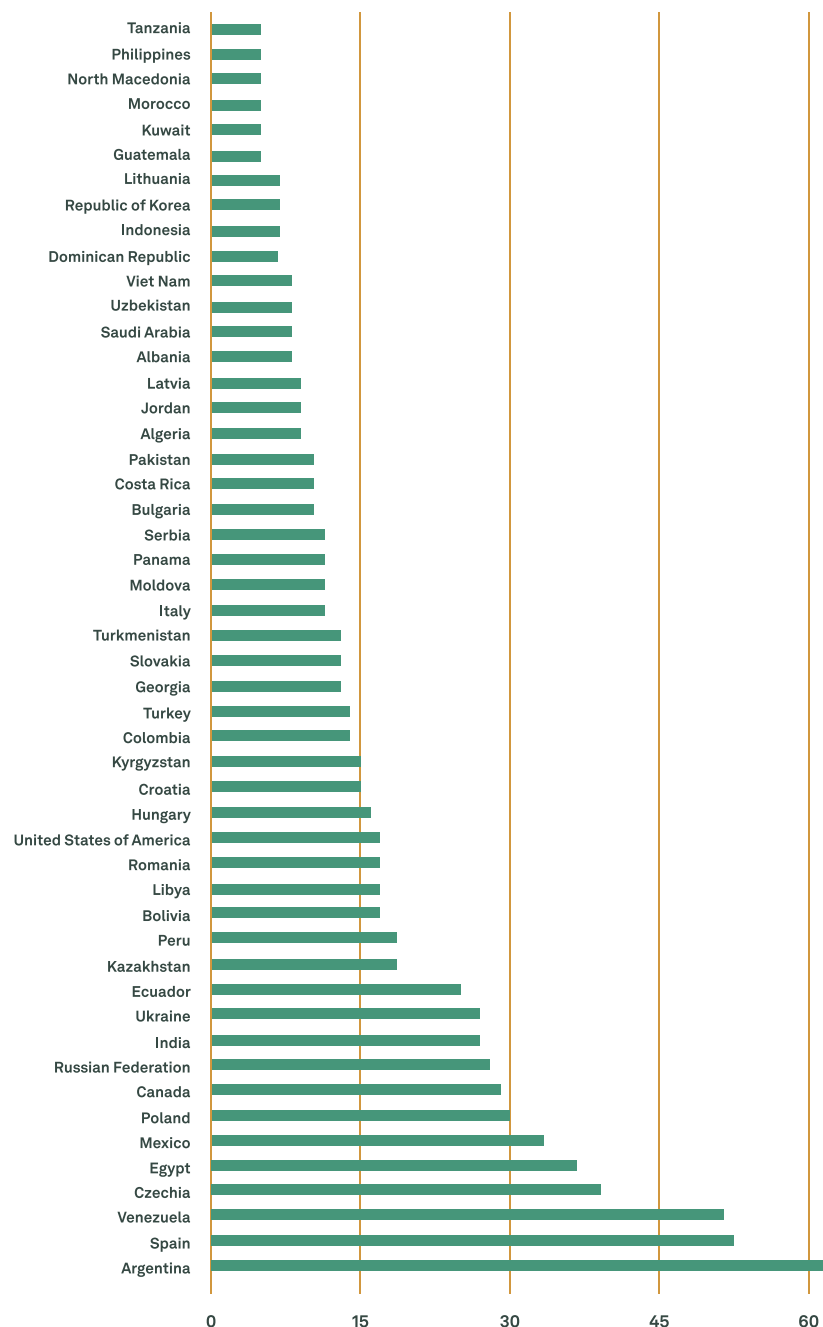
**Claims by foreign investors under investment treaties are increasingly common.** At the end of 2019, there had been over 1,000 claims brought by investors under investment treaties against 120 different host economies around the world.



Source: UNCTAD, World Investment Report 2020

A number of host economies have faced multiple, even dozens, of claims.

Number of cases as Respondent



## HOW MUCH COMPENSATION CAN A HOST ECONOMY BE ORDERED TO PAY IN AN INVESTMENT TREATY ARBITRATION?

**Claims brought by investors under investment treaties are often very large.** The median size of a claim by a foreign investor is approximately USD \$113 million, and claims for much larger amounts are not uncommon.<sup>2</sup>

Although foreign investors often do not recover the full amount that they claim, awards against host economies can be large, especially relative to the size of the economy. The largest award to date was rendered in 2014 for USD \$50 billion against Russia for the expropriation of the Yukos Oil Company.<sup>3</sup> In 2019, an award of more than USD \$8 billion was rendered against Venezuela.<sup>4</sup>

## HOW MUCH DOES IT COST THE HOST ECONOMY TO DEFEND ITSELF IN AN INVESTMENT TREATY ARBITRATION?

**Arbitration of disputes under investment treaties is expensive.** It is estimated that the average cost of defending an investment treaty arbitration is USD \$5 million.<sup>5</sup> In addition to the financial costs, defending an investment treaty claim requires a significant expenditure of time and human resources by the host economy. The average investment treaty arbitration takes 4-5 years to resolve.<sup>6</sup>

## WHICH PARTS OF GOVERNMENT CAN VIOLATE INVESTMENT TREATY OBLIGATIONS?

**All of them.** Investment treaties apply to the actions of government at all levels, whether central, regional or local. In addition, investment treaties apply to all branches of government. The executive, the legislature, and even the judiciary can take actions that can result in the violation of the host economy's investment treaty obligations.



### Compañía de Aguas del Aconquija, S.A. v. Argentina (2000)

A French investor brought a claim against Argentina for a violation of the France-Argentina investment treaty. Part of the investor's complaint concerned actions taken by officials in the Argentine Province of Tucumán. In its defense, Argentina argued that according to its constitution it was not responsible for the acts of officials of the province.

#### Lesson :

Actions of a political subdivision of a federal state are attributable to the central government. The constitutional structure of a country can not alter these obligations. As a result, Argentina was found responsible for the acts of officials of the Province of Tucumán.



