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NEWS: MALAYSIAN HISTORICAL SALVORS JURISDICTIONAL AWARD ANNULLED; COMMITTEE SPLIT ON QUESTION OF ECONOMIC DEVELOPMENT AS CRITERIA OF ICSID INVESTMENTS

By Damon Vis-Dunbar

The members of an ICSID committee hearing an annulment request in *Malaysian Historical Salvors v. the Government of Malaysia* have come to starkly different conclusions on whether a foreign investment must contribute to the economic development of the host state in order to fall within the ambit of ICSID Convention.

Two out of three members of the ICSID committee—Judge Stephen M. Schwebel and Judge Peter Tomka —have annulled a 2007 award in which the sole arbitrator, Michael Hwang, declined jurisdiction.

Schwebel and Tomka conclude that Hwang "manifestly exceeded" his powers as arbitrator by failing to exercise jurisdiction that was granted under the ICSID Convention and the Malaysia-UK bilateral investment treaty.

In his jurisdictional award, Hwang concluded that Malaysian Historical Salvors' investment in a marine salvage operation had not made a significant contribution to the Malaysian economy, and therefore fell outside the scope of the ICSID Convention.

That award garners strong support from a third committee member, Judge Mohamed Shahabuddeen, who asserts that the promotion of economic development is an essential hallmark of an investment under the ICSID Convention.

The diverging approaches of the committee members "marks a titanic struggle between ideas, and correspondingly between capital exporting countries and capital importing ones", writes Shahabuddeen in his dissenting opinion.

> *"Shahabuddeen laments the tendency among tribunals to diminish the imporance of economic development as criteria of an ICSID investment, a trend he states 'is not compatible with the original objectives of the institution.'"*

Annulment committee divided on definition of an ICSID investment

Malaysian Historical Salvors (MHS), a marine salvage outfit owned by a British national, retrieved thousands of pieces of Chinese porcelain from the Straight of Malacca in the 1990's. In its contract with Malaysia, the company was to receive a portion of the proceeds from the sale of the treasure; however, MHS maintains that it received a smaller cut of the profits than was promised under the contract.

Following an unsuccessful bid to recover damages through domestic courts in Malaysia, MHS turned to

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NEWS: TRIBUNAL DISQUALIFIES CLAIM BY PHOENIX ACTION AGAINST THE CZECH REPUBLIC

By Damon Vis-Dunbar

A three-member tribunal has disqualified a claim by the Israeli-based Phoenix Action LTD, concluding that its purchase of two Czech companies was solely a pretext for exploiting the Israel-Czech Republic bilateral investment treaty.

The jurisdictional award rendered on 15 April 2009 charges Phoenix Action with "an abuse of the international investment protection regime", and orders the company to bear the full cost of the arbitration, including the Czech Republic's legal costs.

Phoenix Action's claim, lodged with the International Centre for Settlement of Investment Disputes (ICSID) in 2006, relates to its purchase in 2002 of two companies, Benet Praha and Benet Group, both of which were involved in the purchase and sale of ferroalloys (iron mixed with other elements, used in the production of steel).

Phoenix Action bought the two Czech companies while they were under a criminal investigation over alleged custom duty evasion. The Israeli company argued that lengthy litigation proceedings, which continued after it took ownership of the companies, amount to a denial of justice.

For its part, the Czech Republic characterized Phoenix Action has a "sham Israeli entity", whose purpose was to gain access to international arbitration by way of the Israel-Czech Republic BIT. Indeed, the case represents "one of the most egregious cases of 'treaty-shopping' that the investment arbitration community has seen in recent history," argued counsel for the Czech Republic.

Tribunal doubts investment was made in good faith

The Tribunal's decision to nix the claim on jurisdictional grounds was linked to the revelation that one family remained in control of the Benet companies, despite their sale to different corporate entities.

According to the evidence presented to the Tribunal, the former Chairman of Benet Praha, Vladimir Beno, established Phoenix Action after fleeing to Israel under charges of tax evasion. Phoenix Action subsequently purchased Benet Praha from a company owned by Mr. Beno's his wife for US$4000. In 2008, Phoenix Action sold Benet Praha back to Mr. Beno's wife for the same price.

> *"'The unique goal of the 'investment' was to transform a pre-existing domestic dispute into an international dispute subject to ICSID arbitration under a bilateral investment treaty,' writes the Tribunal."*

In light of these facts, the Tribunal concluded that Phoenix Action's purchase of the Benet companies was "simply a rearrangement of assets within a family, to gain access to ICSID jurisdiction to which the initial investor was not entitled."

"The unique goal of the 'investment' was to transform a pre-existing domestic dispute into an international dispute subject to ICSID arbitration under a bilateral investment treaty," writes the Tribunal.

Tribunal weighs in on the concept of investment under the ICSID Convention

The Tribunal's verdict is significant, in part, for its analysis of what constitutes an investment under the ICSID Convention.

Because the ICSID Convention does not define the concept of investment, tribunals and commentators have formulated their own criteria. The most common is the so-called *Salini* test, which sets four criteria for an ICSID investment: a contribution of money or other assets of economic value; a certain duration; an element of risk, and; a contribution to the host State's development.

