2008

Policy Impacts of Investment Agreements for Andean States

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Policy Impacts
of Investment Agreements
for Andean Community States

Gus Van Harten
September 2008

I INTRODUCTION

This report examines the impact of certain investment agreements on government decision-making. Primarily, it examines the impact of bilateral investment treaties (BITs) concluded between European Community (EC) member states and Andean Community (CAP) states. Additionally, it examines the impact of the investment provisions of Economic Partnership Agreement. The analysis focuses on CAP states and, in some respects, on government decision-making in strategic sectors.

II STRATEGIC SECTORS

A focus in the report is on the implications of investment agreements for government decision-making in strategic sectors. Strategic sectors are assumed to include (1) the resource sector (where it constitutes a significant source of earnings on the balance of payments), (2) basic infrastructure and core services including energy generation and distribution; transportation; water (or wastewater) treatment and distribution (or disposal); financial services; communication and broadcasting; and health care and education.

An indication of sectors considered sufficiently important to protect from foreign ownership and control is offered by BITs that contain a commitment to pre-establishment national treatment and, by extension, exceptions to this commitment that aim to preserve the state’s right to ensure domestic ownership and control in certain sectors. Most such BITs have

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1 LLB, MES, PhD; Assistant Professor, Osgoode Hall Law School of York University, Toronto, Canada; author of Investment Treaty Arbitration and Public Law (Oxford University Press, 2007). Note that this is a consultation report; it does not constitute legal advice or a legal opinion. The report was made possible by the financial assistance of Intermon Oxfam.
2 The discussion of the impact of EPAs draws on the investment provisions of the EU-CARIFORUM EPA text, which is the only EPA text as yet finalized by the EU and its various counterparts in ongoing EPA negotiations.
3 BIT obligations of states are always post-establishment in that they apply to protect an investor after the investor has made an investment in the state. These include obligations to give post-establishment national treatment, MFN treatment, fair and equitable treatment including full protection and security, protections against expropriation, guarantees of free capital transfers, and umbrella clauses (for example). In contrast, certain forms of obligations may be referred to as pre-
been concluded by either the U.S. or Canada, both having adopted the same general approach to their market access commitments in the North American Free Trade Agreement (NAFTA).

Thus, in BITs concluded by the U.S. or Canada with CAP states, these sectors have been excluded from pre-establishment and post-establishment national treatment and, in some instances, from most-favoured-nation treatment:

- oil & gas
- mining
- fishing
- air and maritime transport
- shipping
- banking, securities, and other financial services
- government insurance, subsidies or grants
- state enterprises
- broadcasting
- telephone services
- social services (e.g. public law enforcement, income security, public education, health and child care);
- investment screening generally.

Notably, these exceptions do not apply to other BIT obligations, including fair & equitable treatment and limitations on expropriation (which are the provisions relied on most often by tribunals to find a treaty violation and order payment of damages by the state). Also, these sectoral exceptions in BITs concluded by the U.S. and Canada are one-sided in that the CAP state is not allowed the same rights to favour domestic firms as its major capital-exporting partner (i.e. the U.S. or Canada). In the case of nearly all BITs of this sort, the developing or capital-importing state is obliged to open its economy to foreign ownership and control, and to relinquish its right to attach conditions to foreign investment, to a much greater extent than is the U.S. or Canada. This non-reciprocity of this aspect of U.S. and Canadian BITs is discussed in more detail below.

establishment in that they apply to protect an investor even before it has made any investment in the state. The obligations of national treatment and MFN treatment may be extended to the pre-establishment stage (in which case they may also be referred to as ‘market access’ or a ‘right of establishment’), typically in BITs concluded by the U.S. or Canada. Also, a prohibition on performance requirements also typically applies to the pre-establishment as well as the post-establishment stage of investment. (On the other hand, an obligation to give post-establishment national treatment would likely include prohibitions on post-establishment performance requirements that treated foreign investors less favourably than domestic investors.)

4 These sectoral exceptions are not included in BITs concluded by EU states presumably because such BITs do not extend national and MFN treatment to the pre-establishment stage. This precludes a need for EU states to protect their economies from foreign penetration and ownership in the way that the U.S. and Canada seek to protect their economies under their BITs that extend national and MFN treatment to the pre-establishment stage.
III IMPACT OF BILATERAL INVESTMENT TREATIES

A Key BITs

We begin with BITs concluded by Andean Community states. In total, CAP states had concluded 70 BITs in force as of 1 June 2006. Of these, Peru had concluded 28; Ecuador had concluded 23; and Bolivia had concluded 19. Colombia had concluded only one BIT in force (with Peru).

The most significant BITs concluded by CAP states are those concluded with a major primary capital-exporting state. Because they generally cover far more capital flows than BITs concluded between developing states, it is these BITs that are most likely to generate investor claims and thus pose threats to the regulatory autonomy of the host government. More specifically, investments covered by these treaties are most likely to lead to disputes and thus put pressure on CAP states to refrain from or restrict regulatory initiatives in order to avoid the risk or threat of an investor claim.

Table 1 indicates BITs in force between CAP states and the 16 major capital-exporters, where the BIT was by 1 June 2006.

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5 BITs in force with Argentina, Australia, Bolivia, Chile, China, Colombia, Cuba, Czech Republic, Denmark, Ecuador, El Salvador, Finland, France, Germany, Italy, Republic of Korea, Malaysia, Netherlands, Norway, Paraguay, Portugal, Romania, Spain, Sweden, Switzerland, Thailand, United Kingdom, and Venezuela.

6 BITs in force with Argentina, Bolivia, Canada, Chile, China, Cuba, Dominican Republic, El Salvador, Finland, France, Germany, Guatemala, Netherlands, Paraguay, Peru, Romania, Spain, Sweden, Switzerland, United Kingdom, United States, Uruguay, and Venezuela.

7 BITs in force with Argentina, Austria, Belgium/ Luxembourg, Chile, China, Cuba, Denmark, Ecuador, France, Germany, Italy, Republic of Korea, Netherlands, Peru, Romania, Sweden, Switzerland, United Kingdom, and United States.

8 The ‘major capital-exporters’ listed are those states whose outward stock of foreign direct investment was more than $100 billion in 2004, and whose outward stock either exceeded their inward stock in 2004 or was exceeded by their inward stock by a ratio of less than 2 to 1: data from UNCTAD, World Investment Report 2005 (New York: United Nations, 2005) annex table B.2. All four CAP states qualify as capital-importers on the basis that their outward stock of foreign investment was exceeded by their inward stock by a ratio of more than 2 to 1.
### Table 1: BITs between CAP states and the major capital-exporters

<table>
<thead>
<tr>
<th>EC:</th>
<th>BOLIVIA</th>
<th>COLOMBIA</th>
<th>ECUADOR</th>
<th>PERU</th>
</tr>
</thead>
<tbody>
<tr>
<td>BELGIUM</td>
<td>10-01-2004</td>
<td>--</td>
<td>--</td>
<td>*12-10-2005</td>
</tr>
<tr>
<td>FRANCE</td>
<td>12-10-1996</td>
<td>--</td>
<td>17-06-1996</td>
<td>4-07-1996</td>
</tr>
<tr>
<td>LUXEMBOURG</td>
<td>10-01-2004</td>
<td>--</td>
<td>--</td>
<td>*12-10-2005</td>
</tr>
<tr>
<td>SWEDEN</td>
<td>2-07-1992</td>
<td>--</td>
<td>31-05-2001</td>
<td>1-08-1994</td>
</tr>
<tr>
<td>Non-EC:</td>
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<tr>
<td>AUSTRALIA</td>
<td>--</td>
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<td>--</td>
<td>2-02-1997</td>
</tr>
<tr>
<td>CANADA</td>
<td>--</td>
<td>--</td>
<td>6-06-1997</td>
<td>20-06-2007</td>
</tr>
<tr>
<td>HONG KONG</td>
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<td>JAPAN</td>
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<tr>
<td>SINGAPORE</td>
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</tr>
<tr>
<td>UNITED STATES</td>
<td>6-06-2001</td>
<td>--</td>
<td>11-05-1997</td>
<td>--</td>
</tr>
</tbody>
</table>

**Source:** UNCTAD Investment Agreements Online (Country-specific Lists of BITs)

All of the BITs of CAP states with the major capital-exporters entered into force after 1990 with the unique exception of the Switzerland-Ecuador BIT.\(^9\) A number of the BITs\(^11\) entered into force after the dangers posed by the investor-state arbitration mechanisms of BITs became apparent by the late 1990s. Notably, no BIT was in force between Colombia and a major capital-exporter by 1 June 2006 because BITs were regarded as unconstitutional in Colombia until a decision in 2007 of the Columbian Supreme Court in which that state’s BIT with Spain was found to be consistent with its constitution (and based on which it is assumed that the Spain-Colombia BIT is now in force).\(^12\)

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\(^9\) The date entered in the chart is date of entry into force of the BIT, unless otherwise indicated. An asterix denotes that the treaty had not entered into force as of 1 June 2006 and that the date entered in the chart is that of signature of the treaty rather than entry into force. In the case of the Spain-Colombia BIT it has been assumed that the BIT entered into force following a 2007 decision of the Colombian Supreme Court in which the BIT was found to be constitutional. In the case of the Canada-Peru BIT, it has been confirmed via non-UNCTAD sources that the BIT entered into force on the date indicated.

\(^10\) The Switzerland-Ecuador BIT is likely one of the very first historically to provide for compulsory arbitration of investor claims on the basis of a prospective consent by the state. Also, remarkably in the current context, the treaty assigns ultimately appointing authority to the President of the International Court of Justice. More recent treaties typically assign such authority to ICSID, the International Chamber of Commerce, the Stockholm Chamber of Commerce, or (for claims filed under the UNCITRAL Rules) to an institution to be chosen by the Permanent Court of Arbitration.

\(^11\) i.e. Bolivia's BITs with Belgium/ Luxembourg, Spain, and the U.S.; Ecuador's BITs with Italy, the Netherlands, and Sweden; and Peru's BIT with Belgium/ Luxembourg.

\(^12\) F. Cabrera Diaz, ‘Colombian court upholds constitutionality of BIT with Spain’ *Investment Treaty News* (15 October 2007).
For a detailed summary of the inclusion of key provisions in Spain’s BITs with CAP states, see Appendix B.

B Claims against Andean Community states

There have been well over 100 known investor-state claims against developing states, brought to arbitration by a foreign investor alleging a violation of a standard of investor protection in an investment treaty, and seeking damages as compensation from the state. Approximately half are ongoing. Typically, the investor can choose whether to initiate a claim under the arbitration rules of the International Centre for the Settlement of Investment Disputes (ICSID) or the UN Commission on International Trade Law (UNCITRAL). Also, some BITs allow claims under the arbitration rules of the International Chamber of Commerce or the Stockholm Chamber of Commerce. The choice of rules is significant for a number of reasons, not least because it determines the institution that holds the vitally important authority to appoint the presiding arbitrator, where the parties do not agree, and to resolve claims of bias against an arbitrator. The role of ICSID is especially important because, in the case of ICSID annulment tribunals, all members of the tribunal are selected by the Chair of the ICSID Administrative Council, which is an ex officio position of the President of the World Bank.

There are 20 known BIT claims against CAP states (see Appendix A). 13 Ecuador has faced 15 claims, of which 10 were brought by U.S. firms (in some cases operating through holding companies established in the Netherlands), three were brought by Spanish firms, and one each was brought by a Canadian and a French firm. Ecuador has been intensively targeted for regulatory decisions it took in the energy sector, concerning both oil exploitation and electricity generation. Ecuador has faced at least seven claims arising from the government’s regulation of oil participation contracts, most recently in relation to the government’s effort to recapture a larger proportion of windfall profits earned by foreign investors as a result of high oil prices. Also, Ecuador has faced four claims arising from the privatization of its electricity network in the mid-1990s.

Of the 15 claims against Ecuador, seven are ongoing. Ecuador was successful in its defence of two and unsuccessful in two others, leading to awards of (US)$75 million and (US)$6 million, respectively, against the state. Three claims were settled and a fourth (Repsol, discussed in more detail below) has reportedly also recently settled.

Bolivia has faced three claims, of which one (Aguas del Tunari) settled after intense public pressure was directed against the investor. Two others are ongoing. Notably, in two of these claims, Bolivia was targeted by a major U.S. or European firm that structured its Bolivian investments through a holding company established in the Netherlands so that the U.S. or European owners could bring a claim under the Netherlands-Bolivia BIT. This highlights the importance of Bolivia considering withdrawal from its BIT with the Netherlands in the

13 Eleven have been brought under the U.S.-Ecuador BIT, three under the Spain-Ecuador BIT, two under the Netherlands-Bolivia BIT, and one each under the Canada-Ecuador BIT and the France-Ecuador BIT. All such claims were brought by investors from a major capital-exporting state against the CAP state party to the relevant BIT. Two other claims have been filed by Chilean investors under the Chile-Bolivia BIT and the Chile-Peru BIT, respectively.
event that the Netherlands is unwilling to renegotiate the treaty’s liberal provisions on forum-shopping. In the third claim, Bolivia was targeted by a Chilean investor.

Peru has faced two claims. Notably, both were brought by an investor not from a major capital-exporting state (i.e. from Chile and China, respectively). Peru was successful in its argument that the first claim related to a dispute that preceded Peru’s consent to compulsory investor-state arbitration in the relevant BIT, and thus fell outside the temporal jurisdiction of the tribunal. The other claim against Peru is ongoing.

Unsurprisingly, given the constitutional position on BITs adopted by its Supreme Court until 2007, Colombia is not known to have faced any claims.

Prevalence of claims in strategic sectors

Of the 20 claims against CAP states, most have involved governmental decisions in strategic sectors. In the case of Bolivia, the Aguas del Tunari claim implicated conduct of the government (including its use and potential use of coercive force against citizens) in relation to public opposition to rate hikes that followed the privatization of the water/wastewater system of the city of Cochabamba. The dispute engaged basic questions of accessibility and affordability in relation to an essential service and the corresponding implications of market-based approaches to service delivery. One of the two known ongoing claims against Bolivia, Euro Telecom, involves a policy decision of national importance to renationalize the country’s telephone network (prior to which the affected foreign investor held majority ownership of the company delivering 60% of the country’s telephone services). The other ongoing claim involves a mining concession. All claims against Bolivia may therefore credibly be said to arise in strategic sectors.

In the case of Ecuador, as mentioned, seven claims have involved oil and gas exploitation and four have involved the provision of electricity (generally in conditions of severe supply shortage and corresponding emergency in the country). There is less information available on the four remaining claims; one involved the provision of information technology services to the Ministry of Finance and Public Credit, another involved a dispute over crude oil sales, and two others involved a dispute over the expansion of a refinery. The latter three may therefore be linked to the strategic sector of resource extraction.

Finally, the two known claims against Peru involved a pasta factory (sited near a protected wetland) and a fish flour factor. Neither of these can be said to represent strategic sectors although they may hold significance for industrial policy.