### CAN THE HOST ECONOMY BE RESPONSIBLE FOR THE ACTIONS OF STATE-OWNED ENTERPRISES (SOES)?

**Yes.** While an economy will not ordinarily be responsible for the actions of SOEs, this conclusion can change if the actions of the SOE are being controlled or directed by government officials.

### UAB E Energija v. Latvia<sup>(2017)</sup>

The government of Latvia created two SOEs with the responsibility to arrange heating for the residents of Rēzekne, Latvia. In connection with this responsibility, the SOEs entered into a 30-year agreement with a foreign investor to provide heating services. Following the deterioration of relations between the investor and the SOEs, the investor brought a claim against Latvia under the relevant investment treaty.

#### Lesson :

Although states are usually not responsible for the actions of the SOEs, in this case Latvia was responsible because there was evidence that key decisions by the SOEs regarding the investor (such as a decision to sue the investor for breach of contract in the Latvian courts) had been taken on directions from, or under the control of, the Latvian government.

In addition, the actions of organizations (such as companies, SOEs, etc.) exercising authority entrusted to them by the government can also result in investment treaty claims.

#### **Fleming v. Poland** <sup>(2016)</sup>

The Polish Airport State Enterprise (PPL) was a legal entity that had been created to develop and operate airports in Poland, and whose shares were wholly owned by the Polish State Treasury. The government of Poland described the PPL as an independent state enterprise, operating without interference or influence in its commercial policies, while the investor characterized the PPL as operating under the control and supervision of the Ministry of Transport.

#### **Lesson :**

Even though the PPL was not officially an organ of the Polish government, looking at the actual functions and roles played by the PPL, the PPL was a de facto state organ. The PPL's responsibilities for operating a large airport were not the typical function of a private business and Poland itself had said in various contexts that the PPL was performing a "strategic" function for the state. It was also relevant that the PPL was owned by the Polish State Treasury and that it was required to obtain government approval for various transactions, including for airport lease agreements.

## Investors Protected under Investment Treaties

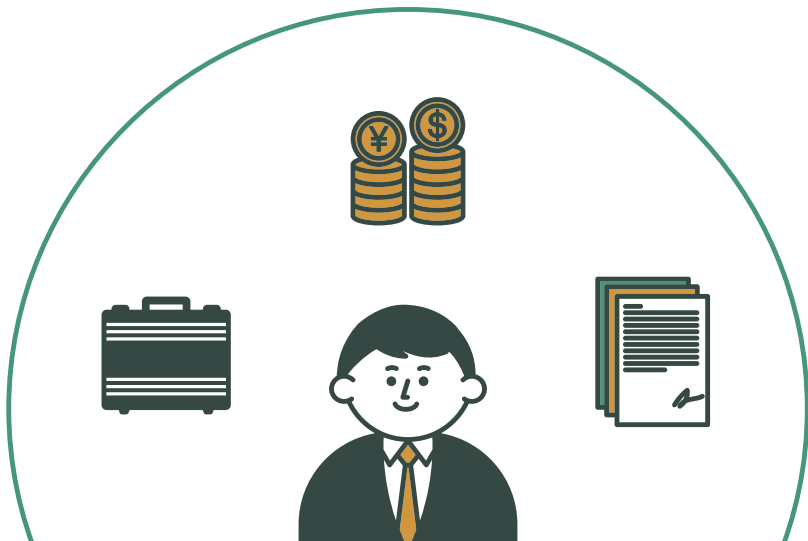


## INTRODUCTION

To help avoid investment disputes, it is important to be familiar with the obligations contained in investment treaties. While individual government officials are not expected to become experts on the law of investment treaties, it is important that government officials become familiar with their economy's obligations, understand how they relate to their duties, and ensure that they communicate promptly with the relevant government advisors about any questions or concerns regarding the application of these obligations to individual investors and investments.

### WHICH INVESTORS ARE PROTECTED UNDER INVESTMENT TREATIES?

Investment treaties protect foreign investors who are investing in or already have invested in the host economy. In some cases an investment treaty may also protect an investor who is trying to invest in the host economy.



## WHO QUALIFIES AS A PROTECTED INVESTOR?

Protected investors include natural persons and legal entities, such as corporations. Corporate investors can take almost any form, such as corporations, trust companies, joint-stock companies, single-person businesses, joint ventures, associations or other similar organizations. **Investors can be publicly or privately owned and can include state-owned enterprises.**

### Beijing Urban Construction Co. v. Yemen<sup>(2017)</sup>

Beijing Urban Construction Group (BUCG), a Chinese SOE, undertook to construct an airport terminal facility in Yemen. Subsequently, BUCG complained that its investment had been expropriated. In response, Yemen argued that BUCG was not protected under the relevant investment treaty because it was publicly funded and wholly owned by the Chinese government.

#### Lesson :

SOEs are protected under investment treaties unless the treaty specifically says otherwise. Only where the SOE simply acts as an agent of the government will it be denied protection under an investment treaty.

## ARE DOMESTIC INVESTORS PROTECTED UNDER INVESTMENT TREATIES?

Investment treaties only cover foreign investors from the economies that have entered into them (e.g., a treaty between Peru and the United States would protect US investors in Peru and Peruvian investors in the United States). Note, however, that **even though domestic investors are not protected directly by investment treaties, a domestic investor may be owned (in whole or part) by foreign shareholders who are themselves protected by an investment treaty.** As a result, mistreatment of the domestic investor may end up causing a claim by the foreign shareholders.

### Genin et al. v. Estonia<sup>(2001)</sup>

The claimants, US nationals, were the principal shareholders of EIB, a financial institution, incorporated in Estonia. Following a series of measures by the Estonian government which affected EIB's profitability, the claimants alleged that Estonia had violated the US-Estonia investment treaty.

#### Lesson:

As shareholders in an Estonian company (EIB), the US claimants owned a protected investment in Estonia and could bring a claim for harm caused to EIB.