In this case, the Tribunal adopts the *Salini* test as its starting point, but takes issue with the fourth criteria, on the grounds that determining an investment's contribution to development is "impossible to ascertain." Instead, the Tribunal favours "a less ambitious approach", and proceeds to consider if there has been a contribution to the economy of the host state.

In addition to restricting the scope of the *Salini* test's fourth criteria, the Tribunal would consider two other criteria: were the assets invested in accordance with the laws of the host state and was there a *bona fide* investment of those assets?

Ultimately, Phoenix Action's claim would fail to meet the Tribunal's benchmark for of *bona fide* investment.

This conclusion was drawn in part because the company displayed no intention of engaging in actual economic activities (the Tribunal notes, for instance, the absence of a business plan, program of re-financing, valuations, etc).

The timing of the claim—served two months after Phoenix Action purchased the Benet companies—also served to bolster the Tribunal conviction

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NEWS: TRIBUNAL REJECTS COUNTERMEASURES DEFENSE IN RECENTLY PUBLISHED CORN PRODUCTS INTERNATIONAL INC. V. THE UNITED MEXICAN STATES AWARD

By Elizabeth Whitsitt

In a recently published ICSID award, a tribunal found Mexico liable to an American company, Corn Products International Inc. (CPI) and its wholly-owned Mexican subsidiary, Corn Products Ingredientes (CPIng) for violating NAFTA Chapter 11. While the 15 January 2008 decision does not address the extent of Mexico's liabilities, it represents yet another setback for Mexico in its continued dispute with the United States over the sugar trade.

High Fructose Corn Syrup (HFCS) is a sweetener made from yellow corn and used in the food and beverage industry, where it competes directly with sweeteners made from sugar cane. By the mid-1980s, HFCS was the sweetener most commonly used in soft drinks in the US and Canada, having gained a competitive advantage over sweeteners made from sugar because it was less expensive and easier to use (i.e. it was supplied in liquid versus solid form).

By the early 1990s, CPI had established itself as a major producer and supplier of HFCS to the soft drink industry in the US and Canada. After NAFTA entered into force, CPI expanded its operations and began producing and supplying HFCS to the Mexican soft drink industry through CPIng.

While HFCS began displacing sugar as a sweetener in the Mexican soft drink industry, Mexico and Mexican sugar producers were in a dispute with the US over access to the United States' sugar market. Specifically, the Mexican government and Mexican sugar producers argued that the US was restricting the importation of Mexican sugar into the US market in violation of its obligations under NAFTA and certain letters exchanged between both governments attached to NAFTA.

Attempting to resolve this dispute, Mexico invoked the dispute-settlement machinery under Chapter 20 of NAFTA, but was unable to resolve its disagreement with the US. In fact, efforts at dispute resolution under Chapter 20 only exacerbated tensions between the two countries, with Mexico maintaining that the US violated its NAFTA obligations by effectively frustrating the operation of the Chapter 20 mechanism.

Subsequently, Mexico amended its excise tax legislation in 2001. The effect of those amendments was to impose a tax of 20% on any drink which used HFCS as a sweetener.

Asserting that the HFCS tax caused the Mexican soft drink industry to switch from HFCS to sugar cane sweeteners, and thereby destroyed its presence in the market, the claimant commenced arbitral proceedings against Mexico under NAFTA Chapter 11. Specifically, CPI argued that: (i) the HFCS tax violated the national treatment principle under Article 1102; (ii) the effect of the HFCS tax was to condition the receipt of an advantage (i.e. exemption from paying the tax) on the use of Mexican produced sugar cane in violation of Article 1106; and (iii) the HFCS tax was tantamount to an expropriation of CPI's investment in violation of Article 1110.

While Mexico argued that CPI had failed to establish a breach of any of the Chapter 11 provisions upon which it relied, Mexico's primary assertion was that the HFCS tax was a countermeasure taken in response to prior violations of the NAFTA by the US. In particular, Mexico referred to the International Law Commission's Articles on State Responsibility and contended that the status of the HFCS tax as a countermeasure precluded its wrongfulness vis-à-vis the US and the claimant.

In addressing the above arguments, the tribunal first assessed CPI's claims under Articles 1106 and 1110. Specifically, the tribunal found that CPI failed to establish that the HFCS tax was a performance requirement giving rise to liability under Article 1106. Moreover, the tribunal concluded that the HFCS tax did not rise to the level of an expropriation or a measure tantamount to an expropriation within the meaning of Article 1110. It did find, however, that Mexico violated the national treatment principle in Article 1102 by "fail[ing] to accord CPI, and its investment, treatment no less favourable than that it accorded to its own investors in like circumstances, namely the Mexican sugar producers who were competing for the market in sweeteners for soft drinks."

Given its finding that the HFCS tax violated Article 1102, the tribunal turned to a discussion of Mexico's countermeasures defense. In so doing, the tribunal noted "...that, in the context of [a NAFTA Chapter 11] claim, there is no room for a defense based upon the alleged wrongdoing not of the claimant but of its State of nationality..." As a result, the tribunal, in a majority and separate opinion, held that Mexico could not invoke such a defense within the context of an investor-state dispute.