Thus, of the 20 known claims, 11 involved the resource sector (oil in gas; mining), four involved electricity generation, and one each involved a major water/wastewater system and the nationwide telephone system, respectively. Three claims involved non-strategic sectors. This indicates that it is likely that a dispute arising under a BIT will engage a strategic sector of the host economy. Moreover, there are numerous other claims or awards, beyond the scope of this report, that involve developing states and that engage the strategic interests of those states and their populations in relation to resource extraction, energy, communications, transportation, major water systems, and the financial and monetary system.
C Awards against Andean Community states

To date, there have been at least 30 known awards of damages in favour of investors under investment treaties (including both BITs and regional investment agreements such as NAFTA). One award was against Spain (in favour of an Argentinian investor for the smallest sum of any known award), one was against Russia (in favour of a German investor), and two were against Canada (in favour of U.S. investors). The remaining awards have been against developing or transition states. Amounts awarded have ranged from several hundred thousand dollars (U.S.) to over one billion dollars.

Of the 30 awards to date, three have been for less than $1 million, thirteen for between $1 million and $10 million, four for between $10 million and $50 million, and nine for over $50 million (up to the award of $1.05 billion including interest in a case against Slovakia\(^\text{14}\)).

Most significant are the large or ‘catastrophic’ awards for over $50 million. The significance of these awards is that they signal to all states the exceptionally potent power of the system to discipline states and their populations. Exposure to investor-state arbitration thus impacts not only the fiscal position of a government but also its ability to plan and cost out any policy that could affect adversely the economic position of a foreign investor. Any such policy could trigger a claim and an award against the state and, as such, all states that have concluded a BIT and that import capital are impacted by the dramatic shift of political bargaining power delivered by BITs in favour of multinational firms.

There have been only two awards to date against a CAP state (both against Ecuador – see Appendix A) although more are likely to follow from ongoing claims, of which there are at least ten against CAP states. The small number of awards is perhaps surprising given that more awards have been made against Latin American states than any other region. On the other hand, Ecuador has been the target of numerous awards and is likely to face more awards or costly settlements. Further, both Ecuador and Bolivia have had to modify policy decisions in the course of a dispute with an investor who brought a BIT claim.\(^\text{15}\) Finally, it is important to keep in mind that the cost of defending a claim – for many states involving the hiring of expensive law firms in New York, London, Paris, or other major centres – poses a fiscal burden in its own right for a developing state. For example, the present author was advised by one legal advisor to the president of a large developing state that the cost of defending a single treaty claim had consumed roughly half of the entire 2005 budget of the country’s department of justice. In the extreme, the Czech Republic reportedly spent $10 million to defend itself against two claims brought by a U.S. investor.\(^\text{16}\)

\(^{14}\) Ceskoslovenska Obchodni Banka v Slovak Republic (award on jurisdiction, 24 May 1999). Note that the tribunal based its jurisdiction in this award on the incorporation into a contract of the compulsory arbitration clause in a BIT which the claimant had not shown to be in force. As the origin of the respondent state’s consent is connected to a BIT, I include it as a BIT claim.

\(^{15}\) BIT claims were settled by Bolivia in Aguas del Tunari and by Ecuador in IBM, Eurocontrol, Tecnicas Reunidas, and (reportedly) Repsol.

\(^{16}\) UNCTAD, ‘Recent developments in international investment agreements’ (Research note, 30 August 2005), p. 15.
The most significant award to date against a CAP states is that of approximately US$75 million against Ecuador in Occidental No. 1 in a dispute involving eligibility for Value-Added Tax (VAT) refunds (for the factual background of this dispute, see Appendix A).¹⁷ The most troubling aspect of this is the fact that the tribunal adopted a series of surprisingly expansive interpretations of the U.S.-Ecuador BIT to favour the position of the investor. In this respect, the award lacks credibility. In the first place, the tribunal adopted an apparently contradictory position on whether or not the underlying dispute arose from a contract. The tribunal concluded, on the one hand, that Occidental’s claim arose under the BIT (as distinct from claims arising under Occidental’s oil contract with Petroecuador), with the implication that the BIT’s ‘fork in the road’ provision did not preclude Occidental from bringing a BIT claim despite Occidental’s pursuit of domestic remedies under the contract. On the other hand, the tribunal concluded that the dispute concerned ‘the observance and enforcement’ of an investment contract, with the implication that the BIT’s exception for tax measures did not apply to Ecuador’s decision to deny VAT refunds to Occidental Petroleum. Thus, the tribunal approached the dispute both as one that arose only under the treaty and as one relating to a contract, in both respects to resolve issues in dispute in favour of the investor and thus facilitate the claim.

Also troubling, on its decision on the merits, the tribunal adopted an expansive reading of various standards of investor protection (discussed in more detail below) in the BIT, including the concepts of arbitrariness, national treatment, and fair & equitable treatment, in order to find that Ecuador violated the treaty. Regarding ‘arbitrariness’, the tribunal concluded that, even though Ecuador’s conduct (via its Servicio de Rentas Internas – SRI) had not been motivated by ‘prejudice or preference’ but was rather based on ‘reason and fact’. Nevertheless, the tribunal concluded based on a very loose framing of the standard, the ‘very confusion and lack of clarity’ arising from the SRI’s practices ‘resulted in some form of arbitrariness, even if not intended’. Regarding ‘national treatment’, the tribunal resorted to the BIT’s most-favoured-nation obligation in order to remove the usual requirement that national treatment is only required where foreign and domestic investors are ‘in like circumstances’. Instead, the tribunal found that national treatment was not limited to a comparison of domestic and foreign investors who were in like circumstances, and that it required Ecuador to provide the same treatment on VAT refunds to oil ‘producers’ (such as OEPC) as it did to ‘exporters’ of e.g. flowers (which unlike ‘producers’ were eligible for VAT refunds under Ecuadorian law). In addition, the tribunal concluded that, although the SRI did not intend to discriminate against OEPC or foreign-owned firms, the less favourable effects of the SRI’s decision were sufficient to violate national treatment.

Lastly, the tribunal also adopted a broad reading of ‘fair & equitable treatment’. It adopted the expansive (and controversial) approach of certain earlier tribunals by obliging Ecuador to ‘ensure a transparent and predictable framework for [investors’] business planning and investment’ and to ‘act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor’. Yet further, the Occidental No. 1 tribunal concluded that the state’s duty of transparency and predictability ‘is an objective requirement that does not depend on whether the Respondent [state] has proceeded in good faith or not’. Also,

¹⁷ Occidental Exploration and Production Company v Republic of Ecuador (award on the merits, 1 July 2004).
with very little discussion and with no reference whatsoever to outside legal authorities, the tribunal concluded that its very broad reading of fair & equitable treatment ‘is not different from that required under [customary] international law’. This contradicted not only the arguments of Ecuador but also those of other states, including the U.S. and Canada, in other investment treaty arbitrations. Thus, the tribunal turned the words ‘fair and equitable’ into a very onerous standard, almost assuredly surpassing that which would apply to governmental activities in the investor’s home state under U.S. law. In subjecting capital-important states to this intrusive standard, especially in combination with the remedy of a damages award against the state, tribunals apply much more intensive constraints on the regulatory decisions in developing states than apply to governments in North America and Europe under their domestic law.

On these several issues, the tribunal in Occidental No. 2 adopted expansive readings of the BIT, found a violation by Ecuador, and issued a substantial award in favour of Occidental. Notably, a related BIT arbitration is ongoing in Occidental No. 2, where the same claimant seeks more than one billion dollars in compensation. It remains to be seen whether the members of the tribunal in Occidental No. 2 will adopt as expansive an approach in favour of the investor as did the tribunal in Occidental No. 1 (for a list of tribunal members in both cases, see Appendix A).

IV IMPLICATIONS FOR GOVERNMENT DECISION-MAKING

Bilateral investment treaties have three key elements. First, they apply broadly to virtually any regulatory activity that affects assets of a foreign investor. Second, they lay out broadly-framed standards (open to varying interpretations by tribunals, as in Occidental No. 1) in order to protect investors from regulatory activity, even where the activity is a general measure that does not specifically isolate or target a particular foreign investor or groups of foreign investors. Third, via the use of investor-state arbitration, they provide for the most aggressive and intrusive form of treaty-based dispute settlement and award enforcement ever established in the regulatory sphere. We begin with the significance of this third element – which combines compulsory arbitration with state liability in the regulatory sphere, even for legislative decisions – before turning to the scope and standards of investor protection under investment treaties.

A The dynamic of state liability

Investment treaty arbitration is a uniquely powerful method to regulate and discipline states because it (a) allows direct claims by investors, often without the customary requirement to exhaust legal remedies in the host state, (b) allows for an internationally-enforceable damages award against the state for virtually any regulatory act, including legislation, and (c) relies on private arbitration to resolve public law disputes in a manner that is structurally biased against host governments. More specifically, in terms of this structural bias, BITs allow privately appointed arbitrators (rather than tenured judges) to resolve regulatory disputes between business and the state, and to determine the available policy space of host governments, in a context where only one class of parties (investors) brings the claims – giving arbitrators an incentive to interpret the law in favour of that class of parties in order to encourage more claims and more appointments – and where the ultimate authority to
appoint arbitrators is exercised by organizations whose voting structure is controlled by representatives of either multinational firms or capital-exporting states (speaking of the International Chamber of Commerce and ICSID, respectively). Further, awards made by tribunals cannot be reviewed for errors of law (other than jurisdictional errors or serious procedural unfairness) in any domestic court. Lastly, in many cases, the relevant rules of arbitration provides for the arbitrations and any awards to be kept secret unless both of the disputing parties agree otherwise.

Notably, BITs provide for investors to bring claims against states as a means to discipline states in their treatment of investors. BITs do not provide for states to bring claims against investors for activities of investors that harm the public. In this respect, investor-state arbitration is one-sided in that only one class of parties, the investors, brings the claims and only one class of parties, the states, is ordered to pay damages for violation of the treaty. The only (very minor) exception to this is the possibility that a state might bring a counter-claim against an investor for breach of an obligation of the investor to the state (probably arising under a contract that is brought within the rubric of the BIT by an umbrella clause). But even in the case of a counter-claim by the state, it is the investor who decides first to bring the dispute into the arbitration forum, thus triggering appointment of the tribunal. It is for this reason, among others, that BIT arbitrators may be seen to have a bias in favour of investors: if arbitrators do not interpret BITs in ways that favour claims by investors (while retaining the basic legitimacy for the system) then there will be fewer claims by investors and less business for the arbitration industry.

At the centre of the disciplinary power of BIT arbitration is the remedy of a damages award against the state (involving ‘state liability’ for sovereign acts of the state). These awards of damages are very different from a typical damages award in private or commercial law. They may be issued by arbitrators in order to discipline the legislature, courts, or executive of a state. This is important because it is rare in many states to allow state liability for legislative or judicial acts, and for general policy or discretionary decisions of the executive, in the case of conduct of the state that is found retrospectively to be unlawful. Such liability for the state raises concerns as to its fiscal impacts and potential to deter legitimate regulatory measures that would otherwise be passed in the public interest. Very importantly, outside investment treaty arbitration, it is unheard of to allow such questions to be resolved finally by way of compulsory arbitration (with comprehensive jurisdiction over future disputes), rather than courts, because of the perceived bias that arises from the lack of objective guarantees of independence in arbitration, especially (a) the lack of security of tenure and (b) the failure to stop arbitrators from taking up outside remunerative activity alongside their adjudicative work.

In many cases, awards under BITs arise from general regulatory measures that affect foreign investors only indirectly and in ways that were not planned or intended by the host state. Also, it is reasonable to conclude that many awards have been founded on interpretations of BITs that were more expansive than what was anticipated by states when the treaties were negotiated. The prospect of tribunals adopting expansive approaches to BITs, as in many cases to date, exacerbates other key implications of state liability. First, states face the cost of defending themselves against claims where the relevant law is uncertain or where it has been subject to conflicting interpretations by past tribunals. As noted above, these costs can be severe. Also, in the context of this uncertainty, the state may face greater pressure to settle a
case than would be the case if the law was reasonably clear. In the words of one U.S. lawyer, the ability to sue under an investment treaty is:

‘an open invitation to unhappy investors, tempted to complain that a financial or business failure was due to improper regulation, misguided macroeconomic policy, or discriminatory treatment by the host government and delighted by the opportunity to threaten the national government with a tedious expensive arbitration.’

Second, states face the cost of damages awards. To date, as mentioned, there are 30 known awards against states under investment treaties, usually against mid-sized developing states. The majority of awards were for less than $10 million (although even an award of a few million dollars can be significant for a smaller state). However, at least nine awards were for more than $50 million. These awards send a message to all states that virtually any regulatory measure, where it affects the assets of an investor in a significant way, could devastate the state’s fiscal situation.

Third, the threat of a claim and an award may cause the state to abandon legitimate measures that it would otherwise pursue in the public interest. For example, in the case of Ethyl under the investment chapter of NAFTA, the Canadian government had banned a gasoline additive that was manufactured by a U.S. firm. The ban was justified on environmental and public health grounds, including scientific opinion that inhalation of its fumes could damage the nervous system of children. The additive had been banned in California since the 1970s. In response, the U.S. firm brought a NAFTA arbitration claim against Canada, arguing that the ban was an expropriation without the required compensation. After the tribunal decided that it had jurisdiction over the claim, Canada settled. In the settlement, Canada agreed to remove the ban, declare publicly that the gasoline additive was not an environmental or a health risk, and pay $19 million in compensation to the U.S. firm.

Unlike where a state consents to arbitration in a contract, a BIT consent to arbitration opens the door to any investor, including investors unknown to the host government, initiating an arbitration in relation to virtually any regulatory dispute. The state thus loses its relative ability (under a contract) to predict and manage its liabilities arising from consents to arbitration. Arbitrators are in turn given wide-ranging, comprehensive jurisdiction, and

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18 W. Rogers, ‘Emergence of the International Centre for Settlement of Investment Disputes (ICSID) as the Most Significant Forum for Submission of Bilateral Investment Treaty Disputes’ (Presentation to the Inter-American Development Bank Conference, 26-7 October 2000).


20 Likewise, the Canadian government’s abandoned a proposal to require cigarette manufactures to remove descriptive terms from cigarette packages and use plain packaging only following a threat by cigarette manufacturer Philip Morris to bring a NAFTA claim on the basis that Canada’s proposed regulation would be ‘unfair and inequitable’ and would ‘expropriate and destroy the affected trademarks and brands in Canada as well as the substantial goodwill that accompanies them in violation of both NAFTA and TRIPS’. Thus, the threat of an investment treaty claim may have contributed to a government’s decision not to pursue a public health measure that was aimed at the legitimate objective of deterring consumption of an addictive poison. See ‘Submission by Philip Morris International Inc. in Response to the National Center for Standards and Certification Information Foreign Trade Notification No. G/TBT/N/CAN/22’.
tremendous power to evaluate and discipline states in relation to their past decision-making, including choices of elected legislatures, general governmental policies, and final decisions of the courts. This makes it difficult for states to govern in the public interest wherever there is a risk of offending the business priorities of a foreign investor.