Under normal circumstances, a government official is unlikely to know at the time of decision whether he or she is dealing with a protected foreign investor or not. A government official reviewing a permit application (just like a minister reviewing a bid proposal of national importance) will not normally have access to information concerning the nationality of an applicant's shareholders. **As a result, to make sure that they are complying with the obligations of an investment treaty, government officials should treat those obligations as though they were owed to each investor they encounter.**

### CMS Gas Transmission Co. v. Argentina<sup>(2003)</sup>

The claimant, CMS, a company based in the United States, owned 29 per cent of TGN, a natural gas company incorporated in Argentina. Following a series of actions by the Argentine government that affected TGN's profitability, CMS alleged that Argentina had violated its investment treaty with the United States. Argentina argued that CMS, as a minority shareholder, could not bring a claim for damage resulting from its participation in TGN.

#### Lesson:

It did not matter that CMS was a minority shareholder in TGN. As a shareholder, even a minority one, CMS was entitled to claim protection under the Argentina-US investment treaty.

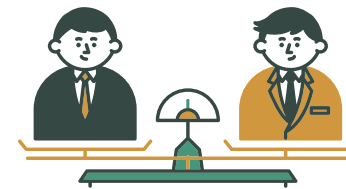
# IV

## Obligations under Investment Treaties

# IV

### WHAT ARE THE MAIN OBLIGATIONS CONTAINED IN INVESTMENT TREATIES?

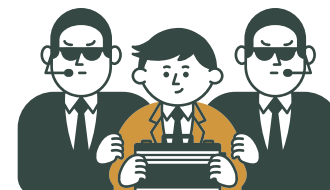
Each investment treaty sets forth the specific obligations that each government owes to protected investors. There are, however, a number of obligations which are largely common to all investment treaties. These obligations are discussed in this section.



(1) NON-DISCRIMINATION



(2) FAIR AND EQUITABLE TREATMENT



(3) FULL PROTECTION AND SECURITY



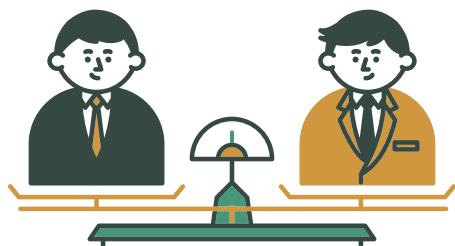
(4) PROHIBITION AGAINST ILLEGAL EXPROPRIATION



(5) OBSERVANCE OF UNDERTAKINGS



(6) FREE TRANSFER OF FUNDS RELATED TO INVESTMENTS



## (1) THE OBLIGATION OF NON-DISCRIMINATION

Investment treaties generally contain obligations of non-discrimination with respect to the treatment of protected investors and investments. There are two obligations of non-discrimination: “national treatment” and “most-favored-nation treatment”.

### NATIONAL TREATMENT

The obligation of national treatment requires the host economy to give protected investments and investors **treatment that is no less favorable than the treatment that it accords to national investors/investments in like circumstances**.

#### Clayton et al. v. Canada<sup>(2015)</sup>

A project to operate a quarry and marine terminal in the Canadian province of Nova Scotia was rejected by the government as a result of an environmental assessment process. The foreign investors argued that the project had been subjected to a stricter standard of review than had been used in the review of similar projects by Canadian investors

(i.e., projects involving quarries and marine terminals in ecologically sensitive zones).

#### Lesson :

Less favorable treatment of a foreign investor in similar circumstances to a domestic investor is likely to violate the ‘national treatment’ standard. In this case, the tribunal concluded that there was a violation of the non-discrimination provisions of the treaty. In three other cases domestic investors had been accorded more favorable treatment and Canada was unable to demonstrate that there was any justification for the different, less favorable treatment given to the foreign investors.

#### Corn Products International v. Mexico<sup>(2008)</sup>

Mexico adopted a tax of 20 per cent on any drink which used a sweetener not made from cane sugar. The foreign investor produced a sweetener made from corn – high fructose corn syrup (HFCS). The investor claimed that as a result of the tax, soft drink bottlers which were its customers switched from HFCS to sugar cane sweeteners, thereby eliminating its market.

#### Lesson :

A discriminatory motive is not necessary in order for a government measure to violate the “national treatment” standard. In this case, it did not matter that the Mexican government may not have intended to discriminate against the foreign investor. Rather, it was sufficient for the investor to show that the adverse effects of the tax were felt exclusively by HFCS producers, all of them foreign-owned, to the benefit of the cane sugar producers, the majority of which were Mexican-owned.

## MOST-FAVORED-NATION TREATMENT

The obligation of non-discrimination also requires the host economy to give protected investments and investors **treatment that is no less favorable than the treatment that it accords to the investments and investors of any third state in like circumstances.**

### Bayindir Insaat Turizm v. Pakistan<sup>(2009)</sup>

A Turkish investor entered into a highway construction contract with an agency of the Pakistani government. In the dispute which arose, the investor alleged that Pakistan had treated it less favorably than it had treated other foreign investors. The investor, who had fallen behind in its performance of the contract, alleged that it had been the only contractor expelled from Pakistan for delays, even though other foreign contractors were far more behind in their completion of work under government contracts.

#### Lesson :

The ‘most-favored-nation’ clause obligated Pakistan to treat the investor no less favorably than it treated other foreign investors with respect to the way in which Pakistan exercised its rights under government contracts. Nevertheless, on the facts of this particular case, the investor failed to prove that it had in fact been treated differently than foreign investors in similar situations.