While the attempt to use traditional principles of international law as defenses in investor-state disputes is not new, this decision reflects the difficulty states often have when attempting to do so. Indeed, it appears that states will have particular difficulty using countermeasures as a defense against claims made by foreign investors

NEWS: MEXICAN TRUCKERS GROUP LAUNCHES NAFTA CHAPTER 11 DISPUTE AGAINST THE U.S. OVER TRUCKING BAN

By Fernando Cabrera Diaz

The Mexican trucking industry group CANACAR has initiated Chapter 11 arbitration against the United States, alleging that the U.S. has violated its NAFTA commitments by barring Mexican trucking companies from operating freely within its borders.

> *"The claimants argue that the U.S. policy is a protectionist measure designed to shield American carriers from competition from Mexican firms whose drivers command significantly lower wages. The U.S., on the other hand, has cited safety concerns as the reason behind its policy. "*

The cross-border trucking services dispute between Mexico and the United States originated in 1982 when the U.S. passed legislation establishing a moratorium on issuing permits for foreign trucking companies to operate in the U.S. Although the initial moratorium applied to both Canadian and Mexican firms, it was subsequently amended to include only Mexican firms.

When NAFTA came into force in 1994, the U.S. made assurances that the moratorium would be phased-out. However, the U.S. reneged on that commitment, instead passing legislation indefinitely extending the moratorium in 1995.

While Mexican-owned carriers are allowed to operate between Mexico and U.S. Border States or in transit through the U.S. on their way to Canada, they are not authorized to transport international cargo within the United States.

In 1995 the government of Mexico challenged the United States' continued moratorium under NAFTA's Chapter 20 party-to-party dispute resolution mechanism (*In the Matter of Cross-Border Trucking Services*).

In 2001, a five-member panel unanimously concluded that, among other things, the U.S. was in violation of Chapter 11's national treatment and most favoured nation obligations. After the ruling, the U.S. lifted a ban on Mexican citizens owning American trucking companies, a move that did not resolve the dispute as Mexican-owned companies were still not granted the necessary permits to operate in the U.S.

ITN spoke to Pedro M. Ojeda Cárdenas, council for CANACAR, who says that the U.S. has failed to implement the tribunal's 2001 decision. According to Mr. Ojeda, after years of negotiations the Bush administration sought to implement the tribunal's ruling but could not gain approval from Congress. Instead, the administration set up a pilot program in 2007 which allowed inscribed Mexican trucking companies to operate in the United States.

Yet the U.S. Congress refused to fund the project, allegedly bowing to pressure from the Teamsters Union. In March of this year, President Obama's budget scrapped the project, prompting the claimants to commence their arbitration.

ITN contacted the U.S. State Department who said they could not comment on the case, although according to their website they intend to defend the claim vigorously.

In their notice of arbitration sent to the United States government on 2 April 2009, legal counsel for CANACAR charges the U.S. with violating Chapter 11's most favoured nation obligation, on the grounds that its restrictive policy towards Mexico does not apply to other nations, including Canada. CANACAR also alleges violation of the national treatment obligation, given that Mexican carriers are discriminated against vis-à-vis their American counterparts.

The claimants argue that the U.S. policy is a protectionist measure designed to shield American carriers from competition from Mexican firms whose drivers command significantly lower wages. The U.S., on the other hand, has cited safety concerns as the reason behind its policy.

Although their notice of arbitration does not specify the damages being sought, the claimants point to the over US$ 2 billion per year estimated cost of the U.S. policy toward Mexican trucking companies.

NEWS: TRIBUNAL ORDERS COMPENSATION IN DUTCH FARMERS' CLAIMS AGAINST ZIMBABWE

By Damon Vis-Dunbar

An ICSID tribunal has ordered the government of Zimbabwe to compensate a group of Dutch nationals who saw their farms expropriated under Zimbabwe's controversial land-reform program. The victory is expected to lead other European nationals who lost farms in Zimbabwe to seek compensation under bilateral investment treaties.

The thirteen Dutch claimants in the case *Bernardus Henricus Funnekotter and Others v. Republic of Zimbabwe* owned some of the thousands of farms that were expropriated by the state, as the Mugabe-led government adopted an aggressive approach to redistributing farm land from white owners to the historically disenfranchised black population.

Between 2001 and 2003, thousands of acres of farmland were forcibly seized by settlers, after a proposed constitution that would have empowered the government to compulsorily take over farms was rejected in a referendum. The claimants maintain that the government of Zimbabwe was complicit in the invasions; a charge that the government denies.

In any case, an amendment to the Zimbabwean constitution in 2005 formalized the state's right to expropriate the farms that had been seized by settlers.

The claimants, who have not been paid for the loss of their farms, registered their case with ICSID in 2005, in an effort to leverage the Netherlands-Zimbabwe BIT to gain compensation.

In its defense, Zimbabwe recounted its effort since independence to address inequities in land ownership, rooted in its colonial past. While Zimbabwe held that its land reform measures were "in the public interest and under due process of law", the country acknowledged that "the deprivation (of property) was not accompanied by compensation."

Indeed, in its counter-memorial, Zimbabwe declared its intention to compensate the claimants. But later in the proceedings Zimbabwe would double back on its offer, on the grounds that the claimants had failed to fulfill certain certification procedures prescribed under domestic law.

