Reflections on the Definition of an 'Investment'

Martin Hunter & Alexei Barbuk *

Introduction

By the early years of the twenty-first century it had become widely recognised that within fifty years the world would not be able to feed its population adequately unless radical action is taken. It is also acknowledged that gift aid or loans from the governments of rich countries to the poor countries, and even writing off debts, can do no more than scratch the surface of the long-term problem.

So what action is needed to provide a stable solution for the medium to long term? Whole books have been written about the various economic, political, sociological and legal aspects of distributing the planet's wealth-generating resources in a fair and appropriate manner without regard to the incidence of random geographical, tribal, ethnic or religious elements. A huge number of factors need to be addressed before the existing imbalances can be eliminated—if indeed they ever can be eliminated altogether. However, the advent of the 'global economy', giving people the ability (through geostationary satellites in space) to communicate with each other almost instantaneously wherever they are in the world, provides present generations with a unique opportunity to make significant progress.

It might be thought that the responsibility for resolving this problem lies with governments and international agencies. Indeed, to a certain extent, this is how it has been tackled over the last half century or so. Unfortunately, there is an upper limit to the level of overseas aid that is acceptable to a developed nation's taxpayers, especially at a time when so many problems exist nearer to home, such as health and social services, roads and other forms of transport, crime prevention and so forth. It is not realistic to expect democratically elected governments that must seek re-election every four or five years to spend more than a certain percentage of the money they extract from their taxpayers on the re-distribution of global wealth. It follows that the necessary increase in rich to poor country investment must come chiefly from the private sector.

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In this commentary the authors review the current position concerning one small—but important—aspect of encouraging a steady stream of commercial investment from the private sectors of rich countries into poor countries. This aspect is the balance between the protection of investors on the one hand and investee nations (and their citizens) on the other; and the role that the definition of the term 'investment' plays in achieving the appropriate balance.[1]

It is clear that an appropriate level of investor protection must be established if commercial enterprises are to be attracted to invest in the world's poorest countries. This feature accounts for, as examples, the inclusion of Chapter 11 in the North American Free Trade Agreement (the NAFTA), and the remarkable growth in the number of bilateral investment treaties (BITs) that governments on both sides of the so-called—although no longer accurately—'North-South divide' have entered into in recent times.[2] Furthermore, the investors are, in the main, corporate entities and as such are obliged by law to look after the interests of their shareholders. They need to have an element of 'legal' investor protection to insert into the risk/reward balance sheet when deploying their shareholders' money.

Sadly, the dispute resolution system appears to be creaking at the seams. Frequent concerns have been expressed about inconsistent decisions of arbitral tribunals established under the NAFTA and BITs, as well as criticism that excessive sums have been awarded in favour of foreign investors by way of damages for loss of expected future returns under concessions and similar long-term agreements. Such criticism makes a particular impact where, as is not

1 Previously published studies on the topic include: 'Scope and Definition', UNCTAD Series on issues in international investment agreements, Vol. 2 (UNCTAD/ITE/IIT/11(Vol. II), 1999) (http://www.unctad.org/Templates/webflyer.asp?docid=189&intItemID=2322&lang=1) [URLs mentioned herein are correct as of March 2005.]; P. Juillard, 'Freedom of Establishment, Freedom of Capital Movements, and Freedom of Investment' (2000) 15 ICSID Rev. 322; M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 1994); K.J. Vandevelde, 'Arbitration Provisions in the BITs and the Energy Charter Treaty' in T.W. Wälde, ed., *The Energy Charter Treaty: An East-West Gateway for Investment and Trade* (The Hague: Kluwer Law International, 1996); D.H. Bliesener, 'La compétence du CIRDI dans la pratique arbitrale' (1991) 68 *Revue de droit international et comparé* 95; M.M. Moore, 'International Arbitration Between States and Foreign Investors—the World Bank Organization' (1966) 18 *Stanford Law Review* 1369 at 1362; N. Rubins, 'The Notion of "Investment" in International Investment Arbitration' in N. Horn, ed., *Arbitrating Foreign Investment Disputes* (The Hague: Kluwer Law International, 2004) at 283–324. The present authors have endeavoured to update, rather than repeat, the valuable work of these distinguished practitioners and scholars.