## (2) THE OBLIGATION OF “FAIR AND EQUITABLE TREATMENT”

The “fair and equitable treatment” standard establishes a minimum level of treatment to be given to protected investors and their investments. Violations of the fair and equitable treatment standard are the most common type of treaty violation committed by governments. What constitutes “fair and equitable treatment” is determined by analysing all of the circumstances of a particular case. Not all treaties are the same however, so the way in which fair and equitable treatment is interpreted and applied may depend upon the exact wording of the treaty. That said, it is possible to identify a number of circumstances that have been considered when determining whether there has been fair and equitable treatment. These include:

- A. whether there has been a fundamental change in the host economy’s law that is contrary to the investor’s legitimate expectations;
- B. whether the host economy has gone back on specific representations made to the investor that the investor relied upon in making the investment decision;
- C. whether due process has been denied to the investor;
- D. whether there has been an absence of transparency in the legal process or actions of the host economy;

- E. whether there has been harassment, coercion, abuse of power or bad faith conduct by the host economy; and
- F. whether the actions of the host economy can be labelled as arbitrary, disproportionate, or inconsistent.

The examples which follow provide illustrations of how these circumstances can arise in real situations.

**A. Fundamental Change in the Law Contrary to Legitimate Expectations**

(i.e., whether there has been a fundamental change in the framework for investment that is contrary to the investor's legitimate expectations);

**Murphy Exploration & Production Co. v. Ecuador** <sup>(2017)</sup>

In response to a large increase in the price of crude oil, the Ecuadoran government imposed a windfall levy on profits in the oil sector. Initially it imposed a 50 per cent windfall levy, which was later raised to 99 per cent. The US investor owned shares of stock in a domestic company that had concluded a contract with the government of Ecuador for the exploration and exploitation of hydrocarbons. The investor claimed that the windfall levy constituted a violation of its right to fair and equitable treatment.

**Lesson :**

The tribunal held that the 50 per cent levy did not violate the fair and equitable treatment standard as it did not "fundamentally change" the balance of rights agreed with Ecuador in the service contract. It was not reasonable for the investor to expect no government response to the sharp increase in oil prices. However, when the levy was raised to the 99 per cent rate, the tribunal found that Ecuador had violated the fair and equitable treatment standard, by violating the claimant's legitimate expectations.

According to the tribunal, "[n]ot only did this development fundamentally change the nature of the [contract], it occurred within the context of an increasingly hostile and coercive investment environment".

**Micula v. Romania** <sup>(2013)</sup>

Investors established a series of food processing and other manufacturing businesses in Romania's north-western region. As an incentive for investment, Romania provided the investors with preferential subsidies, as well as exemptions from customs duties (for e.g. the import of raw foodstuffs), and exemptions from value-added taxes and taxes on profits. Over a period of several years following the investment, Romania terminated these benefits as part of its preparation to join the European Union. This caused economic damage to investors who had made investments under the development scheme.

**Lesson :**

An investor cannot reasonably expect that the law prevailing at the time the investment is made will remain unchanged over the lifetime of the investment. However, if the host economy has taken actions that create a legitimate expectation that the law will not change, then the investor may have cause to complain if the host economy later acts differently.

Here, Romania was found to have created a legitimate expectation that the incentives would be available substantially in the same form as they were initially offered (for a period of ten years). First, the purpose and structure of the legislation, which had been communicated to the investors, was to attract investment by creating an expectation that the benefits would be in place in substantially the same form for a period of ten years. Second, the benefits



of the legislation were only available to investors who had qualified by applying through an administrative process and who fulfilled certain requirements.

**B. Reversal of Specific Representations by the Government**

(i.e., whether the host government has gone back on specific representations to the investor that the investor relied upon in making the investment decision);

**Crystallex International Corp. v. Venezuela<sup>(2017)</sup>**

The investor, Crystallex, entered into a contract to develop gold mining deposits located within the Imataca National Forest Reserve in Venezuela. After the contract was concluded in 2002, Crystallex sought the necessary permits to commence operations, and in May 2007 it received a letter from the Ministry of Environment assuring it that the authorization would be granted after the company posted a security bond. Crystallex posted the bond as required, but nevertheless in April 2008 the Ministry of Environment denied the environmental permit, based on what it said were concerns about the project's impact on the environment and indigenous peoples in the Imataca reserve.

**Lesson :**

Where the government goes back on specific representations to an investor, it may give rise to claims. In this case, the Ministry's May 2007 letter giving the assurance of authorization to commence operations created legitimate expectations on which Crystallex relied and acted. By acting in a different way than it had represented to the investor that it would, Venezuela frustrated these legitimate expectations and thereby violated the treaty. Ultimately, Venezuela was ordered to pay USD \$1.2 billion plus interest to the investor.

**C. Absence of Due Process**

(i.e., whether due process has been denied to the investor);

**Dan Cake (Portugal) S.A. v. Hungary<sup>(2016)</sup>**

The investor invested in a biscuit-making business in Hungary, "Danesita", which became the subject of liquidation proceedings in the Hungarian courts. During those proceedings, Danesita asked the Metropolitan Court of Budapest to convene a "composition hearing" of Danesita's creditors, which the investor hoped would allow Danesita to be reorganized rather than liquidated.

In connection with its request, Danesita submitted the documents required by the Hungarian Bankruptcy Act. Nevertheless, the court refused the application, and instead ordered Danesita to make supplementary filings, listing seven additional requirements to be fulfilled within 15 days before a composition hearing could be convened. Danesita did not satisfy the order and was subsequently liquidated in a public sale.

**Lesson :**

Reviewing the individual requirements imposed by the court, the tribunal concluded that they "defeat common sense," "appear almost impossible to satisfy within 15 days," demonstrated "a lack of understanding by the Court" of key underlying facts, and were "more than surprising." On this basis, the tribunal concluded that the actions of the court were a denial of justice and a violation of the relevant treaty.

### **Cervin Investissements SA v. Costa Rica** <sup>(2017)</sup>

The investor submitted an administrative challenge to a tariff decision by the host government's regulator. Under Costa Rican law, the regulator should have decided the challenge within eight days. The regulator took two years and four months to render a decision.

#### **Lesson :**

While not every failure to follow administrative procedure will be actionable under an investment treaty, in this case the magnitude of the delay resulted in a violation of the duty of fair and equitable treatment.

### **Clayton et al. v. Canada** <sup>(2015)</sup>

A project to operate a quarry and marine terminal was rejected by the government following an environmental assessment process.