The Tribunal would conclude, however, that the certification procedure referred to by Zimbabwe did not provide for full compensation; rather, it only promised payment for "fixed improvements on or to the land expropriated."

Zimbabwe also invoked the state of necessity defense, essentially arguing that its land reform program was an effort to address entrenched historical inequalities in land-ownership in Zimbabwe, and therefore was justified as a measure taken in the public interest.

Yet, according to the Tribunal, Zimbabwe failed to explain "why such a state of necessity prevented it from calculating and paying the compensation due to the farmers in conformity with the BIT."

The Tribunal was left to conclude that Zimbabwe was in violation of its obligation to provide "just compensation" in the case of expropriation, and moved to a consideration of how best to calculate damages.

Zimbabwe and the claimants came to widely divergent estimates on the value of the expropriated farms, based on differing methodologies.

An valuation conducted by the Zimbabwean Ministry of Lands, Lands Reform and Resettlement, which placed a value on the arable land, as well as buildings and farm equipment on the farms, was rejected because it did not arrive at the market value of the whole farm.

Zimbabwe also argued that large-scale nationalizations called for a discounted rate of compensation, although this was swiftly dismissed by the tribunal, which held the value of an investment should be considered independently "of the number and aim of the expropriations done."

According to the Tribunal, a valuation conducted on behalf of the claimants, which took into account the production of each farm, came closer to the mark, although it arrived at figures that were too high when considering the unstable economic situation in Zimbabwe at the time of expropriations.

Ultimately, the Tribunal would establish a value based on the quality of the land, the production of the farms, and equipment on the farms. The claimants are to receive between 450 000 Euro and 930 000 Euro for the expropriated farms, in addition to compensation for assets left on the farms. Interest was set at 10%, compounded every six months. The Tribunal also ordered a payment of 20 000 Euro to each claimant for reparation (i.e., for the cost of re-settling), while it rejected a claim for moral damages. Each party was ordered to bear its own legal costs, while Zimbabwe must cover the Tribunals' costs and ICSID fees.

Co-counsel for the claimants, Matthew Coleman, confirms that his firm is in the process of organizing additional claims for some 50 European nationals have also had their farms expropriated in Zimbabwe.

Zimbabwe has ratified bilateral investment treaties with China, Denmark, Germany, the Netherlands, Serbia and Montenegro, and Switzerland.

IISD ANNOUNCEMENT: NATHALIE BERNASCONI JOINS IISD'S INVESTMENT PROGRAM

The International Institute for Sustainable Development (IISD) is pleased to announce that Nathalie Bernasconi, a Swiss-based international lawyer with an extensive background in trade and investment law, is joining the IISD's program on investment.

Ms. Bernasconi will take over the management of IISD's Investment for Sustainable Development program. The program has been managed since its inception over a decade ago by Howard Mann, who will continue to play a major role in the development and delivery of IISD's work on investment.

"I am delighted to be able to hand over the reins to Nathalie. We have worked together on many occasions in the past few years. I do not think there is anyone better placed to take the program forward into its second decade. I look forward to working with Nathalie, and to the opportunities her joining IISD will create," said Mann.

Mark Halle, Director of IISD's Trade and Investment Program, said that the team at IISD dedicated to foreign investment issues has been remarkable for the influence it has achieved. The addition of Ms. Bernasconi to the team will allow that influence to grow:

"Nathalie is a fantastic addition to our team. She has established herself as an extremely articulate advocate of trade and investment laws and policies that make a positive contribution to sustainable development. Nathalie's management experience also brings added depth at a time when the program's scope and workload is expanding." said Halle.

Ms. Bernasconi joins the IISD after four years as the managing attorney of the Center for International Environmental Law's Geneva office, where she concentrated on issues relating to trade, investment and sustainable development. Prior to this, Ms. Bernasconi was a fellow of the Institute of International Economic Law in Washington D.C. She has also worked for the UNDP in Viet Nam, for the Australian law firm of Phillips Fox, and in the International Law Section of the Justice Department of Switzerland.

She has an LL.M., Georgetown University Law Center, Washington D.C., and Lic. iur. Université de Neuchatel, Switzerland. She is a member of the Bar of Basel, Switzerland.

IISD's Investment for Sustainable Development program focuses primarily on the international legal regime that governs foreign investment. Among its many activities in this field, the Institute provides capacity support and capacity training to developing countries, has developed a model international investment agreement designed to foster sustainable development, conducts research into the state of the art of investment treaties, and has actively engaged with the UNCITRAL Working Group on Arbitration in an effort to promote greater transparency in investor-state arbitrations.

IISD is also the publisher of Investment Treaty News.

TRIBUNAL DISQUALIFIES CLAIM...

that Phoenix Action was a vehicle designed to bring a domestic dispute to international arbitration.

Indeed, the Tribunal characterized the claim as "an abusive manipulation of the system of international investment protection under the ICSID Convention and BITs."

This damning assessment led the Tribunal to order Phoenix Action to pay the full cost of the arbitration proceedings, amounting to some USD$356 000, in addition to the Czech Republic's legal costs of some US$1 million. Phoenix Action estimated its own legal costs at some US$1.6 million.

Number of investment claims against the Czech Republic undisclosed

The prompt release of the Phoenix Action award—published by the Czech Republic a day after it was dispatched to the parties—stands in contrast with the secrecy that shrouds other investment treaty claims against the Czech Republic.