2 The number of BITs increased from 385 in 1989 to 2265 in 2003 <www.unctadxi.org/templates>.

uncommon, the definition of an 'investment' in the BIT in question includes a formulation along the lines of 'any contract having a monetary value', and an award of a large sum by way of damages follows a finding of breach of such a contract even though the so-called 'investor' has not actually invested any money at all in the country concerned.

In many such cases, of course, the 'investor' pursuant to a qualifying agreement may have been denied the opportunity to make the investment that he or she had contracted (and indeed was keen) to make. It would be harsh to withhold appropriate compensation in such a case on the grounds that the commercial investor had not injected any money or other valuable material into the host country, when the investor was prevented from doing so by corruption or other egregious behaviour within the controlling regime of the host country.

Below the authors look at how the definition of an 'investment' is worded in current BITs[3] and in the NAFTA, and then analyse the decisions in a number of arbitrations where the status of the claimant as an 'investor' was disputed.

Treaty definitions

Businessmen, lawyers, economists, journalists and politicians use the term 'investor' and 'investment' on a daily basis, although few would be able to provide a precise definition. It is somewhat like the terms 'sovereignty', 'national security' and 'public order'. Most people know how to spell them but do not have a clear idea of what they mean. The word 'investment' belongs to the vocabulary of prosperous people who think in terms of 'capital' and 'income',[4] while the more general notion of 'investment' in international parlance is about wealth, power and economic development. These are important for all people without distinctions based on race, sex, language, or religion. Thus, phrases such as 'investing for the future' come into the English language.

Nevertheless, defining the term appears to be an imprecise science. Even the major English language dictionaries appear to be unable to find a common theme. The Oxford English Dictionary gives, as the primary meaning, 'the act of putting clothes on', before proceeding to explain the meaning of 'investiture'.[5]

3 As at the last quarter of 2004.

4 These terms seem equally hard to define—are they not both simply 'money'?

5 *Shorter Oxford English Dictionary on Historical Principles*, 3d ed.

Somewhat nearer the mark for present purposes, the *Encyclopædia Britannica* defines 'investment' as a 'process of exchanging income during one period of time for an asset that is expected to produce earnings in future periods'.[6] According to this definition, investment is not just a subset of assets; the assets in question must be part of a long-term income regenerating process. Thus, in pedantic terms, trade in goods or services would not be an investment, as its objective is only to gain profit without developing an income-producing capacity for the future. By contrast, expenditure on the development of an essential infrastructure or a distribution network would be an investment.

Moving closer to the present context, Article 25(1) of the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington Convention) provides that the jurisdiction of the International Centre for the Settlement of Investment Disputes (ICSID):

> shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre.

However, nowhere in the Convention is the term 'investment' defined. Instead, under Article 25(4), the Contracting States themselves may determine the class or classes of disputes that they will consider submitting to the jurisdiction of the Centre.

A review of the legislative history of the Washington Convention reveals that there was in fact considerable debate about whether or not, and if so how, the term 'investment' should be defined in the text of the Convention. The first draft described 'investment' as 'any contribution of money or other assets of economic value for an indefinite period, or . . . not less than five years'.[7] This definition seems to be reasonably clear, but the result would have been be that someone who contributed one dollar to the economy of a host State for a period of five years would be an investor, while another who contributed fifty million dollars for three years would not. This formulation evidently lacked the flexibility that

6 *Encyclopaedia Britannica Online.*

7 Washington Convention, First Draft, Art. 30, in ICSID, *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States. Part I. Analysis of Documents Concerning the Origin and Formulation of the Convention* (New York: Dobbs Ferry, 1970) at 116.

the proponents of the Convention were seeking. At the same time, other proposals were too rigid. Eventually, reminiscent of the UNCITRAL Model Law on International Commercial Arbitration and many national arbitration laws, it was decided not to attempt a definition of the term at all. Delaume noted:

> The term 'investment' is not defined in the Convention. This omission is intentional. To give a comprehensive definition . . . would have been of limited interest since any such definition would have been too broad to serve a useful purpose [or] might have arbitrarily limited the scope of the Convention by making it impossible for the parties to refer to the Centre a dispute which would be considered by the parties as a genuine 'investment' dispute though such dispute would not be one of those included in the definition in the Convention.[8]

This position was also reflected in the Executive Directors' Report:

> No attempt was made to define the term 'investment' given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the classes of disputes which they would or would not consider submitting to the Centre (Article 25(4)).[9]

The Washington Convention was designed to be an instrument of universal procedural application, designed to provide a commonly accepted means by which investors and States around the world would have the opportunity to resolve investment disputes through arbitration. However, the treaty was perceived by some commentators to be over-protective of the interests of the host State, in that States were given considerable latitude to regulate such matters as the definition of an investment and the interpretation of the investment treaties to which they adhered. It therefore did not inspire businessmen to make substantial investments in the less-developed world.