#### **Lesson :**

The failure to follow proper procedures in making decisions may lead to a violation of investment treaty commitments. In this case, the way in which the review process was carried out constituted a violation of Canada's obligations to the investor. In particular, the environmental assessment panel had adopted, without notice to the investor, an "unprecedented approach" to the review of the project by reviewing it according to a criterion not previously identified nor found in the panel's terms of reference. In addition, other aspects of the review process were faulty, including the fact that the investors were not given a fair opportunity to present their case and that the panel refused to consider specific mitigation steps to address specific deleterious impacts.

### **D. Absence of Transparency**

(i.e., whether there has been an absence of transparency in the legal procedures or actions of the host economy);

### **Técnicas Medioambientales SA v. Mexico** <sup>(2003)</sup>

The investor held a license of unlimited duration for the operation of a landfill. Following a number of changes in regulations, the investor's unlimited license was replaced by a license of limited duration. The investor complained that the process by which the changes had occurred lacked transparency.

#### **Lesson :**

An investor is entitled to expect that the government will act in a transparent way and in a way which is free from ambiguity. Where the government acts without transparency or in a manner which is ambiguous or inconsistent, it may violate the obligation to provide fair and equitable treatment.



### **Metalclad Corp. v. Mexico** <sup>(2000)</sup>

The federal government of Mexico had issued construction and operating permits for the investor's landfill project. The investor was assured by the Mexican government that it had all the permits it needed and began construction. Subsequently, the investor was ordered to shut down its operations by the local (municipal) government on the grounds that it required a further construction permit. The investor was denied this permit.

#### **Lesson :**

A lack of clarity in the law of the host economy may give rise to claims for an investment treaty violation. In this case, Mexican law did not make clear whether the local government had the authority to require the additional construction permit or whether it had the authority to deny the permit to the investor. Mexico thus failed to ensure a transparent and predictable framework for the investor's business planning and investment. As a consequence, Mexico violated its obligation to provide fair and equitable treatment.

- E. **Harassment, Coercion, Abuse of Power, or Bad Faith** (i.e., whether there has been harassment, coercion, abuse of power or bad faith conduct by the host economy);

### **Deutsche Bank AG v. Sri Lanka** <sup>(2012)</sup>

Sri Lanka's state-owned Ceylon Petroleum Corporation (CPC) entered into hedging contracts with several international banks in an effort to manage its price and foreign exchange risks on imports of oil. Following a decline in world oil prices in 2008, CPC's obligation to

pay the banks millions of dollars under the hedge contracts was triggered.

Following a public outcry about the hedging contracts and other similar arrangements entered into by CPC, the Sri Lankan Central Bank launched an investigation into the hedging agreement with Deutsche Bank, ultimately issuing a "stop-payment" order, prohibiting further payments under the agreement.

#### **Lesson :**

Governmental power must be used for the purpose it was given by the law, and must not be exercised as a pretext for other motives. In this case, the investigation conducted by the Central Bank was found to have been undertaken for improper motives and in bad faith, serving as a pretext for a stop-payment order to be issued. In addition, the investigation lacked transparency and due process, with the final report prepared in the course of a mere 24 hours and containing findings to which the claimant did not have the opportunity to respond.

- F. **Arbitrary, Disproportionate, Inconsistent Treatment** (i.e., whether the actions of the host economy can be labelled as arbitrary, disproportionate, or inconsistent).

### **Occidental Petroleum Corp. v. Ecuador** <sup>(2012)</sup>

Occidental Petroleum had entered into a concession agreement with the government of Ecuador for oil exploration and production. Occidental made a partial transfer of its rights under the concession to another company without notice to the government. Making this transfer was in violation of the concession agreement. In response, the government terminated the concession.

### Lesson :

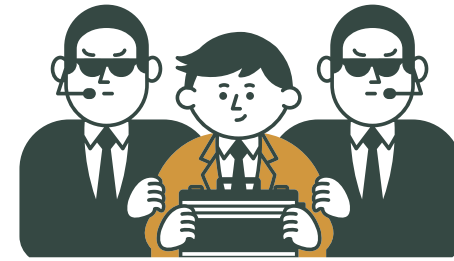
The government must not act in a way which may be characterized as disproportionate. In this case, the penalty imposed on the investor (termination of a concession, worth many hundreds of millions of dollars) was out of proportion to the investor's wrongdoing (failure to provide notice). Similarly, the penalty was out of proportion to the effectiveness of any "deterrence message", which Ecuador intended to send to the wider community of oil and gas companies in the economy. As a result, Ecuador violated its obligation to provide fair and equitable treatment.

### Micula v. Romania <sup>(2013)</sup>

In connection with its preparations to join the European Union, Romania terminated a scheme under which it had offered investors incentives in exchange for investing in Romania's north-western region and undertaking certain other obligations and duties.

### Lesson :

The decision to leave in place the duties and obligations imposed under the incentive framework, while at the same time eliminating virtually all the benefits for investors, was unreasonable and violated the obligation to provide investors with fair and equitable treatment.



### (3) THE OBLIGATION TO PROVIDE "FULL PROTECTION AND SECURITY"

The obligation to provide full protection and security generally requires the host economy **to exercise vigilance and due diligence with regard to the physical protection of investments and investors**, taking into account the circumstances and resources of the host economy.

### Ampal-American Israel Corp. v. Egypt <sup>(2017)</sup>

Between February 2011 and April 2012, a gas pipeline in Egypt, on which the claimants' investment relied, sustained 13 attacks by certain terrorist organizations. The damage to the pipeline disrupted the flow of gas and caused economic loss to the investor.

### Lesson :

The due diligence required of the host economy means taking reasonable steps in response to warnings. In this case, the security situation at the time of the attacks was difficult because of ongoing political events in Egypt and the region, and as a result armed militant groups took advantage of the political instability. Nevertheless, although Egypt could not have prevented the first attacks on the pipeline – of which it

had no warning – those attacks “should have been seen as a warning to the Egyptian State that further attacks might be carried out if security measures were not taken and implemented”. Egypt, however, did not take “any concrete steps” to protect the pipeline from further attacks and, consequently, violated its obligation.