Indeed, the exact number of investment-treaty claims against the Czech Republic has not been disclosed. An official with the Czech Ministry of Finance declined to provide ITN with a list of investment treaty claims currently pending against the Czech Republic, explaining that it is "not a policy of the Czech Republic to actively support the public availability of that information."

At least a few recent rulings in known claims against the Czech Republic, which are not in favour the country, remain confidential.

INTERVIEW: DO BILATERAL INVESTMENT TREATIES LEAD TO MORE FOREIGN INVESTMENT?

By Damon Vis-Dunbar and Henrique Suzy Nikiema

The global network of over 2800 bilateral investment treaties (BITs) has been built on the basis of promoting foreign direct investment (FDI), and yet, after a decade of research, whether in fact BITs encourage FDI flows is a matter of debate. There are a number of reasons for the diverse results in the empirical studies that have addressed this question, and they are well explained in a book published last month by Oxford University Press, which brings together an impressive collection of essays and empirical studies on the impact of investment treaties on FDI flows (*The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*). As an introduction to the topic, ITN has posed a few questions to three academics for their views on the relationship between BITs, FDI flows and sustainable development.

Eric Neumayer is a professor in the department of geography and environment at the London School of Economics and Political Science. An economist by training, he is the coeditor of the *Handbook of Sustainable Development and author of Greening Trade and Investment: Environmental Protection Without Protectionism*.

Kevin P. Gallagher is an economist in the Department of International Relations at Boston University and senior researcher at the Global Development and Environment Institute at Tufts University. He is the co-editor of a new book titled Rethinking Foreign Investment for Sustainable Development: Lessons from Latin America, and co-author of The Enclave Economy: Foreign Investment and Sustainable Development in Mexico's Silicon Valley.

Horchani Ferhat is professor of law and political science at the University of Tunis, Tunisia. He is the author of numerous articles and books on international law, including *Les Sources Du Droit International Public*.

INTERVIEW WITH ERIC NEUMAYER

ITN: What does your research tell us about the relationship between BITs and FDI?

My research, which was published in an article co-authored by Laura Spess in the journal World Development in 2005, was one of the very first studies to demonstrate a positive effect of BITs on FDI to developing countries. In other words, by signing more BITs with developed countries, particularly those that are major FDI exporters, developing countries give up some of their domestic policy autonomy by binding themselves to foreign investment protection, but could expect to receive more FDI in exchange. The research also showed that the effect was possibly more pronounced in countries with weak domestic institutions, i.e. in countries for which the confidence and credibility-inspiring signal to foreign investors following the signing of BITs was most important.

ITN: Different analyses produce different results on the question of BITs and their impact on FDI flows. What are the key methodological differences, and differences in assumptions, that drive the different results? Are there any clear "best practices" in estimating these impacts?

The majority of studies confirm a positive effect of BITs on FDI. Some of the earlier studies had key methodological deficiencies, such as employing a small and non-representative sample. Best practice studies now should employ a large, representative sample, should use so-called bilateral or dyadic FDI data (i.e. data that tells us from where the FDI comes from and where it is flowing to) and not just aggregate FDI data (i.e. total FDI flows to countries without information on where it comes from), should estimate both static and dynamic models (i.e. models that exclude and include the temporally lagged dependent variable, respectively), should deal with possible non-stationarity (in simple words: should deal with trends in the data) and should deal with errors in the data generating process. My own research on BITs is now more than five years old, which is a long time in academia. Naturally, in retrospect it should have done all of the things I would now regard as "best practice". It did some of it, but not others. However, other more recent studies have improved on our initial study and most of them come to the same overall conclusion. This makes me confident that our initial result is in fact robust.

ITN: What steps should governments take to ensure that BITs make a positive contribution to their economic development?

Governments can promote sustainable development with appropriate policies. There is nothing in BITs that would prevent them from adopting these policies, as long as they affect all economic actors evenly, and do not discriminate against foreign investors merely because they are foreign. There is a widespread misunderstanding that BITs, or BIT-like provisions in regional trade agreements such as the North American Free Trade Agreement (NAFTA), have been abused by foreign investors to knock down environmental and other sustainable development related policies. However, as I have tried to show in my book *Greening Trade and Investment: Environmental Protection without Protectionism* (London: Earthscan 2001), in practically all cases where foreign investors have sued governments and were awarded

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damages by an arbitration panel they have done so because the policies in question were formulated in a way that clearly discriminated against foreign investors. If governments wish to pursue policies that promote sustainable development without discriminating against foreign investors, BITs and the investor-to-state dispute resolution mechanisms contained therein will not stand in their way.

Moreover, by promoting FDI, BITs are likely to make an indirect contribution to sustainable development. There is some evidence that, on average, foreign investors pay higher wages and are environmentally more friendly than their domestic counterparts. Naturally, this depends on which country the foreign investment comes from and to which sector it goes to. Chinese foreign investment is likely to contribute less than FDI from Scandinavian countries to sustainable development. FDI into natural resource sectors has often created large-scale environmental damage in the past, but this may be changing for the better as multinational corporations take corporate social responsibility more seriously.