Some commentators proposed that, in order to balance the interests of States and investors more evenly, a set of objective criteria should be applied. For example, Schreuer refers to the following core features of investment projects:

8 G.R. Delaume, 'Convention on the Settlement of Investment Disputes Between States and Nationals of Other States' (1966) 1 Intl Lawyer 64 at 70.

9 Report of the Executive Directors of the World Bank on the ICSID Convention, 6 August 1964, (1965) 4 I.L.M. 524, <www.worldbank.org/icsid/basicdoc/partB-section05>.

a) an investment project has an extended duration;

b) it envisages a certain regularity of profit (expectation of return) or

c) the assumption of some form of risk by both parties;

d) the project's commitment should be substantial;

e) the project should have some significance to the host State's development.[10]

Although these criteria are rather general, they would have the effect of limiting to some extent the scope of the discretion of host States to interpret their own investment laws as well as the investment treaties to which they have adhered. In fact, these criteria constitute the core of investment definitions in many modern instruments. Notable examples are the latest US Model BIT,[11] and the third draft of the FTAA.[12]

Modern treaties contain much more elaborate definitions of 'investment', without necessarily making them less obscure. Some thirty years before Schreuer wrote the commentary referred to above, the concept of an 'investment' implied merely bringing capital into, or founding a business enterprise in, the host country. For example, the 1972 International Chamber of Commerce Guidelines for International Investments provided merely that foreign investors should 'establish businesses and investments in the ordinary sense of the word of bringing capital into the host State and having a management role in the business enterprise in which they have a clear stake'.[13] At that time assets considered to be investments included real estate, direct property rights, any form of participation in a company, claims to payment or performance, intellectual property, other intangibles, and concession agreements. These somewhat basic examples of investments have been adopted, over the years, in national legislation. For example, the Albanian Law No. 7764 of 2 November 1993[14] defines 'foreign investment' as:

> every kind of investment in the territory of the Republic of Albania owned directly or indirectly by a foreign investor, consisting of:

10 C.H. Schreuer, *The ICSID Convention: A Commentary* (Cambridge: Cambridge University Press, 2001) at 140.

11 US Model Bilateral Investment Treaty (2004), <www.state.gov/documents/organization/38710.>.

12 Free Trade Area of the Americas, 3d draft, 23 November 2003, Chap. XVII <www.ftaa-alca.org/FTAADraft03/ChapterXVII_e.asp>.

13 ICC Publication No. 272 (1973).

14 Cited in *Tradex Hellas S.A.* v. *Republic of Albania*, Decision on Jurisdiction of 24 December 1996, ICSID case ARB/94/2, (1999) 14 ICSID Rev. 159 at 172.

a) moveable and immoveable, tangible and intangible property and any other property rights;

b) a company, shares in stock of a company and any form of participation in a company;

c) loans, claim to money or claim to performance having economic value; (handwritten addition: 'and related with an investment')

d) intellectual property, including literary and artistic works, sound recordings, inventions, industrial designs, semiconductor mask works, know how, trademarks, service marks and trade names; and

e) any right conferred by law or contract, and any license or permit pursuant to law.