### Copper Mesa Mining Corp. v. Ecuador <sup>(2016)</sup>

The investor, Copper Mesa, faced significant opposition from the local population to its operation of a mining concession. Protesters imposed a physical blockade, which interfered with the investor’s ability to carry out its activities, including the completion of a required environmental impact study. In response, the government of Ecuador issued an administrative resolution, prohibiting access to the site by anyone, including the investor.

#### Lesson:

The guarantee of “full protection and security” requires the host economy to exercise reasonable diligence. In this case, Ecuador had not made any efforts to assist the investor in gaining access to the site in order to carry out the activities required for its environmental impact study. To the contrary, by issuing a resolution prohibiting access to the site by anyone, including the investor, Ecuador had given “legal force to the factual effect of the anti-miners’ physical blockade” of the concession. By doing so, Ecuador made it impossible, both legally and physically, for Copper Mesa to complete the environmental impact study, resulting in the loss of its investment.



## (4) THE PROTECTION AGAINST ILLEGAL EXPROPRIATION

Host governments are entitled to expropriate (i.e., take ownership of) the property of foreign investors, but only where the expropriation is:

- A. for a public purpose;
- B. done in accordance with due process;
- C. non-discriminatory; and
- D. accompanied by the payment of compensation, usually “market value” compensation.

An expropriation that does not meet these conditions will violate the host economy’s obligations under international law.

It is important to understand that “expropriation” can refer to two types of situations:

### A “DIRECT” EXPROPRIATION

The situation in which ownership of a protected investment is legally transferred from the investor to the government or the entities for which it is responsible.

#### Rusoro Mining Ltd . v . Venezuela <sup>(2016)</sup>

The Venezuelan government adopted a decree formally transferring ownership and control of all private gold mining companies’ property and rights to the Venezuelan state. As a consequence, the investor’s rights to mine for gold were directly expropriated.

#### Lesson :

Each host economy has the right to expropriate an investment, but it must be done in accordance with the criteria set forth in the relevant investment treaty. Here, although the expropriation had been properly done for a public purpose, in a manner consistent with due process, and without discrimination, Venezuela failed to satisfy the criterion that the investor be paid the fair market value of its investment. Instead, the government’s expropriation decree established a limit to the amount of compensation available to investors, resulting in the payment of less than market value compensation. As a consequence, Venezuela failed to comply with the requirements for a lawful expropriation.

### AN “INDIRECT” EXPROPRIATION

The situation in which, even though legal ownership has not been transferred from the investor to the government, the government has taken measures that have the effect of depriving the investor of the economical use and enjoyment of the investment.

#### RosInvestCo UK Ltd . v . Russia <sup>(2010)</sup>

The investor held shares in Yukos Oil Company, a company incorporated in Russia. Following the conclusion of a tax inspection by the Russian Tax Inspectorate, which identified only minor errors in the company’s tax returns, the Russian government undertook a second inspection of Yukos just eight months later. In this new inspection, which covered the same period as the first, the Tax Inspectorate claimed to have discovered new facts that it said showed that Yukos had committed a tax fraud of approximately USD \$24 billion. Yukos was ordered to pay this amount in addition to a 7 per cent enforcement fee on the overall amount of the debt.

Following an unsuccessful effort to challenge the findings of the Tax Inspectorate, Yukos attempted to negotiate a settlement which the government refused. Thereafter, the government commenced bankruptcy proceedings against Yukos. Through the bankruptcy process, Yukos was forced to sell its principal assets at a government auction, effectively bringing those assets under control of the Russian government.

#### Lesson :

Taken collectively, the tribunal found that the actions of the Russian government wiped out the value of Yukos and constituted an indirect expropriation. Although Yukos appeared to have engaged in some questionable tax activity, Russia’s response indicated that “the primary objective of the Russian Federation was not to collect taxes but rather



to bankrupt Yukos and appropriate its valuable assets”. In particular, the tribunal found that the Tax Inspectorate’s imposition of a retroactive VAT charge was disproportionate and could not have been expected by Yukos. Further, the Yukos bankruptcy proceedings, which resulted in the auction of Yukos’ assets, took place “under questionable circumstances”. Finally, there was evidence that Yukos officials were intimidated and harassed during the period.

### **Ampal-American Israel Corp. v. Egypt** <sup>(2017)</sup>

The investors owned shares in East Mediterranean Gas Company SAE (EMG), an Egyptian company that signed a contract in 2005 with the Egyptian authorities to transport gas from Egypt into Israel. In 2012, the contract was terminated on the grounds that EMG had failed to pay an invoice of USD\$37 million. The investors complained that the termination of the contract was a disproportionate response and had the effect of expropriating its investment in EMG.

#### **Lesson:**

The termination of the contract, which was EMG’s principal asset, was wrongful and amounted to an indirect expropriation. Not only did the contract not permit termination for non-payment of an invoice, the termination was a “disproportionate act”, given that the amount of the unpaid invoice was for a small amount compared to the potential economic value of the performance of the contract (billions of dollars).

### **NOTE**

Not all government action which results in a loss of value or profit is an expropriation, even if that loss is substantial. The government is not a guarantor of an investment’s profitability. That said, depending on the circumstances, where government action or a series of actions has seriously damaged the value of an investment, questions may be raised. In such circumstances, it is important to seek specialized legal advice.





## (5) THE OBLIGATION TO “OBSERVE UNDERTAKINGS”

Many investment treaties guarantee that the host economy will “observe undertakings” that it has assumed with regard to an investment. These clauses are sometimes referred to as “umbrella clauses” because in a number of cases they have been interpreted as bringing the host economy’s contractual undertakings with the investor under the treaty’s protective umbrella. What this means, practically, is that in some cases when the government violates its contractual commitments regarding an investment, the violation of those contractual commitments may also amount to a violation of its umbrella clause obligation under an investment treaty.