INTERVIEW WITH KEVIN P. GALLAGHER

ITN: What do empirical studies tell us about the relationship between BITs and FDI?

There is widespread agreement in the peer reviewed literature that the major determinants of FDI are macro economic and political stability, having a large and growing GDP, or being in proximity to a country with a large and growing GDP that can be exported to. A BIT or an FTA may help but without a stable and growing economy (or the ability to serve as an export platform to a stable and growing economy) a BIT is of little help.

An illustrative example is comparing Brazil and Haiti. Brazil, year after year, is the leading recipient of FDI in Latin America. Indeed, it is always in the top three among developing nations. Firms move there to serve its large domestic market, access natural resources, and serve as an export platform to other hubs (that are less stable) in South America. Brazil has no BITS and is very concerned about some of the measures that are found in US style BITS. Haiti receives little to no FDI and if they signed a BIT they would not become the new fad for foreign investors.

Thus, given that the benefits in terms of increased market access to FDI are in question, countries should think twice about surrendering the costs in terms of the lost policy space for sustainable development policies.

ITN: Is there any evidence that BITs in combination with other reforms can drive sustainable development?

Investment forms the core of growth and sustainable development. Thus, agreements that can attract and steer investment into productive and sustainable economic activity should be a top priority. Unfortunately we are not there yet. Indeed, most US BITS make it more difficult to put together a sustainable development path by giving countries little wiggle room in terms of having the necessary tools to do so. A country needs a very well developed set of institutions to counteract some of the components of the treaties.

Of course, nations "trade away" such instruments for the hope that a BIT will bring more investment. As the World Bank implicitly said in the Global Economic Prospects of 2005, nations need to be careful about this trade off.

That being said, Chile is a nation that has been able to have FDI enable broader based development. Although BITS and the US-Chile FTA outlaw the ability of the nation to have pre-establishment screening of firms, selective performance requirements, and environmental impact statements, Chile pursues many of these instruments at the deal level, rather than requiring them. They bargain hard to ensure that the environmental practices of firms are reviewed, that linkages to the local economy will be created and so forth. They also have policies at the national level for research and development and supplying credit to local firms to make sure their domestic economy has the absorptive capacity to make FDI work for development.

In the case of Mexico however, FDI has been of only limited success. Mexico's policy focuses on increasing the quantity of FDI with hopes that other benefits will come automatically. Foreign firms ended up wiping out a lot of local capacity, creating "enclave economies" cut off from the rest of the economy. This process partly explains Mexico's slow growth despite massive surges in FDI and exports.

The US is now in the process of reforming its model BIT. Given the heightened awareness regarding some of the impacts BITS have had, the process will include many more inputs from stakeholders than in the past. I'm confident and hopeful that the new US BIT will look different than recent ones.

ITN: What steps should governments take to ensure that BITs make a positive contribution sustainable development?

The best way for smaller developing countries to ensure that investment agreements are more conducive to sustainable development is to lean toward multilateral and larger regional FTAs. In those settings they have more bargaining power by working in

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coalition with the larger developing nations like Brazil, India, and China that are able to attract FDI for development.

ITN: Different analyses produce different results on the question of BITs and their impact on FDI flows. What are the key methodological differences, and differences in assumptions, that drive the different results? Are there any clear "best practices"in estimating these impacts?

Most of the studies done are econometric analyses that model the extent to which a BIT has a statistically significant and independent effect on investment flows. The results vary depending on the sample size, number of countries and years analyzed, and the types of control variables. A best practice would be to systematically combine a large N panel econometric analysis (having lots of countries and lots of data for those countries)with a series of corresponding qualitative on the ground case studies where researchers put together surveys on firm behavior. The big econometric analysis would help deal with some of the statistical issues that are beyond the scope of this interview to go into. The case studies would help capture things that are tough to quantify.

INTERVIEW WITH HORCHANI FERHAT

ITN: In your opinion, have international investment agreements concluded between developed and developing countries had a positive impact on economic development?

It is difficult to answer this question precisely, in part because the extent to which IIAs effect the flow of FDI is unclear. The presence of IIAs is certainly less important to foreign investors than factors like market size, quality of infrastructure and the availability of a skilled workforce. That said, not concluding IIAs may have a negative effect on economic attractiveness of the country, as it may raise concerns regarding the security of investments, particularly if other factors that are important to investors are not present to a significant degree.

Overall, I believe that IIAs are an important factor in promoting economic development, as they can influence not only the flow of FDI, but also whether FDI serves a public good. However, whether IIAs promote FDI in a positive way very much depends on how well they are negotiated. Unfortunately, many countries still lack the necessary expertise in this area, particularly in understanding the relationship between investment and sustainable development.

ITN: Are there certain clauses or provisions on which developing countries should be particularly careful when negotiating bilateral investment treaties?

Many terms must be given special attention by developing countries. First the preambles of the agreements are particularly useful in interpreting agreements in the case of disputes. Preambles should include development issues in addition to other issues such as economic cooperation. One must be aware that IIAs between African and European countries, for example, are not reciprocal agreements: the rationale for such agreements for each country is different (development for the former and market penetration for the latter). So, this should be written in the preambles to protect the interests of both parties. Notably, the first generation of IIAs tended more balanced. Often other agreements were concluded in parallel, such as agreements on technical assistance, cooperation in education, financial assistance, etc. Unfortunately, this is not the case with most modern IIAs, in which the sole purpose is to protect the interests of investors and not those of the host countries.