According to Article 1 of the Belarus Investment Code of 22 June 2001:

> investment means any asset including monetary funds, securities, equipment and any results of intellectual activities owned or possessed by the investor, and any property rights contributed by the investor in objects of investment activities in order to gain profit (income) and (or) attain other significant result.[15]

Other drafting proposals take a rather different approach. The 'anti-investment' definition proposed in the third draft of the FTAA states that:

> the term 'investment' does not mean real estate or other property, tangible or intangible, not acquired in the expectation or used for the purpose of economic benefit or other business purposes. The term also does not imply stocks or shares (portfolio investment) of companies in one Party acquired for speculative purposes and held for a short-term by nationals of the other Party.[16]

Thus, modern treaties reflect a more sophisticated approach to identifying the scope of protected investments than the treaties concluded twenty or more years ago. Those that have been adopted in the twenty-first century on the basis of the US and OECD models describe 'investment' very broadly. Article 1 of the latest US Model BIT provides that 'investment' means:

> every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:

15 Инвестиционный кодекс Республики Беларусь Кодекс Республики Беларусь от 22 июня 2001 г. № 37-З <www.pravo.by/webnpa/text.asp?RN=HK0100037)>.

16 See *supra* note 12.

(a) an enterprise;

(b) shares, stock, and other forms of equity participation in an enterprise;

(c) bonds, debentures, other debt instruments, and loans;

(d) futures, options, and other derivatives;

(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;

(f) intellectual property rights;

(g) licenses, authorizations, permits, and similar rights conferred pursuant to applicable domestic law; and

(h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

The US Model BIT also mentions some illustrative exclusions:

- Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due and result from the sale of goods or services, are less likely to have such characteristics;
- Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law.
- The term 'investment' does not include an order or judgment entered in a judicial or administrative action.[17]

In a commentary of this length it is not practicable to review all of the many BITs that have been negotiated in the present century. However, the examples cited demonstrate that there are many different objectives amongst the drafters, and several different techniques for achieving those objectives. All of these different approaches may be useful in drafting future investment protection instruments; but the more detailed the provisions, the more prone they become to arguments raised by ingenious lawyers. In particular, many existing treaties seem to be somewhat opaque in their treatment of investments that arise out of a contract or other some other form of legal obligation entered into between a citizen of the host State and a foreigner.

17 US Model Bilateral Investment Treaty (2004) at 3–4 <www.state.gov/documents/organization/38710.pdf>.

Nevertheless, whatever objectives and techniques are adopted by the drafters, it seems that the scope of the protection conferred by these international instruments remains riddled with ambiguity. For example, where an investor protection provision exists, and when a dispute arises, is it necessary for the claimant to have made an *actual* monetary (or monetary equivalent) investment before that claimant is considered to be an investor? Or is it enough if the claimant can prove that he or she was *ready and willing* to make such an investment but was prevented from doing so by unjustifiable government intervention?

Furthermore, it seems clear that the Executive Directors' 1964 Report contemplated that Article 25(1) of the Washington Convention would confer jurisdiction on an ICSID tribunal only where a claim is founded on legal obligations, not obligations arising from moral, ethical or equitable principles: 'The dispute must concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation.'[18]

This is an important point of departure for interpreting the Washington Convention, as well as for a proper understanding of the nature of arbitration as a process. Subject to the scope of the specific arbitration agreement or treaty, an ICSID arbitration may proceed only where the legal rights of an investor are infringed, not merely where a claimant's 'legitimate expectations' are unfulfilled. As things stand, arbitral tribunals may take consideration of legitimate expectations into account only where this can be done within the applicable legal framework.

Unfortunately, it is sometimes difficult for arbitral tribunals to analyse the scope of this limitation in the context of specific scenarios. For example, what do the following phrases imply?

> 'Investment' means every kind of asset and rights of any nature acquired with resources transferred to the territory of a Party, or reinvested therein [, by investors of another Party,] such as [but not limited to] ... *rights conferred by law or contract to carry out economic and commercial activities.*[19]
>
> '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

18 *Supra* note 9 at para. 26.

19 FTAA, see *supra* note 12. Emphasis added.

> includes without limitation . . . a claim to money or a claim to performance *having economic value and directly related to an investment* . . . any right *conferred by law or contract, and any licenses and permits pursuant to law.*'[20]

> '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 . . . *a claim to money or a claim to performance having economic value, and associated with an investment.*[21]

Such provisions are not free from ambiguity. At one level, they appear to establish some legal basis for the protection of those who have not yet contributed 'classic' investment assets into the host country—even though they may have already spent considerable efforts in order to do so in the legitimate expectation that they would earn a fair return. At another level, it is hard to reconcile these provisions with the idea that investor protection should be based on a clear and unjustifiable interference by the host State of a legal right arising under a contract or otherwise.