In the context of the EC, a concern has been expressed by governments where the European Court of Justice applies its so-called Francovich doctrine to award damages in favour of an individual who has suffered harm due to a breach of EC law by a member state. According to the Danish and U.K. governments, as well as the EC Commission:

> ‘If questions of interpretation are shrouded in uncertainty and a Member State exercises discretion in a reasonable way, it would seem unreasonable for it to incur liability if it is later held that Community law precludes the national law or administrative practice in question. Unblameworthy legal mistakes should not lead to liability to make reparation.’

The very same concern arises in relation to state liability and compulsory arbitration under investment treaties.

On the other hand, it important to point out that a host state does not lose all of its options in the face of a BIT claim, even if its options are much reduced by a consent to investor-state arbitration. States retain the opportunity to negotiate for settlement, with the state’s bargaining position tending to reflect the context in which the dispute arose and, especially, the investor’s degree of interest in maintaining good relations with the host government or avoiding adverse publicity arising from a claim. Investors will themselves wish to avoid the cost of an arbitration, especially where the investor is not a major firm and where it is evident that the state will fight it out in an extended litigation. Perhaps most importantly, the ability of investors to collect on awards is not beyond question. States may opt to refuse to pay on various grounds such as violation of domestic law or the unfairness of the award or arbitration process. In such cases, investors would have to chase assets of the state in the territory of other states, pursuant to the relevant arbitration treaties allowing for extraterritorial enforcement, subject to uncertainties about the value, location, and vulnerability to enforcement of a state’s assets abroad. States threatened with or involved in an investment treaty claim are thus well advised to take cognizance of their assets abroad and ensure that they are not exposed in foreign states (e.g. France) whose domestic law adopts a liberal approach to the enforcement of foreign awards.

Fiscal reforms in the extractive sector

The following expands on the implications of state liability under BITs in relation to fiscal reforms in the extractive (or resource) sector. A fiscal reform in this sector would almost certainly be covered by a relevant BIT (i.e. one to which an affected investor had access), given the broad definition of the term ‘measure’ in BITs (see below). Thus, such fiscal reforms would likely be subject to BIT arbitration and disciplines. Any BIT would be ‘applicable’ to such reform where the affected investor could demonstrate that it was an

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investor of the other state party to the BIT, including by resort to liberal provisions on
forum-shopping (typically contained in BITs concluded by the Netherlands, the U.K., the
U.S., Canada, and Switzerland; typically not contained in BITs concluded by Germany,
France, Belgium, and Spain). Such forum-shopping provisions allow an investor to obtain
very easily the nationality of a state party to the treaty (and thus gain access to its arbitration
mechanism) simply by establishing a holding company in the state’s territory. In a number of
arbitrations against CAP states (especially under BITs with the Netherlands), the ‘investor’
was merely a holding company that was in fact owned by investors from a third state.

Notably, tax measures have been the subject of a number of claims by investors, including
against CAP states. For example, in Occidental No. 1, the decision of Ecuador’s Servicio de
Rentas Internas to deny VAT refunds to oil companies on the basis that ‘producers’ in the
oil sector did not qualify as ‘exporters’ under the relevant law and policy (which the tribunal
concluded was applied by the SRI in good faith and without an effort to prejudice foreign-
owned companies or preference domestic investors). Also, in Occidental No. 2, the target of
the investor’s claim has been an effort by Ecuador to renegotiate or terminate investment
contracts in the oil sector on the grounds that the investor breached the terms of the
contract or that the existing terms, in changing market conditions, did not deliver sufficient
benefits to the host state.22

Importantly, as discussed above, even where a state acts in good faith as in Occidental No. 1
(and elsewhere), arbitrators have awarded damages against the state by holding that mere
uncertainty or confusion arising from the state’s decisions were ‘arbitrary’, because the
effects (though not the intentions) of the state’s decisions were ‘discriminatory’, and because
of the state was said to have an ‘objective responsibility’ to ensure fair treatment for foreign
investors.

On the other hand, fiscal reforms would not be subject to a BIT if they were tax measures
that fell within the meaning of an exception for such measures in the BIT. Typically, BITs
concluded by the U.S. or Canada contain express exceptions for tax measures. That said, the
exceptions may be limited in various ways, as demonstrated in Occidental No. 1, where
Ecuador’s denial of VAT refunds was found not to fall within the BIT’s tax exception
because the dispute with Occidental involved aspects of an investment contract with
Petroecuador. It is therefore important to read any BIT exception carefully to determine its
scope and conditions of application (and its level of uncertainty). Moreover, exceptions are,
like other BIT provisions, often ambiguous and, as such, open to interpretation by tribunals
so as to favour the investor. (Indeed, in some cases, arbitrators have concluded
controversially that ambiguity in an investment treaty should be interpreted in favour of the
investor interest because the purpose of investment treaties is to protect investors.23)

More broadly, in terms of the wider dynamic of state liability, any public program or service
that requires expenditure of public funds – whether for infrastructure, health or education

22 For a detailed discussion of Repsol’s participation contract in Ecuador’s Bloque 16 oil field, and
components of the contract that involve apparent under-investment by the investor and transfers of
costs to the state, see H. Llanes Suárez, OXY – Contratos Petroleros – Inequidad en la distribución de la
23 e.g. SGS Société Générale de Surveillance v Pakistan (award on jurisdiction, 6 August 2003), para 116.
services, public security, administration of justice, arts and culture, regional development, and so on – will be impacted by BITs in two inter-related ways. First, the general budget may be severely impacted by awards and by the cost of defending claims. Second, uncertainties regarding the prospects of a claim or an award against the state in response to a proposed fiscal reform may deter the state from pursuing the reform. This was discussed in relation to the *Ethyl* case above. *Ethyl* did not involve a fiscal reform in the extractive sector, of course. Nevertheless, the case demonstrates the pressure that can be brought to bear by multinational firms, using an investment treaty, against even a major developed state.

Given that resource extraction is centrally important to the governments of all the CAP states, and that it makes up a significant proportion of state revenues, it is predictable that long-term contracts in that sector will periodically be subject to renegotiation pressures as market conditions evolve. Indeed, it may be irresponsible for a state to stand back and not seek a fairer share of extraordinary profits flowing to private firms where the price of a commodity has risen rapidly and unexpectedly on international markets (just as a private firm can be expected to seek renegotiation of long-term contracts where prices collapse). Such efforts may be viewed as a part of the state’s responsibility to ensure that the value of its extractive sector delivers commensurate benefits to its economy and population, including by way of the state’s tax and spending policies.

### B The wide coverage of BITs

BITs apply to virtually any regulatory activity because they typically define key terms such as ‘investor’, ‘investment’, and state ‘measures’ in broad terms. The implications of this are discussed below.

*Democratic choice, governmental flexibility, and the definition of ‘state measures’*

BITs apply presumptively to any measure of the state. In some cases, this is specified to include, for example, ‘any law, regulation, procedure, requirement, or practice’ under the Canada-Peru BIT. In other cases, the definition of measure is not laid out specifically but would almost be regarded by tribunals to include any act of the state. In either case, the treaties apply to virtually any measure of any branch or level of government. This is critical because it means that BIT obligations and liabilities apply not only to government acts that target or abuse specific investors, but also to general discretionary or policy choices of the executive, to final decisions of the judiciary, and to general legislative measures, including measures that are consistent with or even mandated by the domestic constitution. The fettering of democratic choice and regulatory flexibility is in turn given force by the exceptional power of the remedy, a damages award that is internationally-enforceable under the terms of arbitration treaties including the *ICSID Convention*, the *New York Convention*, and the *Panama Convention*.

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24 *Agreement Between Canada and the Republic of Peru for the Promotion and Protection of Investments*, Art. 1 – definition of ‘measure’ (signed but not in force as of 1 June 2006).
The definition of ‘investment’ in BITs is also typically broad, such that it extends beyond tangible assets to include such intangibles as market share, goodwill, intellectual property rights, or ‘any asset’. The definition of investment in the U.S.-Ecuador BIT is indicative:25

‘“investment” means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes: (i) tangible and intangible property...; (ii) a company or shares of stock or other interests in a company...; (iii) a claim to money or a claim to performance having economic value, and associated with an investment; (iv) intellectual property...; and (v) any right conferred by law or contract, and any licenses and permits pursuant to law;’

Similarly, the Netherlands-Peru BIT provides:26

‘the term “investments” shall comprise every kind of asset and more particularly, though not exclusively: (i) movable and immovable property as well as any other rights in rem in respect of every kind of asset; (ii) rights derived from shares, bonds and other kinds of interests in companies and joint ventures; (iii) title to money and other assets and to any performance having an economic value; (iv) intellectual and industrial property rights...; (v) rights granted under public law, including rights to prospect, explore, extract and win natural resources.’

The breadth of the term ‘investment’ in investment treaties means that disciplines placed on states will often overlap with disciplines arising from agreements on trade in goods (given that investments may be linked to the production of goods for export or import), trade in services (given that services may be supplied by the business establishment or ‘commercial presence’ of a service supplier), or intellectual property rights (themselves typically included in the definition of investment).

As a result of this wide coverage, the obligations of a CAP state under a BIT will typically apply to virtually any governmental act that is carried out by any branch or level of the state unless the act is expressly exempt from the treaty. Where a state is unaware of the degree of foreign ownership and BIT coverage in a particular industry or sector, therefore, it should assume out of caution that BIT liabilities could arise from regulatory measures in that industry or sector.

Even so, to found an actual claim under a BIT, the assets at stake would need to be of sufficient value to justify the cost of bringing a claim. This cost can be prohibitive for investors (just as the cost of defending claims is very burdensome for states). Moreover, an investor – before bringing a claim – must consider its wider interest in not jeopardizing its relationship with the host government. In light of these considerations, a state should be

26 Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Republic of Peru, Art. 1(a).
attentive to its BIT liabilities but not unduly intimidated. States have bargaining options too, typically reflecting the size and importance of its market or resource sector for foreign investors and their preparedness to refuse to pay an award.

**Forum-shopping and the definition of ‘investor’**

Under investment treaties, an ‘investor’ typically includes not only natural persons or corporations that are owned directly by natural persons of a state party to the treaty, but also mere holding companies that are established formally in the other state party to the treaty, but are actually owned and controlled by investors of a third state. Thus, the Netherlands-Bolivia BIT contains this provision to allow forum-shopping (as in *Occidental No. 1*) under the BIT via the establishment of holding companies: 27 ‘the term “nationals” [i.e. ‘investor’] shall comprise with regard to either Contracting Party: ... (ii) ... legal persons constituted in accordance with the law of that Contracting Party.’

Based on such provisions, many BITs adopt a liberal approach to forum-shopping such that a state – in the face of these BITs – must assume that any foreign investor in its economy may be able to access compulsory arbitration under an investment treaty even where the host state does not have a BIT with the state or origin of the foreign investor itself. A liberal approach to forum-shopping, adopted not only in the treaties but also in the interpretations of BITs by numerous tribunals – invites foreign investors to design their corporate structure in order to maximize their opportunities to bring a BIT claim against the state in which their assets are located.

Thus, in the *Aguas del Tunari* claim against Bolivia, 28 the U.S. firm Bechtel – after it became apparent that there was public opposition to its privatized water utility in Cochabamba – reorganized its corporate structure so as to insert three Dutch holding companies in the corporate structure between Bechtel itself and the Cayman Islands firm (later moved to Luxembourg at the time the Dutch holding companies were established) that owned the Bolivian firm Aguas del Tunari (which was the firm that was a party to the Cochabamba water concession). Tracing this chain of ownership, the actual majority shareholder of Aguas del Tunari (and of the concession) was a U.S. firm that had no access to a U.S.-Bolivia BIT (because none was in force at the time). However, the broad definition of ‘investor’ in the Netherlands-Bolivia BIT allowed Bechtel effectively to re-create itself as a Dutch investor, by way of Dutch holding companies, and to bring a claim against Bolivia under the Netherlands-Bolivia BIT.

So, investment treaties often protect far more than actual capital flows between states parties to the treaty. Actual flows may not correspond to the legal arrangements for ownership of assets. Investors can make themselves foreign by a paper transfer of assets among various companies without any commitment to invest new capital to the host economy. This was so

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27 *Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Republic of Bolivia*, Art. .

28 *Aguas del Tunari S.A v Republic of Bolivia* (award on jurisdiction, 21 October 2005), para 69, 73, and 237, and para 4 and 10 (dissenting opinion).
in *Aguas del Tunari*, but also in the *Fedax* arbitration, where the tribunal allowed a Dutch company to bring a BIT claim against Venezuela in a dispute concerning promissory notes issued by the Venezuelan government. Prior to the claim, the promissory notes had been transferred to the Dutch company by a Venezuelan firm. Venezuela’s argument that the investor had not made an actual investment in the country’s economy was, however, rejected.

C. **The standards of investor protection**

BITs lay out broadly-framed standards by which the conduct of host states for investment is to be evaluated in the arbitration of an investor claim. The standards typically include (most prominently): national treatment (denial of which is often called ‘discriminatory’ treatment), most-favoured nation (MFN) treatment, fair & equitable treatment (including for present purposes ‘full protection and security’), limitations on expropriation (or ‘deprivation’), specific prohibitions on performance requirements (both pre- and post-establishment), and duties to observe obligations to investors (also called ‘umbrella clauses’). Each of these is discussed below.

In the 30 awards against states to date, a tribunal based its finding that the state violated the relevant treaty on fair and equitable treatment in 23 cases (in one case, this was via an MFN clause in the treaty), limitations on expropriation in ten cases, national treatment in seven cases, an umbrella clause in five cases, and prohibitions on performance requirements in one case. In a number of cases, multiple standards were found to have been violated by the state.

**National treatment**

Although the language used in the treaties may vary, generally speaking ‘national treatment’ requires a host state to treat foreign investors from the other state party ‘no less favourably’ than it treats domestic persons or firms who are in similar circumstances (although it may treat foreign investors more favourable, as in the provision of tax holidays or exemptions from regulatory requirements). To demonstrate, under the U.S.-Ecuador BIT:

> ‘Each Party shall permit and treat investment, and activities associated therewith, on a basis no less favourable than that accorded in like situations to investment or associated activities of its own nationals or companies....’

And, according to the Spain-Colombia BIT:

> ‘Cada Parte Contratante... no obstaculizará, mediante medidas injustificadas o discriminatorias, la gestión, el mantenimiento, el desarrollo, la utilización, el disfrute, la extensión, la venta ni, en su caso, la liquidación de tales inversiones.’

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29 *Fedax NV v Republic of Venezuela* (award on jurisdiction, 11 July 1997), para 18 and 24-25.
30 *Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment*, Art. II(1).
31 *Acuerdo para la promoción y protección recíproca de inversiones entre la República de Colombia y el Reino de España*, Art. 3 (not in force as of June 2006).
State measures that favour domestic firms or employees are commonly said to be ‘discriminatory’ against foreign investors.

National treatment generally applies to the post-establishment stage of an investment, but may be extended to the ‘pre-establishment’ stage. Where a treaty extends national treatment to the pre-establishment stage, any restrictions on foreign ownership and control of the economy – including its strategic sectors – are also forbidden (unless the treaty specifically exempts them from the pre-establishment obligation). Pre-establishment national treatment is also often referred to as ‘market access’ or as a ‘right of establishment’. Under an absolute rule of pre-establishment national treatment, a state would be required to allow 100 percent foreign access and ownership in every sector of its economy.