Secondly, clauses that permit exceptions or derogations from the rules of treatment and protection are of crucial importance, particularly in the case of a dispute between the host country and foreign investor. Indeed, some BITs contain exceptions related to health, safety, public morals or the protection of the environment. This is the case of the 2004 U.S. model BIT, for example, which allows the parties to take necessary measures if such measures do not constitute "arbitrary or unjustifiable discrimination or a disguised restriction on trade or investment." In all cases, the more clearly the exception is explained, the better. Exceptions that are broadly worded provide a lot of discretion to tribunals.

In addition, Most-Favoured Nation provisions should be negotiated with caution, especially regarding the question of its extension to the settlement of disputes. Regarding the application of fair and equitable standard of treatment, it is now generally recognized that tribunals need to take into account of the investor's conduct. The investor cannot claim unfair and inequitable treatment, if he commits a fraud or is liable for illegal conduct, for example. But this should still be emphasized treaties.

I could go on; this list is certainly not comprehensive.

ITN: What additional steps should governments take to ensure that BITs make a positive contribution sustainable development?

We should keep in mind that BITs have as their primary purpose the protection of foreign investments against discriminatory measures by the host state. This explains the

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COMMENTARY: DOWNING NAFTA?

By Howard Mann
Senior Legal Advisor, the International Institute for Sustainable Development

On 31 March 2009 Dow AgroSciences LLC, a subsidiary of the U.S. Dow Chemical Company, initiated its NAFTA Chapter 11 arbitration against Canada due to the banning of cosmetic lawn chemicals in the province of Quebec. This is not the first case of a foreign investor challenging environmental and human health protection legislation under NAFTA. But if Dow's full frontal assault on the right of governments to protect its citizens from potential risks wins, it may be the last before NAFTA's Investment chapter is either torched or significantly amended.

Dow's NAFTA claim centers on the allegation that Quebec failed to apply a strict science-based test to its ban on the lawn pesticide 2,4-D as required by NAFTA's rules protecting foreign investors. There appears to be two grounds for this: that NAFTA's investment chapter imposes a science-based test for new regulations; and that the Quebec government had allegedly committed to applying a science-based process which it then did not do.

Dow's claim fails to address the fact that the Quebec ban is not alone in Canada. Indeed, at the time of adoption of the provincial measure, there were almost 50 municipals laws in the province banning cosmetic pesticide use. Today, there are over 100. Municipalities in other provinces have followed suit, as have other provincial governments.

Dow's claim also fails to note that the Supreme Court of Canada (SCC) had issued a judgment in 2001 holding that these municipal bans on cosmetic pesticides were constitutional and legal. Moreover, the SCC stated expressly that they were in keeping with the right of governments to take preventive action under the internationally recognized "precautionary principle".*

So why are none of these other measures being challenged? Would the national outcry for doing so would be too great? Or, perhaps Dow hopes to start slow and grow afterwards in its claim? No company can realistically argue that literally hundreds of governments are all simultaneously in breach of "basic due process, transparency, good faith and natural justice", as Dow argues here.** But if it establishes another test first in one case, maybe it can then be applied to the other measures?

This can only be done if a NAFTA tribunal supports Dow's argument that Chapter 11 creates a science-based test for the adoption of all new regulations impacting its products. But it does not do so. So Dow is asking that it be read into Chapter 11.

No existing case law under NAFTA or other investment treaties establishes a science-based test for adopting all new regulations, or a requirement for the abandonment of the precautionary

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NEWS: GERMAN GOVERNMENT MUM ON PENDING VATTENFALL ECT CLAIM

By Damon Vis-Dunbar

The German government has declined to provide information on an investment dispute with the European utility Vattenfall on the grounds that it is against government policy to comment or disclose information on pending arbitrations.

As has been reported in the financial press, Vattenfall is bringing the German government to international arbitration due to environmental restrictions imposed on a planned coal-fired power plant.

According to press reports, Vattenfall was given preliminary approval to build the plant in 2007; however, a new coalition government that includes the Green Party raised concerns over the environmental impact of the plant. The company complains that Hamburg has introduced restrictions on the plant that make the operation economically unfeasible.

Vattenfall is suing Germany for violations of the Energy Charter Treaty (ECT), a multilateral trade and investment agreement that governs investments in the energy sector.

The ECT contains a dispute resolution mechanism that allows investors to bring member governments to international arbitration over alleged violations of the treaty. While twenty investor-state arbitration cases under the ECT have been documented, this is the first publicly disclosed claim against a western European government. The governments of the former Soviet Union and Eastern Europe have received the bulk of the ECT investor claims. There is, however, no definitive account of ECT claims, as the arbitrations do not need to be publicly announced.

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ICSID arbitration under the Malaysia-United Kingdom bilateral investment treaty.

However, the claim was disqualified after Hwang concluded that MHS had not made an "investment" as contemplated by the ICSID Convention.

Hwang's jurisdictional award has been denounced by Schwebel and Tomka on several grounds.