The authors therefore turn to review the decisions in some twenty-first century investment arbitrations.

Published awards

The distinction between an 'investment' and trade in goods and services is a key element in the definition of an investment both in commentaries and in the treaties themselves. In particular, the NAFTA establishes separate regimes for trade and investment activities. These regimes envisage separate dispute resolution procedures, and different levels of substantive protection.

In *Pope & Talbot* v. *Canada*[22] the claimant was a US corporation engaged in the production and export softwood lumber from Canada to the USA. In order to fulfil its obligations under the Softwood Lumber Agreement ('SLA') entered

20 Treaty between USA and the Argentine Republic concerning the Reciprocal Encouragement and Protection of Investment, Art. 1 <www.sice.oas.org/bits/usaarge1.asp>. Emphasis added.

21 Treaty with the Czech and Slovak Federal Republic Concerning the Reciprocal Encouragement and Protection of Investment of 22 October, 1991, Art.1. <www.cefta.org/memberstates/czech/czbusiness/czustreaty.htm>. Emphasis added.

22 *Pope & Talbot, Inc.* v. *Government of Canada*; award of 26 January 2000 on Canada's preliminary motion to dismiss; <www.naftalaw.org>.

into between the Canadian and US Governments, Canada had introduced an export control regulation. According to this regulation, exporters of softwood lumber from several Canadian regions obtained export permits and paid special fees.

The Canadian Minister of Foreign Affairs exempted several exporters from paying the full fee amount subject to the quota established in the SLA. Pope & Talbot claimed that this practice violated the NAFTA provisions concerning discrimination, fair and equitable treatment, performance requirements and expropriation. Canada asked the Tribunal to dismiss the claim, stating that the export regulation did not relate to investments because softwood lumber fell within the regime established for 'goods' in the NAFTA. However, the Tribunal determined as follows:

> There is no provision to the express effect that investment and trade in goods are to be treated as wholly divorced from each other. . . . where a quota allocation system is involved of the type here under consideration, it necessarily involves that quota be[ing] directly conferred upon or removed from enterprises. It is not a mere linguistic truism to say that such a system directly applies to a particular enterprise, namely each of the relevant softwood lumber producers. . . . It directly affects their ability to trade in the goods they seek to produce, but it can equally be described as the way that the measures applied to the various enterprises affect the total trade in the relevant products. . . the fact that a measure may primarily be concerned with trade in goods does not necessarily mean that it does not also relate to investment or investors.[23]

The dispute in *S.D. Myers, Inc.* v. *Canada*[24] arose out of a Canadian ban on the export of highly toxic polychlorinated biphenyl wastes (PCBs). SDMI was a US corporation located in Tallmadge, Ohio, and one of the leading operators in the business of the disposal of toxic waste products in the USA. The Canadian inventory of PCBs was at the time mainly in storage, and was a source of some continuing embarrassment to its owners. There was only one credible disposal facility in Canada, and that was in Alberta which was several thousand miles from the East Coast.[25] At the time the Canada/USA border was closed to transit of PCB wastes by reason of US Government regulations, but there was reason to believe that the US ban might be lifted.

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23 *Ibid.* at paras 26 and 33.

24 *S.D. Myers, Inc.* v. *Government of Canada*, partial award of 13 November 2000 <www.naftalaw.org>.

25 Tallmadge was only a short distance from the Canadian/US border, near to the southern shore of Lake Michigan.

Perceiving a potential business opportunity, SDMI created a Canadian corporation (Myers Canada) and embarked on a well-designed business plan to collect PCBs in Canada, undertake some initial processing locally and then transport the highly toxic residue to SDMI's facilities for disposal in the USA, where its processing facilities had spare capacity as a result of the successful disposal of most of the US inventory of PCBs. In due course the US Government lifted its ban on the importation of PCBs, whereupon the Canadian Government immediately imposed an export ban from its own side of the border. SDMI started a NAFTA Chapter 11 arbitration, claiming that it had 'suffered economic harm to its investment through interference with its operations, lost contracts and opportunities in Canada' as a result of the export ban.