For this reason, states include positive exceptions to pre-establishment national treatment. Exceptions adopted by states parties to BITs between CAP states and the U.S. or Canada were discussed briefly above. Table 2 offers more detail on such exceptions in relevant BITs.

**Table 2: Exceptions to national/ MFN treatment in U.S. or Canadian BITs with CAP states**

<table>
<thead>
<tr>
<th>State (BIT)</th>
<th>Exceptions from national treatment and/or MFN treatment</th>
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<tbody>
<tr>
<td>Bolivia (U.S.-Bolivia)</td>
<td>land ownership within 50 kilometers of national borders, in so far as required by Article 25 of the Constitution; air transport; transportation on interior navigable waterways; ownership of international passenger and freight land transportation companies; subsidies or grants, including government-supported loans, guarantees and insurance; obligation of foreign construction and consulting companies participating in public sector tenders to associate with a Bolivian company; and leasing of minerals and pipeline rights of way on government lands, regarding which national treatment is subject to limitations set forth in Article 25 of the Constitution.</td>
</tr>
<tr>
<td>Columbia (NA)</td>
<td>No BITs concluded with the U.S. or Canada.</td>
</tr>
<tr>
<td>Ecuador (Canada-Ecuador)</td>
<td>land ownership within 50 kilometres of the national borders, and within territories designated as reserved areas such as national parks.</td>
</tr>
<tr>
<td>Ecuador (U.S.-Ecuador)</td>
<td>traditional fishing (not including fish processing or aquaculture); and ownership and operation of broadcast radio and television stations.</td>
</tr>
<tr>
<td>Canada (Canada-Ecuador)</td>
<td>social services (i.e. public law enforcement; correctional services; income security or insurance; social security or insurance; social welfare; public education; public training; health and child care); services in any other sector; government securities; residency requirements for ownership of oceanfront land; measures implementing the Northwest Territories and the Yukon Oil and Gas Accords.</td>
</tr>
<tr>
<td>Country (Country-...)</td>
<td>Issues</td>
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<tr>
<td>----------------------</td>
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<tr>
<td>Canada (Canada-Peru)</td>
<td>acquisitions of Canadian businesses subject to the Investment Canada Act; commercial air transport; duty-free licences at land border crossings; examiners of cultural property; fishing licensing; licensed custom brokerages; limitations on interests in controlled land; limitations on ownership of uranium mining property; oil and gas production and development; the Hibernia Project; ownership of an existing state enterprise or governmental entity; Canadian ownership requirements of federally incorporated corporations; requirement that 25 per cent of directors of federally-incorporated corporations be resident Canadians; limitations on voting shares held in Air Canada, Cameco Limited, Nordion International Inc., Theratronics International Limited, and Canadian Arsenals Limited; Patent Office and Trade-Mark Office representation; pilotage services; ship registration.</td>
</tr>
<tr>
<td>United States (U.S.-Bolivia)</td>
<td>air and maritime transport, and related activities; atomic energy; banking, securities, and other non-insurance financial services; customhouse brokers; fisheries; insurance (obligation extends to NAFTA-level treatment); licenses for broadcast, common carrier, or aeronautical radio stations; COMSAT; subsidies or grants, including government-supported loans, guarantees and insurance; state and local measures exempt from Article 1102 of the North American Free Trade Agreement pursuant to Article 1108 thereof; landing of submarine cables; one-way satellite transmissions of direct-to-home (DTH) and direct broadcast satellite (DBS) television services and of digital audio services; leasing of minerals and pipeline rights of way on government lands, which is subject to the Mineral Lands Leasing Act.</td>
</tr>
<tr>
<td>United States (U.S.-Ecuador)</td>
<td>air transportation; banking; customhouse brokers; government grants; government insurance and loan programs; energy and power production; insurance; maritime services and maritime-related services; mining on the public domain; ocean and coastal shipping; ownership of real property; ownership and operation of common carrier radio and television stations; ownership of shares in the Communications Satellite Corporation; primary dealership in United States government securities; provision of common carrier telephone and telegraph services; provision of submarine cable services; and use of land and natural resources.</td>
</tr>
</tbody>
</table>

Very importantly, under each of these BIT’s, the Andean Community (i.e. capital-importing) state enjoys far fewer exceptions from national treatment and MFN treatment. Thus, CAP states accepts much wider obligations to allow foreign entry into the economy, free from screening requirements or other conditions of access, and to refrain from preferencing domestic firms in their development strategy.32 The treaties are thus non-reciprocal in this critical respect. It is obviously counter-intuitive, from a development perspective, for the developing or capital-importing state to be required to expose itself to greater penetration by

32 On the other hand, even in the case of the U.S. and Canada, significant gaps are apparent where sectoral exceptions included in one BIT are omitted from another BIT, particularly where the latter permits forum-shopping.
foreign capital than does the capital-exporting state. That is, the treaties reflect a double standard in that CAP states are precluded from taking steps to ensure domestic ownership (whether public or private) in strategic sectors where, in many cases, their developed country partner under the BIT is permitted to do just that. 33

The same non-reciprocity does not arise in the case of BITs concluded by EU states because, as discussed above, those BITs do not extend national and MFN treatment to the pre-establishment stage of investment, and thus they do not necessitate sectoral exceptions to protect the states parties’ economies from foreign penetration and ownership.

One approach to national treatment is that it is normally violated only where a state specifically targets a foreign investor for discriminatory treatment because the investor is foreign. This approach would be a reasonably predictable one that probably accords with the intentions of many states when BITs were negotiated. However, the interpretation of national treatment by tribunals has not been so straightforward. It has been characterized by difficult questions of, for example, whether ‘like circumstances’ must be shown to exist and, if so, what constitutes like circumstances; whether arbitrators should focus on treatment given to a single foreign investor only or on treatment given to foreign investors as a group; and whether the treatment afforded to foreign investors should be compared to domestic investors as whole or merely to any singular case where a domestic investor was treated more favourably. There are variations in the answers given to these questions thus far by tribunals, with major implications for the ability of states to assess their treaty obligations and liabilities.

National treatment also goes beyond intended discrimination by a state to include so-called de facto discrimination. Thus, a violation of the standard may occur when a state measure, though neutral on its face, has a discriminatory effect on foreign investors relative to whatever category of domestic investors that is selected for comparison by the tribunal. For example, in Occidental No. 1, the tribunal concluded that, although Ecuador did not intend to discriminate against OEPC or foreign-owned firms in that case, the less favourable effects of the Servicio de Rentas Interna’s decision to disallow VAT refunds to the investor (and other oil producers) was sufficient to violate national treatment.

This concept of de facto discrimination is potentially so broad that, in its extreme, any exercise of public authority that differentiated between investors would be prohibited. In the Pope & Talbot arbitration under NAFTA, the tribunal adopted this broad approach, concluding that ‘any differences in treatment’ presumptively violates national treatment ‘unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or de facto, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA’. 34 Thus, the Pope & Talbot tribunal adopted an extraordinarily expansive reading of national treatment, and then

33 Of course, it is unlikely that CAP states would offer a sufficient base of capital in order to generate domestic investors that in turn could acquire significant levels of ownership and control in strategic sectors in the U.S. or Canada. However, by way of forum-shopping, foreign investors originating in a CAP state could conceivably tap capital from a third country in order to penetrate the North American market.

34 Pope & Talbot Inc v Government of Canada (award on the merits, phase 2, 10 April 2001), para 78-79.
subjected that interpretation to a vague set of exceptions. Depending on how those exceptions are in turn interpreted by tribunals, and given that most governmental activity inherently involves differentiation among subjects of regulation, a presumptive prohibition on any differentiation between investors effectively exposes a wide range of commonplace regulatory measures to investor claims.

**Most-favoured-nation treatment**

Similar to national treatment, the standard of MFN treatment requires a state to treat foreign investors from the other states party to the investment treaty no less favourably than it treats investors from third states. Thus, different protections may be extended from one BIT to another in the full set of treaties concluded by the state, to the benefit of investors.

According to the U.K.-Ecuador BIT: 35

> ‘Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favourable than that which it accords to... national or companies of any third State.’

Neither Contracting Party shall in its territory subject nationals or companies of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favourable than that which it accords to... national or companies of any third State.’

Likewise, according to the Canada-Peru BIT: 36

> ‘Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to investors of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory.’

These clauses prohibit a state party to the BIT from giving more favourable treatment to the investors of any third state, including another capital-importing or developing state. An exception to this requirement in many BITs exists where more favourable treatment is granted by virtue of the state’s participation in a free trade zone, customs union, or common market, although the applicability of such an exception depends (as always) on the specific language of the BIT.

The implication of a broad reading of MFN treatment, as interpreted broadly by many tribunals, is that investors can ‘shop around’ to pick the best set of protections available to them from all treaties concluded by a host state.

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36 *Agreement Between Canada and the Republic of Peru for the Promotion and Protection of Investments*, Art. 4(1) (signed but not in force as of 1 June 2006).
When MFN treatment is relied on to extend substantive protections from one treaty to another treaty under which the investor has brought a claim, MFN treatment is typically referred to alongside the relevant substantive standard in the other treaty. Thus, in *Occidental No. 1*, the tribunal relied on the BIT’s MFN obligation to remove a requirement in that BIT that national treatment be limited to situations in which foreign and domestic investors were in like circumstances. Using MFN to drop this requirement, by referring to another BIT of Ecuador that did not refer explicitly to ‘in like circumstances’, the tribunal concluded that the combination of national treatment and MFN treatment required Ecuador to provide the same VAT treatment to oil ‘producers’ (such as Occidental) as it did to ‘exporters’ (which unlike ‘producers’ were eligible for VAT refunds under Ecuadorian law). This reading operated in favour of Occidental (and investors in general) by expanding the situations in which a state’s measure can be found to ‘discriminate’ in favour of domestic investors.

In a number of cases, MFN treatment has been used, remarkably, to expand not only substantive obligations but also procedural aspects of a state’s underlying consent to compulsory arbitration. Thus, some BITs contain limitations on the investor’s right to bring a BIT claim (such as a fork in the road clause or a duty of the investor to exhaust local remedies). In *Maffezini*[^37] and other arbitrations,[^38] such limitations were discarded on the basis that a commitment to MFN treatment encompassing procedural benefits of other treaties that were more favourable to the investor. Other tribunals, on the other hand, have rejected this interpretation of MFN treatment, concluding that MFN does not extend beyond substantive protections unless the relevant MFN clause clearly refers to procedural protections as well. The *Maffezini* position exposes a state to compulsory arbitration with respect to all its investment treaties where it has consented to compulsory arbitration in just a single BIT. The latter position, on the other hand, probably corresponds to the views of most states when the treaties were negotiated (if they turned their mind to the issue).

**Fair & equitable treatment (including full protection and security)**

Typically, investment treaties require host states to afford ‘fair and equitable treatment’, as well as ‘full protection and security’, to foreign investors. Different treaties phrase these obligations in different ways, but all provide for a minimum level of treatment that states must provide to foreign investors. Thus, regardless of the treatment given to a state’s own investors, the treatment of foreign investors must not fall below this floor set by the treaty.

To illustrate, the Spain-Bolivia BIT provides:[^39]

> ‘Las inversiones realizadas por inversores de una Parte Contratante en el territorio de la otra Parte Contratante recibirán un tratamiento justo y equitativo y disfrutarán de plena protección y seguridad. Ninguna de las Partes Contratantes deberá, en ningún

[^37]: *Maffezini (Emilio Agustin) v Kingdom of Spain* (award on jurisdiction, 25 January 2000), para 65.
[^38]: *Azurix Corp v Argentine Republic* (award on jurisdiction, 8 December 2003), para 60; *Sempra Energy International v Argentine Republic* (award on jurisdiction, 11 May 2005), para 92-4; *Continental Casualty Company v Argentine Republic* (award on jurisdiction, 22 February 2006), para 77-8 and 86.
[^39]: *Acuerdo para la promoción y la protección recíproca de inversiones entre el Reino de España y la República de Bolivia*, Art. 3(1).
caso, otorgar a tales inversiones tratamiento menos favorable que el requerido por el Derecho Internacional.’

Similarly, according to the Canada-Ecuador BIT:\(^40\)

‘Each Contracting Party shall accord investments or returns of investors of the other Contracting Party: (a) fair and equitable treatment in accordance with principles of international law, and (b) full protection and security.’

Finally, according to the Netherlands-Peru BIT:\(^41\)

‘Each Contracting Party shall ensure fair and equitable treatment to the investments of nationals of the other Contracting Party and shall not impair, by unreasonable or discriminatory measures, the operation, management, maintenance, use, enjoyment or disposal thereof by those nationals.

More particularly, each Contracting Party shall accord to such investments full security and protection…’

The fair and equitable treatment standard has been relied on more often than any other as a basis for finding a violation of the treaty and awarding damages against the state. This is not surprising given the variety of meanings that can be attached to the standard, and the very wide range of government activity that can potentially be scrutinized on grounds that it was ‘unfair’ or ‘inequitable’.

The CMS award against Argentina gives an example of a broad interpretation of the standard. Here the tribunal concluded that fair and equitable treatment, although ‘somewhat vague’, nevertheless required Argentina to maintain a stable legal and business environment in the midst of a financial crisis, and that this was ‘an objective requirement unrelated to whether [Argentina] has had any deliberate intention or bad faith…’.\(^42\) On this expansive reading, the tribunal decided that Argentina’s devaluation of the peso violated its BIT with the U.S., requiring payment of a large award to a U.S. investor and heightening the prospect of further awards (which have indeed followed) against the country. Also, the CMS tribunal, along with other tribunals, has rejected Argentina’s argument (echoed by other states, including the U.S. and Canada) that fair and equitable treatment is simply a component of, and thus limited by, the ‘minimum standard of treatment’ as understood in customary international law. In response to this submission by states, tribunals have tended either to reject the argument outright or to adopt an expansive view of the customary standard itself, typically with little or no discussion of relevant sources of international law. Thus, the CMS tribunal – without mention of state practice and opinio juris, relevant cases, or academic writings on international law – incredibly concluded that its far-reaching approach to fair and

\(^{40}\) Agreement between the Government of Canada and the Government of the Republic of Ecuador for the Promotion and Reciprocal Protection of Investments, Art. II(2).

\(^{41}\) Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Republic of Peru, Art. 3(1) and (2).

\(^{42}\) CMS Gas Transmission Company v. Argentine Republic (award on the merits, 12 May 2005), para 274 and 280.
equitable treatment under the U.S.-Argentina BIT was ‘not different from the international law minimum standard and its evolution under customary international law’.  

A similarly expansive reading of fair and equitable treatment was adopted by the tribunal in *Occidental No. 1*, leading to a substantial award against Ecuador, as discussed above. On the whole, it is this standard that presents the greatest uncertainty, and thus the greatest threat, to fiscal planning and regulatory decision-making on the part of states. The standards place an alarmingly wide-ranging discretionary power in the hands of arbitrators to decide how states should resolve conflicts between investors and other social groups according to the collective interest of the community as a whole.