It must be noted, however, that the interpretation and application of umbrella clauses by arbitral tribunals has varied significantly from case to case, often depending upon the precise wording of the treaty. As a result, the ability to make generalizations is limited. In situations involving the potential violation of contractual commitments regarding an investment, it is important to seek specialized legal advice.

### **Société Générale de Surveillance S. A. v. Paraguay** <sup>(2010)</sup>

Société Générale de Surveillance (SGS) entered into a contract with the government of Paraguay to provide customs inspection services. Following a disagreement between SGS and the Paraguayan government, the government refused to pay outstanding invoices for services rendered. SGS brought a claim against Paraguay, alleging that Paraguay’s refusal to pay the outstanding invoices violated the contract and that this also amounted to a violation of the umbrella clause contained in the applicable investment treaty.

#### **Lesson :**

The arbitral tribunal interpreted the umbrella clause contained in the applicable treaty as covering the commitments contained in the government’s contract with SGS. As a result, the government’s violation of its obligations under the contract (refusing to pay the invoices) was also a violation of its obligations under the investment treaty.





## (6) THE OBLIGATION TO ALLOW THE FREE TRANSFER OF FUNDS RELATED TO INVESTMENTS

Most investment treaties contain a general obligation that protected investors be allowed to make transfers in and out of the host economy related to an investment or in connection with an investment.

The flows to which the guarantee of free transfer generally applies, include (but are not limited to):

- A. profits, interest, dividends, and other current investment income;
- B. funds necessary to finance an investment;
- C. proceeds from the sale or liquidation, total or partial, of an investment;
- D. payments under a contract, management fees and royalties;
- E. loan payments;
- F. salaries and other remuneration received by the nationals of the economy of origin of the investment and who have obtained the necessary work permits in relation to an investment.

### Valores Mundiales S.L. v. Venezuela <sup>(2017)</sup>

The investors owned two subsidiary companies incorporated in Venezuela that produced and sold corn and wheat flour. In 2008, Venezuela prevented one of the subsidiaries from transferring investment proceeds to the investors.

#### Lesson :

Under Venezuelan law, investors who wished to acquire foreign currency were required to first update their foreign investment administrative registration with the relevant Venezuelan authority, SIEX. Despite the investors' efforts, however, SIEX never agreed to their request for an update, and rejected the requests without justification. As a result, Venezuela was found to have violated its obligation to allow the free transfer of funds related to an investment.

### Von Pezold et al. v. Zimbabwe <sup>(2015)</sup>

Following the imposition of foreign currency controls, Zimbabwe refused to release foreign currency that the investors needed to repay foreign-currency denominated loans related to their investment. In addition, Zimbabwe forced the investors to exchange some of the profits they had earned in US Dollars for Zimbabwean Dollars. As a consequence, the investors were unable to transfer their returns on investment out of Zimbabwe.

#### Lesson :

These actions were a violation of Zimbabwe's obligation to allow for the free transfer of funds related to investments under the relevant investment treaty.

## NOTE

It is important to note that the guarantee of the free transfer of funds is not absolute. Some treaties contain exceptions allowing for the imposition of “prudential measures” limiting the free transfer in order to maintain the safety, soundness and integrity of financial institutions, the financial system and capital markets. Treaties may also allow for “temporary safeguards,” such as capital controls and exchange restrictions, adopted by the host economy to protect monetary reserves and the host economy’s currency. Without specialized legal advice it will not be possible to tell whether such exceptions apply in a given case.

# Conclusion

This Handbook has provided a brief overview of the main obligations contained in international investment treaties and the risks that host economies face in the event its officials violate those obligations. The goal of this Handbook has been to provide information to government officials at all levels (central, regional, local) and in all branches (executive, legislative, judicial) that will help them avoid violating international investment obligations and potentially triggering an international investment dispute.

**As has been said throughout, this Handbook is not a substitute for specialized legal advice in specific cases.** Instead, it is intended that the contents of this Handbook will allow officials to better understand the types of obligations they may be subject to and when to seek specialist legal advice with their bureaucracy. Note that the timing of any request for specialized legal advice depends on the circumstances of each case and the level of experience of each decision-maker. However, it is always preferable that legal advice be sought before a matter is so advanced that irreparable damage has been done already either to the interests of the government or to the rights of the individuals concerned.



# A Checklist for Decision-Making

This “Checklist for Decision-making” is designed to provide a resource that officials can use quickly to remind themselves of how the concepts discussed in this Handbook apply in the day-to-day work of government. Note, however, that the Checklist is not a substitute for reading and understanding the Handbook. And the Handbook is not a substitute for the specialized legal advice required in individual cases.



### **1. DO I HAVE THE LEGAL AUTHORITY FOR THE ACTION I AM PLANNING TO TAKE? AM I ACTING WITHIN THE AUTHORITY GRANTED BY THE LAW?**

To act lawfully, you or your Ministry or Department must have the legal authority to do what you intend, or it intends. If you do not, your actions may be treated as unlawful and in violation of investment treaty obligations, such as the fair and equitable treatment standard. You should, therefore, know the source of your authority to take actions that are likely to affect investors or their investments.

### **2. AM I EXERCISING MY LEGAL AUTHORITY FOR THE PURPOSE FOR WHICH IT WAS GIVEN?**

As well as having the legal authority to act, it is important that you or your Ministry or Department use that authority for a lawful purpose. If you use your authority to achieve a purpose that the authority was not created to achieve, your action may be found to be an abuse of power and a violation of investment treaty guarantees.

### **3. IN EXERCISING MY LEGAL AUTHORITY, HAVE I TAKEN INTO ACCOUNT ALL RELEVANT INFORMATION AND EXCLUDED IRRELEVANT CONSIDERATIONS?**

In addition to exercising your authority for the purpose for which it was given, it is also important that you have not:

- A. exercised your authority based on irrelevant factors; or
- B. failed to take into account factors that you are under a duty to consider.

Doing either can create a risk of investment treaty claims.