First, the two committee members censure Hwang for not considering the Malaysia-UK BIT, which provides a broad definition of investment. Hwang had considered it unnecessary to apply the Malaysia-UK BIT, reasoning that the ICSID Convention formed the "outer-limits" of ICSID's jurisdiction, and therefore the definition given to investment in the BIT would not alter his decision. However, according to Schwebel and Tomka, ignoring the BIT's definition of investment undermines the importance of these treaties in granting jurisdiction to ICSID.

"To ignore or depreciate the importance of the jurisdiction they bestow upon ICSID, and rather to embroider upon questionable interpretations of the term 'investment' ... risks crippling the institution," write the two committee members.

Second, while Schwebel and Tomka acknowledge that Hwang is not alone among arbitrators in considering economic development as an important criteria for an ICSID investment, they maintain that he erred by elevating it to a jurisdictional condition.

Third, in concluding that an ICSID investment must make a significant contribution to economic development, the committee members say that Hwang failed to account for the fact that the drafters of the ICSID Convention purposely decided not to establish a monetary baseline for ICSID investments.

Dissenting opinion makes the case for development in ICSID investments

Shahabuddeen's dissenting opinion offers a strong defense to the position that an investment must demonstrate a significant contribution to economic development if an ICSID tribunal is to hold jurisdiction.

This view is buttressed by the fact that ICSID operates under the auspices of the World Bank—an intergovernmental organization that offers financing to governments in an effort to alleviate poverty. Shahabuddeen also points to the Preamble of the ICSID Convention, which considers "the need for international cooperation for economic development, and the role of private international investment therein."

According to Shahabuddeen, these facts lead to the conclusion that ICSID is not "meant to be just another arbitration institution"; rather, its overarching objective is economic development.

Shahabuddeen laments the tendency among tribunals to diminish the imporance of economic development as criteria of an ICSID investment, a trend he states "is not compatible with the original objectives of the institution."

Indeed, that trend is highlighted in a jurisdictional award in *Phoenix Action vs. the Czech Republic*, rendered a day before the MHS annulment decision.

In the Phoenix Action award, the tribunal unanimously rejected the notion that a contribution to development should be criteria of an ICSID investment, on the view that "development of the host State is impossible to ascertain."

In the words of the Phoenix Action tribunal:

"A less ambitious approach should therefore be adopted, centered on the contribution of an international investment to the economy of the host state, which is indeed normally inherent in the mere concept of investment as shaped by the elements of contribution/duration/risk, and should therefore in principle be presumed."

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principle as a basis for protecting the public welfare.

Moreover, this approach would be stricter than what is applied under international trade law. In an approach coincidentally established in the Asbestos case brought by Canada to the WTO over the ban of asbestos in the European Union, Dow's current argument that the product is safe if used according to instructions was rejected by the WTO appellate body as the critical legal test. Rather, achieving the desired risk level set by the government—in that case, zero risk of asbestos poisoning—was identified as the appropriate starting point. Dow seeks to reverse this trade-law approach and establish a strict science-based test for governments to meet for all regulations applying to foreign investors. Such a test is simply not expressed in NAFTA or any other investment treaty, and would seriously constrain if not fully deny governments the ability to establish acceptable risk levels to human health

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range of provisions relating to non-discrimination, fair and equitable treatment, prohibition of arbitrary measures, full protection and security, prohibition of measures equivalent to expropriation, and the arbitration of disputes. Foreign investors should be able to use these standards of treatment and protection, including access to arbitration.

Clearly, however, there is an imbalance. The concerns of the host state, including sustainable development, are not covered in a significant way by these agreements. The question, therefore, is how to restore the balance? One solution is for clauses in IIAs that place obligations on foreign investors, such as refraining from activities that amount to an infringement of sustainable development, including human rights, labour law and environmental protection. This proposal could be combined with a consultation mechanism between the host state and national state of the investor, as a prerequisite to any investor-state judicial remedies under the treaty. Another option is a mechanism similar to "Disputes Boards" used by the International Chamber of Commerce, which accompany the implementation of major construction contracts to facilitate the execution of these contracts and prevent possible disputes.

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and the environment based on the precautionary principle.

Dow goes further. It also seems to be arguing that a democratically elected government actually responding to political demands for the protection of human health and the environment, as witnessed by the hundred plus municipal and other provincial bans is, in itself, illegitimate in the face of this claimed science-based test under NAFTA.

In addition, Dow argues that the measure banning the sale of its products in order to protect human health and the environment constitutes an expropriation. This argument was rejected in almost identical circumstances by the 2005 NAFTA tribunal decision in the Methanex v. United States case. A decision here that contradicts the Methanex case would demonstrate unequivocally the inconsistencies of NAFTA and other similar investment treaties, and the complete inability of governments to predict what it might mean when. The obvious unacceptability of this would necessitate changes to NAFTA and some 2600 other bilateral investment treaties. But in the meantime it would act as a powerful deterrent for the taking of new environmental and human health measures by many governments, which may well be Dow's ultimate goal in the present case.

Dow's claim now is for just US$2,000,000. But the stakes are much, much higher than that.

*114957 Canada Ltée (Spraytech, Société d'arrosage) v. Hudson (Town), [2001] 2 S.C.R. 241, 2001 SCC 40, paras. 31, 32

**Dow Notice of Arbitration, para 49.

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