*Limitations on expropriation, including ‘regulatory’ expropriation*

A well-known motivation for the conclusion of BITs was to protect assets of foreign investor from expropriation or nationalization by the host state. According to the U.S.-Bolivia BIT:  

‘Neither Party shall expropriate or nationalize a covered investment either directly or indirectly through measures tantamount to expropriation or nationalization... except for a public purpose; in a non-discriminatory manner; upon payment of prompt, adequate and effective compensation; and in accordance with due process of law and the general principles of treatment provided for in Article II (providing for fair and equitable treatment).’

And, under the Spain-Peru BIT:  

‘La nacionalización, expropiación, o cualquier otra medida de características o efectos similares que pueda ser adoptada por las autoridades de una parte contratante contra las inversiones de inversores de la otra parte contratante en su territorio deberá aplicarse exclusivamente por razones de necesidad o utilidad publica conforme a las disposiciones legales y en ningún caso será discriminatoria. La parte contratante que adoptara estas medidas pagara al inversor o a su derecho-habiente, sin demora injustificada, una indemnización adecuada, en moneda convertible y libremente transferible.’

What was less anticipated was the degree to which these expropriation standards were open to expansive interpretations going beyond direct expropriation to include so-called indirect or ‘creeping’ or ‘regulatory’ expropriation by the state. So, general measures of the state that leave an investor’s ownership title intact, but that otherwise cause the investor economic harm (even incidental harm, potentially) may be regarded as a compensable expropriation that requires payment of market value damages to the investor. This broad definition was

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43 *CMS Gas Transmission Company v Argentine Republic* (award on the merits, 12 May 2005), para 284.
45 Acuerdo para la promoción y la protección recíproca de inversiones entre la República de Perú y el Reino de España, Art. 5.
adopted, for example, in the (infamous) decision in Metalclad, where the tribunal concluded that expropriation included:  

\[\ldots\] not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also 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.

Such a broad reading is possible under virtually all investment treaties (with the qualified exception of some recent treaties concluded by the U.S. and Canada that limit the scope of regulatory expropriation to an extent) and would require compensation for any exercise of public authority that significantly reduced the value of an investment. According to Tysoe J. of the British Columbia Supreme Court in Canada, the reading of expropriation adopted by the tribunal in Metalclad was ‘extremely broad’ and ‘sufficiently broad to include a legitimate rezoning of property by a municipality or other zoning authority’.  

To illustrate further, a similarly expansive interpretation was adopted in the Tecmed arbitration under the Spain-Mexico BIT. Here the tribunal declined to consider public benefits of government acts that are indirectly expropriatory as a basis for differentiating expropriation from regulation. It declared: ‘we find no principle stating that regulatory administrative actions are per se excluded from the scope of the [BIT], even if they are beneficial to society as a whole – such as environmental protection’.

**Prohibitions on performance requirements**

All BITs that contain a national treatment obligation prohibit performance requirements that treat foreign investors less favourably than domestic investors. On the other hand, BITs typically do not prohibit any benefits that are given to foreign investors, but not domestic investors. BITs concluded by the U.S. and Canada, modeled after NAFTA, go further by prohibiting a specific list of performance requirements at both the pre-establishment and post-establishment stage, even where the performance requirements are applied to domestic as well as foreign investors. The prohibitions apply to various performance requirements that governments have put in place as entry conditions for foreign investors. Asian states in particular used this tool historically as a component, alongside market mechanisms, of their industrial development strategies. Typically, such conditions require the investor to export a minimum proportion of its production or to use a minimum proportion of local employees or inputs in its domestic operations. The objective of such performance requirements was to promote a wider policy of export-oriented development, employment, and enhanced

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46 Metalclad Corporation v United Mexican States (award on the merits, 30 August 2000), para 103.  
47 United Mexican States v Metalclad Corporation (2001) 89 BCLR (3rd) 359 (BC Supreme Court), para 99.  
48 Tecnicas Medioambientales Tecmed, SA v United Mexican States (award on the merits, 29 May 2003), para 121.  
linkages between foreign investments and the domestic economy, and many states achieved success by the use of these tools for these purposes.

Typically, a prohibition on performance requirements (besides the basic national treatment obligation) in an investment treaty gives a list of the specific types of requirements that are barred. According to the U.S.-Bolivia BIT:50

‘Neither Party shall mandate or enforce, as a condition for the establishment, acquisition, expansion, management, conduct or operation of a covered investment, any requirement (including any commitment or undertaking in connection with the receipt of a governmental permission or authorization):

(a) to achieve a particular level or percentage of local content, or to purchase, use or otherwise give a preference to products or services of domestic origin or from any domestic source;

(b) to restrict imports by the investment of products or services in relation to a particular volume or value of production, exports or foreign exchange earnings;

(c) to export a particular type, level or percentage of products or services, either generally or to a specific market region;

(d) to restrict sales by the investment of products or services in the Party’s territory in relation to a particular volume or value of production, exports or foreign exchange earnings;

(e) to transfer technology, a production process or other proprietary knowledge to a national or company in the Party’s territory, except pursuant to an order, commitment or undertaking that is enforced by a court, administrative tribunal or competition authority to remedy an alleged or adjudicated violation of competition laws; or

(f) to carry out a particular type, level or percentage of research and development in the Party’s territory.

Such requirements do not include conditions for the receipt or continued receipt of an advantage.’

This list provides a shopping list of the steps taken by many states as part of a wider development policy to expand the domestic economy and support national centres of capital.

That said, as mentioned above, even in the absence of an express prohibition on performance requirements – and based on the more general standard of national treatment under EC-based treaties that do not include such detailed prohibitions – it remains within

50 Treaty between the Government of the United States and the Government of the Republic of Bolivia concerning the Encouragement and Reciprocal Protection of Investment, Art. VI.
the discretion of tribunals to conclude that these types of measures are discriminatory and therefore prohibited where applied at the post-establishment stage, after an investor is admitted into the host economy. For this reason, the fact that EC-based BITs do not contain detailed prohibitions does not preclude them having an effect similar to U.S. or Canadian BITs where the performance requirement is applied post-establishment. This is especially the case where market access for European investors has been agreed by way of an Economic Partnership Agreement. As discussed below, the EU-CARIFORUM EPA also contains its own prohibition on a detailed list of prohibitions on performance requirements, including at the pre-establishment and the post-establishment stage, although this EPA obligation would presumably not be subject directly to investor-state arbitration under a BIT.

Umbrella clauses and BIT arbitration of disputes arising from an investment contract

An ‘umbrella clause’ creates a duty of the state to observe or respect its obligations to foreign investors beyond the BIT itself. Thus, the state assumes an obligation under the treaty to respect any obligation that is has entered into by way of a contract, administrative order, or other legal instrument that is not part of the treaty itself.

According to the U.S.-Ecuador BIT: ‘Each Party shall observe any obligation it may have entered into with regard to investments’.51 Alternatively, the Switzerland-Bolivia BIT provides:

‘Chacune des Parties Contractantes assure à tout moment le respect des engagements assumés par elle à l’égard des investissements des ressortissants et sociétés de l’autre Partie Contractante.’

Not all BIT’s contain an umbrella clause. A difficulty with those that do is the creation of two parallel systems to enforce the underlying obligation to which the umbrella clause applies (i.e. one system of enforcement under the treaty and another under the contract or other legal instrument). It is common for disputes arising from investment contracts to be submitted to arbitration under the BIT in lieu of (or even in addition to) the alternative legal process that can be pursued under the dispute settlement clause of the contract.

This leads to a number of complexities. In particular, BIT’s have generally been interpreted by arbitrators to allow what is essentially the same dispute (between the state or a state entity and the foreign investor or a domestic company owned by the foreign investor) to be submitted to the BIT tribunal in addition to whatever court or tribunal (whether domestic or international) that has the authority to resolve disputes under the underlying contract. Thus, in such circumstances, the investor who brings the BIT claim can also bring a parallel claim (or claims) outside of the BIT. This means that the investor, in the context of a single dispute, may be able to pursue two different legal proceedings in order to pressure the state and win compensation from it, arguably in violation of the principle that a party should be

51 Treaty between the United States of America and the Republic of Ecuador concerning the Encouragement and Reciprocal Protection of Investment, Art. 3(c).
52 Accord entre la Confédération suisse et la République de Bolivie concernant la promotion de la protection réciproques des investissements, Art. 11.
able to litigate a claim only once, and accept the result that is reached in the litigation that it pursued. Also, this means that investors – having agreed in a contract with the state to accept one form of dispute settlement, such as domestic courts, as a condition of the investor’s rights and responsibilities under the contract – has been allowed by BIT tribunals to avoid this commitment by litigating a contractual dispute under a BIT. Lastly, in most cases, disputes that are subject to an umbrella clause tend to arise in the context of sectors that were privatized by the state and then subjected to regulatory requirements or reforms opposed by the foreign investor. Privatization programs that were originally planned by the state to be under the authority of a domestic court or tribunal have in many cases been opened to international arbitration by the liberal interpretation of an umbrella clause in the BIT.

An example of both of these aspects of umbrella clauses is offered by the *Duke Energy* award against Ecuador. Here a dispute arose from contracts entered into between two firms (both of which became claimants under the BIT) and Ecuador dealing with the generation of electrical power in Guayaquil. One claimant, Electroquil (later purchased by the other claimant, the U.S. firm Duke Energy), was the first private power generator to have been established in Ecuador (in 1992) following an energy privatization programme. From 1995, the Instituto Ecuatoriano de Electrificación (INECEL) entered into power purchase contracts with Electroquil to provide power until 1996. In this year, however, the process of electricity contracting was liberalized and INECEL was liquidated by legislation, and the Ministry of Mines and Energy assumed INECEL’s rights and obligations. Under the power purchase contracts, fuel was to be supplied to Guayaquil by the state entity Petrocomercial and paid for by INECEL.

A dispute over alleged non-payment by Petroecuador for power supplied under the power purchase contracts, and over the imposition of fines by INECEL against Electroquil for its alleged failure to satisfy its obligations, led to a contractual arbitration claim by Electroquil before the Arbitration and Mediation Center of the Guayaquil Chamber of Commerce. This claim was dismissed by the tribunal on the basis that the contractual arbitration clause was invalid under Ecuadorian law. However, Duke Energy and Electroquil then brought the BIT claim over outstanding disputes under the contract. Thus, they avoided an unfavourable result in the forum for dispute settlement that had been agreed to in the contract itself by relying in an umbrella clause in a BIT.

In its decision, the BIT tribunal in *Duke Energy* concluded that INECEL had breached its payment obligations arising from the power purchase agreements and that some of the fines levied against Electroquil were unjustified (although the tribunal found no bad faith on the part of Ecuador). In turn, the tribunal found that these contractual breaches constituted a violation of Ecuador’s BIT umbrella clause obligation to ‘observe any obligation it may have entered into with respect to investments’. (The tribunal also found a violation of fair and equitable treatment standard on the basis that Ecuador ‘deceived Duke Energy’s reasonable expectations’ by not implementing a payment guarantee). However, the tribunal limited its damages award to what it described as the ‘nominal sum’ of approximately (US)$5.7 million plus interest. Even so, this was $5.7 million more than what Ecuador was obliged to pay to the investors under the contractual dispute settlement provisions that Electroquil (and, as Electroquil’s owner, Duke Energy) had agreed to in the contract itself.
Another illustration of the tensions arising from parallel claims under both a BIT and a contract, involving the water sector, arose in *Aguas del Aconquija*. The dispute was rooted in a 1995 concession contract between Compagnie Générale des Eaux (CGE) and an Argentine affiliate, on the one hand, and the government of Tucumán, a province of Argentina, on the other hand. The concession followed a decision by the Tucumán government to privatize its water and sewage facilities. The contract contained detailed provisions on the service CGE would provide, tariffs it would charge, and investments it would make. After the agreement was concluded, disputes arose between CGE and Tucumán over various issues including the method for measuring water consumption, the level of tariffs, the timing and percentage of any increase in tariffs, the remedy for non-payment of tariffs, the right of CGE to pass-through to customers certain taxes, and the quality of the water delivered.

CGE alleged that the Tucumán government tried to frustrate its operation of the concession. According to CGE, this was part of a ‘concerted public attack… which included a series of inflammatory statements and other acts encouraging customers not to pay their bills’. Attempts to renegotiate the concession occurred between CGE and Tucumán and, in time, the national government. Negotiations led to a 1997 framework agreement but, according to CGE, the governor of Tucumán changed the terms of this agreement before submitting the necessary implementing legislation to the Tucumán legislature. Further negotiations failed and CGE sought to rescind the concession on grounds of alleged default by Tucumán. Tucumán rejected the CGE notice of rescission and terminated the concession itself, alleging default of performance by CGE. Ten months later, the national government assumed responsibility for the operation of the water and sewage system.

CGE brought a claim under the France-Argentina BIT. Its argument was that, although Argentina was not a party to its concession contract with the government of Tucumán, Argentina had nevertheless failed to prevent Tucumán from its alleged actions concerning the concession contract and thus infringed the investor’s entitlements to protection under the BIT. Yet, the concession itself provided for disputes arising under it to be submitted to the exclusive jurisdiction of the Tucumán administrative courts. In light of this, the BIT tribunal refused CGE’s claim on the basis that, for the tribunal to resolve it, the tribunal would have to undertake a detailed interpretation and application of the contract, a task that was left by the contracting parties to the Tucumán administrative courts. Also, the tribunal held that Argentina’s actions did not constitute a direct breach of the BIT. Following a challenge to this decision by CGE, the decision was overturned by an ICSID annulment panel of three arbitrators (all appointed by the Chair of the ICSID Administrative Council, i.e. the World Bank President). A new tribunal was constituted, the BIT was permitted to proceed in spite of the dispute settlement clause in the contract, and Argentina was found to have violated the BIT, leading to an award of roughly (U.S.$142 million, including interest, to the investor.

Ultimately, these cases demonstrates how umbrella clauses have been interpreted by BIT tribunals to allow investors to avoid their commitments to accept the authority of domestic courts or tribunals in any disputes arising under a contract concluded between the investor and a state entity. In turn, states have been ordered by arbitrators to pay substantial damages.

to these investors in disputes arising from privatization programs, even when the terms of
the privatization contracts limited the state’s liabilities to orders issued by domestic courts
and tribunals. Thus, umbrella clauses in BITs have made the liabilities of states arising from
privatization programmes far more extensive that they first appeared at the time the program
was put in place.

V INVESTMENT LIBERALIZATION UNDER EPAs

The EU has proposed to conclude Economic Partnership Agreements with a number of
developing states, including Andean Community states. The first such EPA was concluded
between the EU and the CARIFORUM states in late 2007. This report looks to the text of
that EPA as a model for the investment and services liberalization provisions that an EPA
with CAP states would potentially contain.

At the outset, it is important to note that ‘services’ liberalization, where it involves the
removal of restrictions on foreign ownership and operation in certain sectors of a host
economy, also involves the liberalization of investment. The two concepts overlap; a
‘service’ may be, or may be comprised of, an investments. Likewise, an investor will often be
a service supplier, and vice versa.\(^{54}\) Thus, when one speaks of the liberalization of services by
the removal of domestic measures restricting the establishment of foreign service suppliers
in a host economy, one also speaks of liberalization of investment, particularly in terms of
pre-establishment or market access privileges.