### **4. CAN I SHOW THAT I HAVE CORRECT REASONS FOR MY DECISION OR ACTION?**

Creating a record of the reasons for your decision may be required by the law under which you are acting. Even if it is not, creating a written record can encourage careful decision-making. A record of your decision can help to show at a later time that you considered the relevant issues and followed appropriate procedures. An effective record of reasons may include:

- A. A statement of any material findings of fact;
- B. An indication of how all relevant matters have been considered (and that no irrelevant matters have been taken into account);
- C. A record of any communications between you or your Ministry or Department and the entity or entities which are the subject of the decision;
- D. An indication of how representations from that entity or those entities have been properly considered, addressed and taken into account in the decision.

### **5. HAVE I HEARD AND CONSIDERED THE POINT OF VIEW OF THOSE LIKELY TO BE AFFECTED BY THE DECISION? HAVE THEY BEEN GIVEN A FAIR OPPORTUNITY TO MAKE REPRESENTATIONS?**

Consultation may be required by the law under which you or your Ministry or Department are acting, or it may be decided on a case-by-case basis. In either situation, it is important that the consultation be genuine, and that the information received be given genuine consideration.

In addition, in conducting a consultation it is also important that those consulted have sufficient information to enable them to provide meaningful responses and that there be enough time for them to respond.

**6. HAVE I MADE UP MY MIND IN ADVANCE OF MY DECISION OR GIVEN THE IMPRESSION THAT I HAVE? IF I AM FOLLOWING A GENERAL POLICY, HAVE I CONSIDERED WHETHER ANY EXCEPTIONS ARE PERMITTED OR WARRANTED?**

A decision-maker should approach its decisions with an open mind. Decisions should be based on what is required by the law under which the decision-maker is acting. In addition, a decision-maker should take into account the facts and circumstances of the matter before it, not prejudging its decision.

**7. DO I OR ANYONE INVOLVED IN MAKING THE DECISION HAVE ANY CONFLICTING INTEREST WHICH MIGHT LEAD SOMEONE TO SUPPOSE THAT THERE IS BIAS?**

If you have a conflict of interest (or there is an appearance of a conflict of interest), there will be concerns that the decision-making process has not been genuine because your mind was closed and/or the decision was taken for reasons other than those which have been given. This can lead to claims under investment treaties.

**8. HAVE I CAUSED ANYONE TO BELIEVE THAT I WILL BE ACTING IN A DIFFERENT WAY FROM THE WAY IN WHICH I NOW INTEND TO ACT?**

A “legitimate expectation” may be found where a decision-maker makes an express or implied (e.g. from past practice) promise or representation that an investor or category of investors will receive a particular benefit or continue to receive a particular (or not substantially varied benefit). Where a legitimate expectation has been created, acting in a different way may give rise to a claim that there has been a violation of the investment treaty.

**9. AM I ACTING IN A WAY THAT MIGHT BE REGARDED AS “ARBITRARY” OR “DISPROPORTIONATE”?**

As well as acting within the limits of your legal authority and using a fair process to come to a decision, decision-makers must not exercise their powers and duties in an arbitrary or disproportionate way. Generally speaking, tribunals will not second-guess decisions made by government officials, however, where the object of the decision lacks proportion to the effects of the measure adopted there may be grounds for a claim and a finding of a treaty violation. Similarly, there may be a violation of the treaty where the decision taken is one that a tribunal considers to be arbitrary, i.e., beyond the range of responses open to a reasonable decision-maker or devoid of any relevant justification.

**10. DOES MY DECISION RESULT IN LESS FAVORABLE TREATMENT BETWEEN PERSONS OR ENTITIES IN SIMILAR CIRCUMSTANCES?**

Investment treaties prohibit discrimination on the basis of nationality. Where a decision results in a person or entity being treated less favorably than another person or entity in like circumstances, a claim may arise if it turns out that those persons or entities (or their shareholders) have different nationalities. The obligation not to discriminate not only prohibits direct, intentional discrimination, but it can raise claims about decisions that have a discriminatory impact (even if not intended to).

**11. IS THERE A CONTRACT BETWEEN THE INVESTOR AND THE GOVERNMENT? DOES MY DECISION HAVE AN EFFECT ON THAT CONTRACT OR WHAT THE INVESTOR IS ABLE TO DO UNDER IT?**

In some cases when the government violates its contractual commitments regarding an investment, the violation of those commitments may also amount to a violation of its obligations under an investment treaty. Breaching or terminating a contract is a serious matter, whether an investment treaty is applicable or not, and in such situations it is important to seek specialized legal advice.

*The information provided in this Handbook is provided for informational purposes only, and does not, and is not intended to, constitute legal advice. This Handbook contains general information and may not reflect current legal developments or information. This Handbook does not represent the legal interpretations or legal position of any government or the APEC Secretariat.*

*Readers of this Handbook should not act or refrain from acting on the basis of information included in this Handbook without seeking appropriate legal advice on the particular facts and circumstances at issue.*



1. See: [http://statistics.apec.org/index.php/key\\_indicator/index](http://statistics.apec.org/index.php/key_indicator/index).
2. United Nations Conference on Trade and Development (UNCTAD), “Special Update on Investor-State Dispute Settlement: Facts and Figures” (Nov. 2017), 5.
3. *Hulley Enterprises Ltd. v. Russian Federation*, PCA Case No. AA 226, Final Award (18 July 2014); *Veteran Petroleum Limited (Cyprus) v. Russian Federation*, PCA Case No. AA 228, Final Award (18 July 2014); *Yukos Universal Limited (Isle of Man) v. Russian Federation*, PCA Case No. AA 227, Final Award (18 July 2014).
4. *ConocoPhillips Pretozuata B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Award (8 March 2019).
5. UNCITRAL Working Group III (Investor-State Dispute Settlement Reform), “Possible Reform of Investor-State Dispute Settlement (ISDS) – Cost and Duration”, UN Doc A/CN.9/WG.III/WP.153 (31 August 2018), 9 ff.
6. Id.

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