The substantive merits of the dispute turned on whether Canada had discriminated against SDMI as a non-Canadian national. But, for present purposes, the relevant aspect is the preliminary issue raised by Canada that SDMI was not an 'investor', because the only money that SDMI had brought into Canada was about US$ 1 million spent on marketing and preparing for its projected transportation operations. Canada thus asserted that SDMI did not have an 'investment' in Canada. However, the Tribunal determined that SDMI's Canadian associated corporation was an 'enterprise' which, according to Article 1139 of the NAFTA, constituted an investment by SDMI in Canada. The arbitral tribunal noted that (a) SDMI and Myers Canada had entered into a joint venture, (b) Myers Canada was effectively a branch of SDMI (not a subsidiary), (c) it had made a loan to Myers Canada, and (perhaps most interestingly in the context) (d) its expenditure on gaining 'market share' in Canada constituted an investment.[26] The arbitral tribunal also stated that other grounds existed on which SDMI might also have been categorised as an investor.

These particular cases illustrate circumstances in which governments were unsuccessful in asserting that the claimant was not an 'investor'. But the cases do not all point in the same direction.

In *Mihaly* v. *Sri Lanka*,[27] the arbitral tribunal examined the issue of when, if at all, the commitment of financial resources in a pre-contract phase could constitute an investment. The claimant, a US corporation, entered into a letter of intent (LoI) with the Government of Sri Lanka. This document created a basis for negotiations for the construction of a power plant in Sri Lanka on a 'built-

26 *Supra* note 24 at para. 232.

27 *Mihaly International Corporation* v. *Sri Lanka*; award of 15 March 2002, ICSID case ARB/00/2, (2002) 17 ICSID Rev. 142 at 156; (2002) 41 I.L.M. 867 at 875.

own-transfer' basis. Under the express provisions of the the LoI the project itself and the contract details were subject to government approval, and did not constitute 'an obligation binding on any party'.

Mihaly incurred substantial expenditure (approximately US$ 7 million). This pre-contract expenditure was necessarily incurred in order to prepare financial and technical documentation, undertake technical and commercial studies and, generally, to participate in the tender in a credible manner. In the event, the Government of Sri Lanka refused to sign the construction contract. Mihaly started an ICSID arbitration. The ICSID tribunal determined that there was no 'investment' by Mihaly within the territory of Sri Lanka, stating that:

> It is an undoubted feature of modern day commercial activity that huge sums of money may need to be expended in the process of preparing the stage for a final contract. However, the question whether an expenditure constitutes an investment or not is hardly to be governed by whether or not the expenditure is large or small. Ultimately, it is always a matter for the parties to determine at what point in their negotiations they wish to engage the provisions of the Convention by entering into an investment . . . The Respondent clearly signalled, in the various documents which are relied upon by the Claimant, that it was not until the execution of a contract that it was willing to accept that contractual relations had been entered into and that an investment had been made.[28]

One member of the arbitral tribunal, David Suratgar, in a separate concurring opinion, stated that he had signed the award with reluctance. He noted that the absence of an international forum in which foreign businessmen may remedy such situations might be detrimental for the prospect of future foreign investment. In Mr Suratgar's view, ICSID's 'protection mechanism should be available to those who are encouraged to embark on such expensive exercises' in pre-contract foreign investment projects.[29]

The result in this case may seem to be inequitable, but businessmen take calculated risks. One commentator stated that '[t]o expand access even further by making a new category of disputes – pre-investment disputes – eligible for ICSID arbitration risks alienating the developing countries and slowing down development of the BIT process'.[30]

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28 *Ibid.* at para. 33.

29 Individual Concurring Opinion by Mr. David Suratgar, (2002) 17 ICSID Rev. 161 at 165; R.N. Hornick, 'The *Mihaly* Arbitration Pre-Investment Expenditure as a Basis for ICSID Jurisdiction' (2003) 20 J. Int. Arb. 189 at 191.

30 R.N. Hornick, *ibid.* at 193.

Bribery and corruption preventing foreign investments are not the same things as objective economic calamities which sometimes cause economic and political stress in less-developed countries. In *CMS* v. *Argentina*,[31] the dispute was provoked by a serious economic and financial crisis which occurred in the late 1990s in Argentina. CMS was an entity incorporated in the USA. It filed a claim against Argentina with regard to the alleged suspension by the government of a tariff adjustment formula for gas transportation applicable to an Argentine incorporated company (TGN) in which CMS had investment (approximately 30 per cent).