The EPA model provides, in short,\(^{55}\) for the states parties to remove restrictions on foreign
ownership of their economy in those sectors where they undertake positive commitments to
liberalize. The commitment to allow market access in liberalized sectors in the EU-
CARIFORUM EPA states as follows:\(^{56}\)

‘With respect to market access through commercial presence, the EC Party and the
Signatory CARIFORUM States shall accord to commercial presences and investors
of each other a treatment no less favourable than that provided for in the specific
commitments contained in Annex […] (commitments on investment and trade in
services).’

The EPA model also prohibits, in liberalized sectors, a variety of performance requirement
commonly used by states to restrict or screen foreign investment, with a view to enhancing
its benefits for the host economy. In particular the EU-CARIFORUM EPA states:\(^{57}\)

‘In sectors where market access commitments are undertaken, the measures which
the EC Party and the Signatory CARIFORUM States shall not maintain or adopt

\(^{54}\) For example, where a government restricts foreign ownership in the oil and gas sector, it will by
implication preclude the delivery of oil and gas services by companies via mode 3 of the GATS; that
is, by establishment of a foreign service supplier in the host economy.

\(^{55}\) The author examined the significance of investment provisions in the EU-CARIFORUM EPA in a
report to Oxfam in March 2008.

\(^{56}\) EU-CARIFORUM Economic Partnership Agreement, Part II, Title II, Article 6(1).

\(^{57}\) EU-CARIFORUM Economic Partnership Agreement, Part II, Title II, Article 6(2).
either on the basis of a regional subdivision or on the basis of its entire territory, unless otherwise specified in Annex [...] (commitments on investment and trade in services) are defined as:

(a) limitations on the number of commercial presences whether in the form of numerical quotas, monopolies, exclusive rights or other commercial presence requirements such as economic needs tests;

(b) limitations on the total value of transactions or assets in the form of numerical quotas or the requirement of an economic needs test;

(c) limitations on the total number of operations or on the total quantity of output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test 58.

(d) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment; and

(e) measures which restrict or require specific types of establishment (subsidiary, branch, representative office) 59 or joint ventures through which an investor of the other Party may perform an economic activity.’

Thus, states parties to the EPA are precluded from imposing a variety of restrictions or conditions on foreign investment, including limits on the number or share of foreign firms in a sector, limits on the proportion of a firm or industry that is foreign-owned, the use of an economic needs test to approve proposed investments, or requirements to engage in joint ventures with local firms. The prohibition is comparable to the detailed prohibitions on performance requirements that are contained in BITs concluded by the U.S. or Canada, although applying to the pre-establishment stage only where investments are permitted according to the EPA’s positive list of commitments to liberalize.

The EPA model establishes further an obligation of national treatment that is likely to preclude performance requirements that are designed to encourage economic linkages or protect domestic enterprises. According to the EU-CARIFORUM EPA: 60

‘1. In the sectors where market access commitments are inscribed in Annex [...] (commitments on investment and trade in services) and subject to any conditions and qualifications set out therein, with respect to all measures affecting commercial presence, the EC Party and the Signatory CARIFORUM States shall grant to

58 Note to text: ‘Subparagraphs 2(a), 2(b) and 2(c) do not cover measures taken in order to limit the production of an agricultural product.’

59 Note to text: ‘Each Party may require that in the case of incorporation under its own law, investors must adopt a specific legal form. To the extent that such requirement is applied in a non-discriminatory manner, it does not need to be specified in a Party’s schedule of commitments in order to be maintained or adopted by the Parties.’

60 EU-CARIFORUM Economic Partnership Agreement, Part II, Title II, Article 7.'
commercial presences and investors of each other treatment no less favourable than that they accord to their own like commercial presences and investors.’

By way of this provision, the states parties to the EPA are precluded from treating domestic firms in a way that alters the conditions of competition in their favour relative to foreign firms. (Note that, like BITs, the EPA does not prohibit states from treating foreign investors more favourably than their domestic counterparts.) The obligation thus appears to bar states from applying performance requirements (other than via subsidies, meaning the attachment of conditions by the state to the eligibility of a firm for direct payments of financial support by the state) to foreign investment as a condition of their commercial presence including, for example, requirements to employ local personnel, use local materials, produce for export, or otherwise establish linkages with the domestic economy or protect domestic enterprises.

A key purpose of EPAs for the EU is thus to provide market access for European investors that complements and activates the post-establishment protections that already exist for these investors under existing BITs between EC states and CAP states. As noted above, unlike BITs concluded by the U.S. and Canada, European BITs do not require the removal of restrictions on foreign ownership or of other conditions of entry by foreign investors. That is, they do not extend the state’s national treatment obligation to the pre-establishment stage of an investment. A critical purpose of provisions on investment and services liberalization in EPAs is to oblige CAP states to remove such restrictions in order to facilitate penetration by European firms into the host economy, including its strategic sectors, which will then trigger the elaborate post-establishment protections provided by existing BITs.

As a result, when it opens a sector to foreign investment, a CAP state faces the prospect of rapid penetration of its economy in the relevant sector, and corresponding expanded liabilities under its BITs. In the experience of some Latin American states that liberalized strategic sectors such as water, electricity, or telecommunications in the 1990s – especially Argentina – these liabilities have manifested themselves in a flood of investor claims, the costs of which have been severe. Argentina has faced dozens of claims under its BITs, and seven awards to date totaling approximately $752 million in damages, in disputes arising mainly from sectors liberalized, and purchased by foreign investors, in the 1990s. These claims have led to damages awards against Argentina in spite of the fact that the foreign investor in many cases took major risks by borrowing in hard currency to finance asset acquisitions in Argentina, while relying for revenues on payments by consumers in local currency. Despite this business decision of investors, arbitrators have awarded them with market value compensation, at the expense of Argentinian taxpayers, for their losses arising from general reforms passed by Argentina in the face of a severe financial crisis.

Further, as discussed earlier, the treaty liabilities accompanying foreign investment, once markets are opened under an EPA, have a strong potential to deter states from taking steps on behalf of consumers and the population to ensure quality, reliability, and accessibility of essential services, where doing so may trigger a dispute with a foreign

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61 EU-CARIFORUM Economic Partnership Agreement, Part II, Title II, Article 1(3).
investor. The experiences of Argentina in Aguas del Aconquija and Bolivia in Aguas del Tunari, as discussed above, demonstrate this dynamic.

EPAs must therefore be understood as blocks that build on the existing arbitration mechanisms of BITs. The EPA does not provide for compulsory investor-state arbitration; its dispute settlement mechanism relies on state-state arbitration. However, by concluding an EPA, the state exposes itself to BIT claims by European investors whose investments are made possible only by the market access commitments in an EPA. The critical point is that, once the investor enters the state’s economy, all of the post-establishment obligations of the under its relevant BITs are triggered.

Lastly, any specific or general exceptions contained in an EPA – for measures of public health or environmental protection, for example – would not apply to the obligations that a state has undertaken pursuant to a BIT. Only rarely to BITs concluded by EU states contain broad exceptions for measures undertaken for reasons of public interest and, even when they do, such exceptions typically do not extend to the provisions most commonly relied on by tribunals to find a violation of the treaty and order the state to pay damages (especially, fair & equitable treatment and limitations on expropriation). Thus, for example, the Spain-Bolivia BIT provides:

62 ‘Las medidas que se adopten por razones de orden público o seguridad y salud pública no se considerarán tratamiento «menos favorables» en el sentido del presente artículo.

However, this exception applies only to the state parties’ obligations to provide national treatment and MFN treatment to foreign investors. Moreover, the fact that this exception is not included in Spain’s BITs with Colombia, Ecuador, or Peru has the alarming implication that public security and public health measures are not excused from national treatment and MFN treatment obligations under these other BITs (or even under the Bolivia-Spain BIT itself, if the MFN clause in that BIT was read liberally to eliminate the exception based on its exclusion (and thus ‘more favourable’ treatment of investors) in other BITs concluded by relevant state).

VI CONCLUSION

BITs presents major fiscal risks to governmental decision-making in a range of sectors, including strategic sectors such as the extractive sector, transportation, banking and financial services, government insurance, state enterprises, broadcasting, telephone services, and social services. Those risks arise primarily from the threat of investor claims that a state is exposed to as a result of broadly-framed standards of investor protection in BITs and the proclivity of many arbitration tribunal to interpret those standards broadly in favour of investors. The system thus shifts political bargaining power dramatically in favour of the business interests of multinational firms and against other social interests that stand to benefit from measures to regulate investors or attach conditions to the entry of foreign investment into the domestic economy.

62 Acuerdo para la promoción y la protección recíproca de inversiones entre el Reino de España y la República de Bolivia, Art. 4(5).
BIT claims are resolved by tribunals with compulsory jurisdiction over host state and constituted under the authority of organizations at which voting power is concentrated in the major capital-exporting states or representatives of multinational firms (as in the case of the World Bank and the International Chamber of Commerce, respectively). Given the apparent bias – arising from the financial interest of the arbitration industry – in favour of investors and against respondents, present arrangements for investment treaty arbitration are understandably regarded to be unfair to developing, capital-importing states. It is of course true that investors have been unsuccessful in many cases under investment treaties, but they have also won many claims and received substantial damages following expansively pro-investor interpretations of the treaties by tribunals.

In this environment, in order to protect the regulatory flexibility and responsiveness of government, states should consider a number of steps to limit their BIT liabilities. First, they should seek to evaluate whether their BITs have in fact generated increased investment in a manner that is desirable to the host state’s economic objectives. In the absence of clear evidence that this is the case, a state should limit its commitments to compulsory arbitration to consents given in investment contracts, where the state is in a stronger position to link such a commitment to actual commitments to invest capital. Existing BITs that do not deliver a demonstrable benefit in terms of increased investment seek either be abrogated at the earliest opportunity or subjected to renegotiation with the other state party in order to excoriate their most problematic aspects (including liberal provisions on forum-shopping, an MFN clause that may be extended to procedural aspects of other BITs, and the allocation of the authority to appoint arbitrators to business organizations). Notably, in order to remove its liabilities under investment treaties, a state must seek to limit or withdraw its consents to compulsory arbitration in BITs (and regional treaties) and not simply to withdraw from ICSID or from the ICSID Convention. Most BITs allow investors to bring claims not only before ICSID but also in other forums, for instance pursuant to the UNCITRAL Rules.

Lastly, the EU’s project to conclude EPAs with developing states must be understood in terms of the interaction between, on the one hand, the market access provisions of the EPA – designed to apply to the pre-establishment stage of investment – and on the other hand the elaborate, broadly-framed post-establishment protections offered by BITs. Developing states that allow penetration of the home economy by foreign capital under an EPA risk some very unwelcome surprises if and when foreign firms later come to dispute aspects of their regulatory treatment by a host government.
Known BIT claims against CAP states
(as at 19 August 2008)

<table>
<thead>
<tr>
<th>State</th>
<th>Claim</th>
<th>Year initiated</th>
<th>Relevant treaty and arbitration rules</th>
<th>Claimant and sector</th>
<th>Host state measure</th>
<th>Resolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bolivia</td>
<td><em>Aguas del Tunari</em></td>
<td>2002</td>
<td>Neth-Bol BIT</td>
<td>Claimant ADT was Bolivian company, owned by series of Dutch companies, in turn owned by U.S. firm Bechtel.</td>
<td>Various acts and omissions of Bolivia concerning the concession agreement, alleged to have breached the BIT.</td>
<td>Claim settled in early 2006. Both claimant and Bolivia agreed to drop financial claims against the other and that ‘the concession was terminated only because of the civil unrest and the state of emergency in Cochabamba and not because of any act done or not done by the international shareholders of Aguas del Tunari’. The settlement followed the extensive public pressure on Bechtel to withdraw BIT claim.</td>
</tr>
</tbody>
</table>

Claim arose from 1999 concession contract between ADT and Bolivia’s Superintendent of Water for exclusive delivery of water and sewage services for city of Cochabamba over 40-year period. The city’s water system was previously run by the state agency SEMAPA.

At time of the concession, 20% of shares in ADT were divided among four Bolivian companies, 25% were owned by Uruguay company Riverstar International, and 55% were owned by Cayman Islands-based International Water which was 100% owned by U.S. firm Bechtel.

The concession contract was subject to various acts and omissions of Bolivia concerning the concession agreement, alleged to have breached the BIT.

Tribunal: U.S. national David Caron, presiding (appointed by Chair of the ICSID Administrative Council – i.e. the President of the World Bank); Canadian national Henri Alvarez (appointed by investor); Mexican national Jose Alberro-Semerena, (appointed by Bolivia).

Tribunal found jurisdiction. Tribunal allowed claim under Netherlands-Bolivia BIT despite forum-shopping by Bechtel via the corporate reorganization that followed mounting public controversy over the concession. It concluded that the corporate re-organization did not breach the concession contract and that it was not necessary to order production of documents regarding alleged misrepresentations by Bechtel. In a detailed analysis,
of public controversy and criticism by citizens’ groups from at least the time it was signed until its termination in 2000 following a major escalation of public protests. A concern of citizens’ groups was that the concession would make illegal the existing communal water systems, previously autonomous of SEMAPA, on which many of the city’s inhabitants relied. Great hardship was also caused by substantial increase in rates that were implemented shortly under the concession.

ADT was aware of and engaged in the public debate from shortly after the initiation of the concession. Notably, after the concession and controversy began, the Cayman Islands company International Water was ‘migrated’ to Luxembourg and its ownership was transferred to a Dutch company in turn owned (via other Dutch companies) by Bechtel and (apparently) the UK firm Edison. The insertion of this Dutch holding company into the ownership chain for the concession contract allowed for a claim to be brought under the Netherlands-Bolivia BIT.

The Tribunal also concluded that there was sufficient control of ADT by the relevant Dutch holding companies to allow the BIT claim.

Dissenting opinion by arbitrator Alberro-Semerena would have dismissed the claim on the basis that the corporate reorganization took place after another proposal to insert a Dutch holding company into the corporate structure had been rejected by Bolivian authorities. This indicated deception or misrepresentation on the issue of the nationality of the investors under the concession agreement.

Tribunal also rejected a petition by non-governmental organizations to participate in the proceeding on the basis that it had no jurisdiction to do so without the consent of the disputing parties.


Bolivia  *Quimica e Industrial del Borax*  2006  Chile-Bol BIT  Claimant is a Chilean chemical firm that owns majority stake in Bolivian mining company Non-Metallic Minerals.

Rescission of Non-Metalic Minerals’ mining concession in 2004 reportedly because the company systematically withheld information from the national customs regarding taxes and for auditing purposes and because

Tribunal: Swiss national Gabrielle Kaufmann-Kohler, presiding (unknown whether appointed by ICSID or by agreement of the parties); Canadian national Marc Lalonde (presumably appointed by the investor); French national Brigitte Stern (presumably appointed by Bolivia).
<table>
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<tr>
<th>Country</th>
<th>Claimant</th>
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<th>Description</th>
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<tr>
<td>Bolivia</td>
<td>Euro Telecom</td>
<td>2007</td>
<td>Neth-Bol BIT</td>
<td>ICSID Rules</td>
<td>Telecommunications sector. Eurol Telecom is reportedly incorporated in the Netherlands and wholly owned by Dutch company International Communication Holding, which is in turn owned 100% by Telecom Italia International, also a Dutch company, in turn owned 100% by Italian company Telecom Italia, in turn owned by Spanish Telefonica (42.3%), among others. Renationalization of Bolivian telecommunications company ENTEL after Euro Telecom allegedly failed to meet investment requirements and pay taxes and tax-related fines. Negotiations regarding appropriate compensation were unsuccessful. Claim is ongoing; tribunal not yet constituted; no jurisdictional award issued. Attempt by Euro Telecom to freeze assets of Bolivia and ENTEL (on the basis that Bolivia has refused to recognize ICSID's jurisdiction) in the UK was rejected by the Court of Appeal. Other attempts to freeze assets are ongoing in other jurisdictions. European Commission has reportedly intervened with Bolivia in support of Telecom Italia. See UK court decision of 28 July 2008; ICSID website; Investment Treaty News report dated 17 January 2008; open letter of Corporate Europe Observatory to EC.</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Repsol v Petroecuador</td>
<td>2001</td>
<td>Not a treaty claim but rather a contract-based claim. Case is noted here to avoid confusion with Repsol claim</td>
<td></td>
<td>Contract between Repsol and Petroecuador (owned by Government of Ecuador) for oil exploration and production. Government of Ecuador sought negotiate changes to the service contract under which Repsol operated for a share-purchase agreement. A dispute arose over alleged non-payment of accounts as between the first and second Tribunal: Costa Rican national Rodrigo Oreamuno Blanco, presiding; Ecuadorian national Eduardo Camigniani Valencia; Ecuadorian national Alberto Wray Espinosa. Jurisdiction and violation of contract found. In</td>
</tr>
<tr>
<td>Country</td>
<td>Company</td>
<td>Year</td>
<td>Treaty</td>
<td>Claim Details</td>
<td>Award Details</td>
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<tr>
<td>Ecuador</td>
<td>IBM</td>
<td>2002</td>
<td>US-Ecuador BIT</td>
<td>Claimant is a U.S. corporation established under New York law. An Ecuadorian subsidiary of IBM was party to a concession contract with the Republic of Ecuador's Ministry of Finances and Public Credit. IBM claimed that money due to its subsidiary had not been paid. The contract was for the provision of Information Technology services.</td>
<td>Jurisdiction found. IBM found to have an investment under the treaty in the form of the concession contract itself as well as IBM's contractual right to collect monies. By its consent to arbitration in the BIT, Ecuador 'irrevocably commits itself to the ICSID jurisdiction for the finding jurisdiction, tribunal dismissed Ecuador's argument, among others, that the dispute had already been resolved by the National Hydrocarbons Board. Tribunal awarded approximately (US)$14 million to investor. Petroecuador's application for annulment rejected. Annulment tribunal (all members appointed by Chair of ICSID Administrative Council – i.e. the President of the World Bank): US national Judd Kessler, presiding; Italian national Piero Bernardini; Chilean national Gonzalo Biggs. See annulment tribunal award dated 8 January 2008; H. Perez Loose, 'Ecuadorian Request to Annul An Icsid Award is Denied' (7 February 2007) <a href="http://www.mondaq.com">www.mondaq.com</a>.</td>
</tr>
<tr>
<td>Country</td>
<td>Case</td>
<td>Year</td>
<td>Details</td>
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<tr>
<td>Ecuador</td>
<td>MCI Power</td>
<td>2002</td>
<td>Claimants are U.S. corporations that own and control Seacoast (also a U.S. company, established under the laws of Texas) that invested in Ecuador via a branch operation. The branch operation agreed to install and operate two electrical power generation plants and sell their power to the Instituto Ecuatoriano de Electrificación (INECEL), an Ecuadorian state entity. Termination of contract by INECEL. Dismissal by a domestic tribunal of Seacoast's claims for compensation arising from alleged breach of contract. Claim dismissed by tribunal in merits award dated 31 July 2007. Investor had claimed violations of fair &amp; equitable treatment; national treatment; and prohibitions on expropriation. Tribunal: Argentine national Raúl E. Vinuesa, presiding (appointed by ICSID after consultation with the parties); Canadian national Benjamin J. Greenberg (appointed by investor); Chilean national Jaime Irarrázabal C. (appointed by investor).</td>
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</table>

Dissenting opinion by arbitrator Aguilera declined to find jurisdiction over the claim on the basis that IBM was obliged by the contract to submit its claims to domestic courts.


solution of disputes arising from the BIT and Ecuador 'cannot unilaterally withdraw itself from the duties it acquired in a sovereign manner when it freely negotiated the BIT...'. Also, ‘the investor is the one to select the different ways of solving controversies... at the moment he files his claim'. Although the contract provided that disputes arising under it were to be referred to the tribunals and courts of Quito, IBM could bring a claim under the BIT (even as its Ecuadorian subsidiary might pursue a contractual claim in domestic courts) so long as IBM had not itself previously initiated court proceedings in Ecuador.

Also, 'the investor is the one to select the different ways of solving controversies... at the moment he files his claim'.
Claim arose from termination of the contract between Seacoast and INECEL and alleged non-payment of monies owed.

Other U.S. subsidiaries of the claimants owned Ecuadorian subsidiary Ecuapower. A further claim arose also from a subsequent contract between Ecuapower and INECEL to provide power.

Claim arise because Ecuapower's eventual sale of its contractual rights to other foreign owners was allegedly under disadvantageous conditions due to unwarranted delay in the signing of the contract by INECEL.

Jurisdiction limited to claims arising from acts or omissions that occurred after entry into force of the treaty. Tribunal lacked jurisdiction over many of the alleged breaches of the treaty which arose from acts and omissions preceding entry into force.

On the merits, tribunal rejected argument by Ecuador that treaty applied only to sovereign acts of Ecuador and not commercial acts of INECEL. INECEL was an organ of the state and ‘any acts or omissions of INECEL in breach of the BIT... are attributable to Ecuador’. Investor's nevertheless claims rejected on basis that the failure to reach agreement on Seacoast's liquidation did not arise from bad faith by INECEL (or Seacoast) and there was no basis to conclude that revocation of a permit in the circumstances amounted to an expropriation.

Annulment proceedings ongoing. Annulment tribunal (all members appointed by Chair of ICSID Administrative Council – i.e. the President of the World Bank): French national Dominique Hascher, presiding; Swedish national Hans Danielius; Slovakian national Peter Tomka.

Filed under UNCITRAL Rules.

California law.

Dispute arose following an oil exploration and production contract with Petroecuador. The contract was a participation contract, which followed earlier services provision contracts. The dispute involved whether or not OEPC was entitled to Value-Added Tax (VAT) refunds, or whether the cost of VAT had been incorporated in the terms of the contract.

OEPC filed four lawsuits in the tax courts of Ecuador objecting to the denial of VAT refunds by the SRI, which were not resolved at the time the tribunal decided OEPC’s BIT claim.

Tribunal: Chilean national Francisco Orrego-Vicuna, presiding (appointed by agreement of co-arbitrators); US national Charles Brower (appointed by investor); Ecuadorian national Patrick Barrera Sweeney (appointed by Ecuador).

Jurisdiction found. The tribunal allowed the BIT claim to proceed, although it ran parallel to challenges brought by OEPC in domestic courts, on the basis that it was a separate, treaty-based claim rather than a contractual claim. This was important because the BIT contained a 'fork in the road' clause, whereby an investor was precluded under the treaty from submitting the same dispute both to domestic courts and to a BIT tribunal.

In addition, the tribunal concluded that the BIT’s exception for tax measures did not apply to OEPC’s claim because ‘in part the dispute finds its origins in [the contract] insofar as it is disputed whether VAT reimbursement is included in Factor X [of the contract]’. This was important because the BIT’s exception for tax measures was did not apply to a dispute concerning ‘the observance and enforcement of terms of an investment Agreement or authorization’. However, the tribunal’s conclusion that the dispute arose from a contract (thus defeating the BIT’s exception for tax measures) contradicts its conclusion that the dispute arose from the treaty (thus allowing the investor’s claim under the BIT despite its parallel resort to domestic remedies and consequent breach of the
On the merits, the tribunal found that Ecuador had violated the BIT by treating the investor arbitrarily; even though the SRI’s decision-making to deny VAT refunds was found by the tribunal not to be based on ‘prejudice or preference’ but rather on ‘reason and fact’, nevertheless, the ‘very confusion and lack of clarity’ arising from the SRI’s practices over several years ‘resulted in some form of arbitrariness, even if not intended’.

Further, on the merits, the tribunal interpreted the BIT’s most-favoured-nation obligation such that it was taken to remove any requirement that national treatment under the BIT be limited to situations in which two investors are ‘in like circumstances’. Instead, the tribunal found that national treatment required Ecuador to provide the same VAT treatment to oil ‘producers’ (such as OEPC) as it did to ‘exporters’ of e.g. flowers (which unlike ‘producers’ were eligible for VAT refunds under Ecuadorian law). This broad reading of national treatment by the tribunal operated in favour of OEPC and investment treaty claimants in general. In addition, the tribunal concluded that, although the SRI did not intend to discriminate against OEPC or foreign-owned firms, the less favourable effects of the SRI’s decision was sufficient to violate national treatment.

Further, on the merits, the tribunal adopted a broad reading of the BIT standard of fair & equitable treatment. Relying on earlier tribunals that adopted a similarly broad reading, the tribunal found that the...
obligation required Ecuador to 'ensure a transparent and predictable framework for [investors'] business planning and investment' and to 'act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor'. Adding to this already broad reading, the tribunal concluded here that this duty of transparency and predictability 'is an objective requirement that does not depend on whether the Respondent [state] has proceeded in good faith or not'. Thus, the good faith decisions of the SRI on VAT refunds led to a violation of the BIT obligation of fair & equitable treatment by Ecuador. Finally, with very little discussion and no reference to outside authorities, the tribunal concluded that this reading of fair & equitable treatment (contrary to what was argued by Ecuador here, and by other states, including the U.S. and Canada, in other arbitrations) 'is not different from that required under [customary] international law'.

Ecuador applied to UK courts for the award to be set aside on the basis that the tribunal exceeded its jurisdiction by finding that the BIT's exception for tax measures did not preclude the investor's claim. This argument was rejected by the UK courts and the award was upheld. Importantly, the UK courts did not review the decision of the tribunal on the merits of the dispute because this was beyond the scope of the UK courts' authority under UK law (in effect implementing the New York Convention) to set aside an arbitration award.

See award dated 1 July 2004; England & Wales High Court of Justice decisions dated 29 April 2005 and 2 March 2006; England & Wales Court of Appeal
Claimant Encana was a Canadian corporation.

Encana owned two Barbadian subsidiaries that had entered into contracts with the state oil company (PETROECUADOR) for exploration and exploitation of oil and gas.

Resolutions of Ecuador’s tax authorities (the Servicio de Rentas Internas – SRI) that denied refunds of value added tax to Encana’s subsidiaries.

The value of the tax credits denied was approximately (US)$80 million.

The Resolutions arose out of complex issues of legal interpretation arising from a series of amendments to Ecuador's Internal Tax Regime Law and its Regulations.

The Resolution also arose from an SRI auditors’ review of VAT refunds granted, especially to oil companies.

Subsequently, the SRI denied the availability of VAT refunds to the Encana subsidiaries on the basis that (1) VAT paid by the subsidiaries was already considered in their participation share at the time of contract negotiations and (2) VAT

Claim dismissed mainly on basis of the BIT’s exception for tax measures.

Tribunal: Australian national James Crawford, presiding (appointed by agreement of co-arbitrators); Argentine national Horacio Grigera Naón (appointed by investor); Canadian national J. Christopher Thomas (appointed by Ecuador).

On the merits, claim was dismissed because treaty contained tax exception in relation to all standards of investor protection other than protections against expropriation.

The expropriation claim dismissed, first, on the basis that no issue of indirect expropriation arose because the tax measure was not extraordinary, punitive in amount, or arbitrary in its incidence. Second, in terms of direct expropriation:

'the executive is entitled to take a position in relation to claims put forward by individuals, even if that position may turn out to be wrong in law, provided it does so in good faith and stands ready to defend its position before the courts... An executive agency does not expropriate the value represented by a statutory obligation to make a payment or refund by mere refusal to pay, provided at least that (a) the refusal is not merely wilful, (b) the courts are open to the aggrieved private party, (c) the courts’
refunds were available only for manufactured goods and not non-renewable resource extraction activities.

The Encana subsidiaries (and other oil companies) challenged the Resolutions before the Ecuadorian District Tax Court, but were unsuccessful; they appealed to the Ecuadorian Supreme Court, but withdrew their appeals when Encana filed its BIT claim.

A subsequent interpretation of the Law adopted by the Ecuadorian National Congress clarified that VAT refunds were not available to oil activities on the basis that oil is extracted and not manufactured.

decisions are not themselves overridden or repudiated by the State.’

In the circumstances, no direct expropriation occurred because (a) the oil companies could and did challenge the SRI’s rulings in the courts, (b) when the SRI lost it complied promptly with the court decisions, (c) the SRI Director General was ‘acting in good faith in a matter where the legal issues were unclear and unsettled’, and (d) there was no evidence that the court decisions were partisan, biased against the oil companies, or otherwise non-independent.

Thus, the SRI’s policy on oil refunds never repudiated an Ecuadorian legal right and thus did not amount to expropriation. On the other hand, the tribunal noted that its conclusion might have differed in the case of claims to tax refunds that were still pending before the Ecuadorian courts at the time of the National Congress’ interpretation of the Law. The Encana subsidiaries had withdrawn their challenges well before then, however.

Arbitrator Naon dissented on the expropriation claim, concluding that there was an expropriation of the investor’s right to returns, ‘including the legitimate expectation inextricably associated with the notion of returns’ and that ‘an interference in legitimate expectations of the foreign investor... includes State incoherent conduct obscuring the national legal treatment of matters directly determining the foreign investor’s entitlement to returns covered by the Treaty’. He concluded that the denial of tax refunds was expropriatory because
the investor’s return was ‘adversely affected in a substantial way by a measure or string of measures’. The measures were also discriminatory because they targeted the oil industry, and because they lacked a clear and principled public purpose. Further, the measures were not excused by the legislation interpreting the Law which ‘may succeed in legitimizing such conduct within the province of the local legal system of such State, but does not necessarily have a similar effect on the international plane’. There was lastly no requirement for the foreign investor to resort to local courts once an act of the State led to an expropriation claim.

Tribunal concluded that costs of the arbitration should be born fully by Ecuador. The costs, including arbitrator fees and expenses as well as institutional charges, were (US)$685,000.


|---------|-------------|------|--------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------
|         |             |      |                                                                          | Second claimant, Electroquil, is an Ecuadorian power generation company.                                                        | Imposition of fines by INECEL against Electroquil for failure to satisfy power purchase agreement obligations, challenged by Electroquil via an arbitration claim before the Arbitration and Mediation Center of the Guayaquil Chamber of Commerce; the |
|         |             |      |                                                                          | Dispute arose from contracts entered                                                                                          | Award issued very recently against Ecuador for (US)$5.7 million plus interest.                                                   |
|         |             |      |                                                                          |                                                                                                                                | Tribunal: Swiss national Gabrielle Kaufmann-Kohler, presiding (appointed by agreement of the parties); Columbian national Enrique Gomez-Pinzon (appointed by investor); Dutch national Albert Jan van den Berg (appointed by Ecuador). |
|         |             |      |                                                                          |                                                                                                                                | Jurisdiction found under both ad hoc arbitration                                                                          |
into between the claimants and Ecuador for electrical power generation in Guayaquil. Electroquil was the first private power generator established in Ecuador (in 1992). From 1995, the Instituto Ecuatoriano de Electrificacion (INECEL) entered into a power purchase agreements with Guayaquil to provide power, until the liberalization of electricity contracting and liquidation by legislation of INECEL in 1996 (with the Ministry of Mines and Energy assuming INECEL’s rights and obligations). Under the power purchase agreements, fuel was to be supplied to Guayaquil by the state entity Petrocomercial and paid for by INECEL.

Duke Energy purchased Electroquil after purchase power contracts were entered into and fines levied by INECEL.

tribunal dismissed the claim on the basis that the applicable arbitration clause was invalid under Ecuadorian law.

Contractual relationships between Electroquil and Ecuadorian state entities were terminated. Duke Energy and Electroquil entered into an agreement with Ecuador to refer outstanding disputes to ICSID arbitration. Subsequent resort by claimants to BIT as basis for claim, alongside the arbitration agreement.

On the merits, the tribunal concluded that INECEL breached its payment obligations arising from the power purchase agreements, and that some of the fines levied against Electroquil were not justified (although the tribunal found no bad faith on the part of Ecuador). Under the BIT, the tribunal concluded that these contractual breaches constituted in turn a breach of Ecuador’s obligation under the BIT’s ‘umbrella clause’ to ‘observe any obligation it may have entered into with respect to investments’. Also under the BIT, Ecuador was found to have violated the fair and equitable treatment standard because Ecuador ‘deceived Duke Energy’s reasonable expectations’ by not implementing a payment guarantee. However, the tribunal limited its damages award to the ‘nominal sum’ of approximately (US)$5.7 million plus interest.


<table>
<thead>
<tr>
<th>Ecuador</th>
<th>Noble Energy</th>
<th>2005</th>
<th>US-Ecuador BIT</th>
</tr>
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<tbody>
<tr>
<td>Tribunal: Swiss national Gabrielle Kaufmann-Kohler, presiding (appointed by agreement of parties); Canadian national Henri Alvarez (appointed by investor); Spanish national Bernardo M. Cremades (appointed by Ecuador).</td>
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<tr>
<td>Jurisdiction found based on BIT (as well as investment contract). Tribunal allowed Noble</td>
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</table>
Electricidad (CONELEC).

First claimant, Noble Energy, was a U.S. company established in Delaware. This claimant brought a claim before the tribunal under the BIT and an investment contract between Samedan Oil Co. (a subsidiary of Noble Energy) and the Ecuadorian government that was to be executed together with the concession contract discussed below.

Second claimant, indirectly owned by Noble Energy, was a Cayman Islands company. It in turn had a branch in Ecuador where it produces and sells thermoelectric power in the spot market and under power purchase agreements. This claimant brought a claim before the tribunal under a concession contract with CONELEC for the construction, installation, and operation of an electric power generation plant. It had commenced commercial electricity generation in September 2002.

government that changed the mechanism for payment of MachalaPower's invoices such that CENACE would no longer collect from distributors and pay generators for the electricity sold in the spot market. Instead, from October 2003, MachalaPower was required to invoice and collect from each distribution company directly.

Agreements between Ecuador and Colombia in context of the Andean Community that allegedly enabled Colombia generators to export energy to Ecuador with preferential treatment.

Alleged refusal of Ecuador and CONELEC to enforce the existing legal framework by their not assisting MachalaPower to collect unpaid receivables from its customers and by not allowing MachalaPower to cut off its dispatch of electricity.

Decrees of the Ecuadorian government that lowered the price of oil bought from Petrolecuador for certain government thermal power generators, allegedly favouring

The arbitration is ongoing on the merits.

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<tr>
<th>Country</th>
<th>Company</th>
<th>Year</th>
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<th>Allegations</th>
<th>Tribunal</th>
<th>Jurisdictional Award</th>
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<tr>
<td>Ecuador</td>
<td>Empresas Electrica del Ecuador</td>
<td>2005</td>
<td>US-Ecuador BIT</td>
<td>Alleged violation of national and MFN treatment, fair &amp; equitable treatment, protection from expropriation, and umbrella clause in BIT. Also, alleged violation of concession contract and stabilization clause of investment agreement.</td>
<td>Tribunal: Mexican national Bernardo Sepulveda Amor, presiding (unknown method of appointment); US national John H. Rooney (unknown whether appointed by investor or by Ecuador); US national Michael W. Reisman (unknown whether appointed by investor or by Ecuador).</td>
<td>No jurisdictional award issued.</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Eurocontrol</td>
<td>2006</td>
<td>Spain-Ecuador BIT</td>
<td>Eurocontrol is a Spanish engineering and construction firm.</td>
<td>Unknown.</td>
<td>Discontinued before a jurisdictional award was issued. Reportedly settled in May 2008. Unknown whether tribunal constituted.</td>
</tr>
<tr>
<td>Country</td>
<td>Company 1</td>
<td>Year</td>
<td>BIT</td>
<td>Arbitration Rules</td>
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<tr>
<td>Ecuador</td>
<td>Chevron</td>
<td>2006</td>
<td>US-Ecuador BIT</td>
<td>Filed under UNCITRAL Rules.</td>
<td>The dispute reportedly arose from a refinery expansion project.</td>
<td>Tribunal: German national Karl-Heinz Bockstiegel, presiding (unknown whether appointed via Permanent Court of Arbitration or by agreement of co-arbitrators); US national Charles Brower (presumably appointed by investor); Dutch national Albert Jan van den Berg (presumably appointed by Ecuador).</td>
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<tr>
<td>Ecuador</td>
<td>Occidental</td>
<td>2006</td>
<td>US-Ecuador BIT</td>
<td>Filed under ICSID Rules.</td>
<td>The dispute reportedly relates to longstanding domestic court disputes over crude oil sales.</td>
<td>Tribunal: Canadian national Yves Fortier, presiding (unknown whether appointed by ICSID or by agreement of the parties); New Zealand national David A.R. Williams (presumably appointed by investor); French national Brigitte Stern (presumably appointed by Ecuador).</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Occidental No. 2</td>
<td>2006</td>
<td>US-Ecuador BIT</td>
<td>Claim under BIT as well as Participation Contract of 1999 between OEPC, Ecuador, and Petroecuador in connection with exploration and exploitation of Caducidad Decree issued in May 2006 by Attorney General to Ministry of Energy and Mines to terminate Participation Contract (and related agreements) for alleged violations of the Participation Contract, including alleged (1) transfer of rights and obligations under the Participation Contract to AEC (a Bermuda-based subsidiary of Canadian oil and gas company EnCana) without ministerial approval, (2) entry into a consortium to carry out exploration and exploitation without ministerial approval, (3) non-investment of minimum</td>
<td>Tribunal: Canadian national Yves Fortier, presiding (unknown whether appointed by ICSID or by agreement of the parties); New Zealand national David A.R. Williams (presumably appointed by investor); French national Brigitte Stern (presumably appointed by Ecuador).</td>
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<thead>
<tr>
<th>Country</th>
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<th>Year</th>
<th>Treaty</th>
<th>Filed under</th>
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<tbody>
<tr>
<td>Ecuador</td>
<td>Tecnicas Reunidas</td>
<td>2006</td>
<td>Spain-Ecuador BIT</td>
<td>Tecnicas Reunidas is a Spanish engineering and construction firm.</td>
<td>The dispute reportedly arose from a refinery expansion project.</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Murphy Oil</td>
<td>2008</td>
<td>US-Ecuador BIT</td>
<td>Murphy is a U.S. oil company.</td>
<td>Unknown, but see description of Repsol (2008).</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Perenco</td>
<td>2008</td>
<td>France-Ecuador BIT</td>
<td>Perenco is a French oil company.</td>
<td>Unknown, but see description of Repsol (2008).</td>
</tr>
<tr>
<td>Ecuador</td>
<td>Repsol</td>
<td>2008</td>
<td>Spain-Ecuador BIT</td>
<td>Repsol is a Spanish oil company.</td>
<td>Ecuador sought to renegotiate the terms of its concession contracts for oil and gas production. It sought to raise the state’s share of extraordinary oil company profits from 50% to</td>
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</table>

hydrocarbons in ‘Block 15’ of the Ecuadorian Amazon.

Claim stated to exceed $1 billion.

amounts required under the Participation Contract, (4) repeated violations of the Hydrocarbons Law and regulations.

Discontinued before a jurisdictional award was issued. Reportedly settled in May 2008. Unknown whether tribunal constituted.


Tribunal not constituted.


Tribunal not constituted.


Repsol reportedly agreed in August 2008 to convert its current participation contracts in Ecuador into service provider contracts, in exchange for the extension of Repsol’s production concessions until 2018. It will reportedly transfer its ICSID claim to a
99%. Extraordinary profits were those that flowed where the market price of oil rose above a benchmark price laid out in the concessions. An offer was later made by Ecuador to reduce this increase in the state’s share from 99% to 70%. This offer was conditional on the relevant firms converting their ‘participation’ concession contracts to ‘service’ contracts (see below) and maintaining current levels of investment and output. It was also conditional on the firms withdrawing any claims they had brought before ICSID or other arbitration bodies, and resorting instead to the use of domestic courts to resolve disputes with Ecuador.

Under the participation contracts, the state receives a percentage of the profits earned from oil production. Under the (proposed) new service contracts, the companies would receive a production fee and reimbursement for their investment costs.

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<thead>
<tr>
<th>Country</th>
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<thead>
<tr>
<th>Country</th>
<th>Investor</th>
<th>Year</th>
<th>BIT</th>
<th>Filed under</th>
<th>Claimant</th>
<th>Nature of Claim</th>
<th>Award Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peru</td>
<td>Luchetti</td>
<td>2002</td>
<td>Peru-Chile BIT</td>
<td>ICSID Rules</td>
<td>First claimant was Chilean company that owned 98% of the shares of the second claimant, a Peruvian company, which owned a property in Lima where it had constructed an industrial plant for the manufacture and sale of pasta. The property was close to, but not within, a protected wetland.</td>
<td>Annulment by Municipality of Lima in 1997-98 of the permits granted to second claimant for construction of its industrial plant, referring to environmental problems and supposed deficiencies in the granting of the permits. This annulment was the subject of Peruvian judicial proceedings in which the second claimant was successful.</td>
<td>Tribunal: US national Thomas Buergenthal, presiding (appointed by ICSID SG after consultation with parties); French national Jan Paulsson (appointed by investor), Spanish national Bernardo M. Cremades (appointed by Peru). Application to annul the award rejected. Annulment tribunal (all members appointed by Chair of ICSID Administrative Council – i.e. the President of the World Bank): Swedish national Hans Danelius, presiding, Italian national Andrea Giardini, and UK national Franklin Berman (who dissented and would have annulled the award). See award dated 7 February 2005; annulment tribunal award dated 5 September 2007.</td>
</tr>
</tbody>
</table>
the Asian market.

First claim ever by a Chinese investor before ICSID.
# APPENDIX B

## Inclusion of key provisions in Spain's BITs with CAP states

<table>
<thead>
<tr>
<th>Key provisions</th>
<th>Spain-Bolivia</th>
<th>Spain-Colombia*</th>
<th>Spain-Ecuador</th>
<th>Spain-Peru</th>
</tr>
</thead>
<tbody>
<tr>
<td>provision for investor-state arbitration</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>application to all acts or measures of state</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>application to all investments, incl intellectual property</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>waiver of duty to exhaust local remedies</td>
<td>Yes, subject only to requirement for six months’ consultation.</td>
<td>Yes, subject only to requirement for six months’ consultation.</td>
<td>Yes, subject only to requirement for six months’ consultation.</td>
<td>Yes, subject only to requirement for six months’ consultation.</td>
</tr>
<tr>
<td>allowance for forum-shopping by investors</td>
<td>No, except (potentially) via MFN clause or liberal interpretation of ‘seat’ by arbitrators.</td>
<td>No, except (potentially) via MFN clause or liberal interpretation of ‘seat’ by arbitrators.</td>
<td>No, except (potentially) via MFN clause or liberal interpretation of ‘seat’ by arbitrators.</td>
<td>No, except (potentially) via MFN clause or liberal interpretation of ‘control’ by arbitrators.</td>
</tr>
<tr>
<td>use of private arbitrators</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>allocation of appointing authority</td>
<td>ICSID, UNCITRAL</td>
<td>ICSID, UNCITRAL</td>
<td>ICSID, UNCITRAL</td>
<td>ICSID, UNCITRAL</td>
</tr>
<tr>
<td>allowance for state liability as remedy</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>national treatment</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>most-favoured-nation (MFN) treatment</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>fair &amp; equitable treatment, full protection &amp; security</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>restrictions on expropriation, incl regulatory expropriation</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>guarantee of free capital transfers</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>specific prohibitions on performance requirements</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>umbrella clause</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>exceptions for local or sub-national state measures</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>exceptions for specific measures</td>
<td>Exception to national treatment and MFN treatment for participation in free trade zone, customs or economic union, or other regional economic organization.</td>
<td>Exception to fair &amp; equitable treatment and MFN treatment for participation in customs union or common market.</td>
<td>Exception to fair &amp; equitable treatment, national treatment, and MFN treatment for participation in free trade zone, customs union, or common market.</td>
<td>Exception to MFN treatment for participation in free trade zone, customs union, or common market.</td>
</tr>
</tbody>
</table>

* Note: The table includes key provisions that are common to Spain's BITs with various countries. The table highlights the presence and conditions of these provisions in the context of BITs with countries in the CAP.
| exceptions for specific sectors | No | No | No | 15 + additional 15 years for existing investments.
|----------------------------------|----|----|----|----------------------------------|
| duration of states’ obligations  | 10 + additional 10 years for existing investments. Minimum duration is 10 years, after which treaty can be denounced with six months' notice. After denunciation, the obligations for existing investments continue for an additional 10 years. | 10 + additional 10 years for existing investments; limited window for denunciation. Minimum duration is 10 years, after which the treaty automatically renews for an additional term of 10 years. Treaty can be denounced only during the six months prior to expiry at the end of the applicable 10 year term. After denunciation, the obligations for existing investments continue for an additional 10 years. | 10 + additional 10 years for existing investments; limited window for denunciation. Minimum duration is 10 years, after which the treaty automatically renews for an additional term of 5 years. Treaty can be denounced only during the six months prior to expiry at the end of the applicable 10 or 5 year term. After denunciation, the obligations for existing investments continue for an additional 10 years. | 15 + additional 15 years for existing investments. Minimum duration is 15 years, after which treaty can be denounced with 12 months' notice. After denunciation, the obligations for existing investments continue for an additional 15 years.

Source for texts of BITs: UNCTAD Investment Agreements Online (Country-specific Lists of BITs)