In its efforts to cope with the crisis, Argentina enacted various regulations that later led to inflation as well as the adoption of additional financial and administrative measures. CMS claimed that those measures affected its business adversely and breached the guarantees that protected its investment in TGN. Argentina argued that CMS was a minority and non-controlling shareholder and was therefore not entitled to recourse to investor-State arbitration under the relevant BIT. In its Decision on Objections to Jurisdiction, the Tribunal determined that CMS could pursue a claim for damages for its investment in TGN, because this was a cause of action that was separate from TGN's rights as an Argentinian party. Nevertheless, the Tribunal noted:

> 29. . . . treaties cannot entirely isolate foreign investments from the general economic situation of a country. They do provide for standards of fair and equitable treatment, non-discrimination, guarantees in respect of exportation and other matters, but they cannot prevent a country from pursuing its own economic choices. These choices are not under the Centre's jurisdiction and ICSID tribunals cannot pass judgment on whether such policies are right or wrong. Judgment can only be made in respect of whether the rights of investors have been violated.
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> . . .
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> 33. . . . the Tribunal concludes on this point that it does not have jurisdiction over measures of general economic policy adopted by the Republic of Argentina and cannot pass judgment on whether they are right or wrong. The Tribunal also concludes, however, that it has jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts.[32]

31 *CMS Gas Transmission Company* v. *Republic of Argentina*, Decision on Objections to Jurisdiction of 17 July 2003, ICSID case ARB/01/8, (2004) 22 *ASA Bulletin* 72.

32 *Ibid.*

This Tribunal's finding is reasonable. It respects the sovereign right of States independently to conduct national policy as well as the right of investors to protection under existing multilateral and bilateral instruments.

Much has been written about the extraordinary story of the privatised Czech television broadcasting industry, which resulted in several arbitrations initiated by the business interests of a US investor. The full, and complex, story is not repeated here. But the 'twin' arbitrations *Lauder* v. *Czech Republic* and *CME* v. *Czech Republic*[33] deserve mention because strikingly different results emerged from claims arising from a single set of broadly uncontested facts.

Central European Television 21 (CET 21) was a Czech company that in 1993 obtained a broadcasting licence for a period of twelve years from the relevant Czech authority. During the process of obtaining the license, CET 21 worked closely with a German corporation, Central European Development Corporation GmbH (CEDC), which was substantially owned by the interests of a US citizen, Mr Lauder. CET 21 rapidly became a popular TV channel in the Czech Republic and gained more than 50 per cent of the local TV market.

The Czech Media Council originally approved CEDC's direct investment in CET 21, but later in 1993 it required the companies to establish a joint venture in order to operate the licence. Thus, CNTS was founded. CEDC was to contribute 75 per cent of the share capital of CNTS. In return CEDC received a 66 per cent ownership interest. CET 21 contributed 'the right to use the Licence "unconditionally, unequivocally and on an exclusive basis"'[34] in return for 12 per cent. Under the terms of CET 21's licence, the Memorandum of Association of CNTS and the Investment Agreement between CET 21 and CEDC became an integral part of the licence.

In January 1996, the Czech Broadcasting Act was amended. It entitled licence holders to request a waiver of all licence conditions that were unrelated to programming. CET 21 asked for a waiver of Condition 17. Later the same year, the Czech Media Council started administrative proceedings against CNTS

33 *Lauder* v. *Czech Republic*, award of 3 September 2001 <http://ita.law.uvic.ca/documents/LauderAward.pdf>; *CME* v. *Czech Republic*, partial award of 13 September 2001 <http://ita.law.uvic.ca/documents/CME-2001PartialAward.pdf>; '*Lauder* v. *Czech Republic*; *CME* v. *Czech Republic*; Panels in London and Stockholm reach Opposite Results in Treaty Arbitration on Media Investment – Summary by Bianca Bezdek' (2002) 20 *ASA Bulletin* 249; C.N. Brower, C.H. Brower, II & J.K. Sharpe, 'The Coming Crisis in the Global Adjudication System' (2003) 19 *Arbitration International* 415.

34 *CME Czech Republic B.V.* v. *Czech Republic*, Partial Award of 13 September 2001, para. 12, <ita.law.uvic.ca/documents/CME-2001PartialAward.pdf>.

in order to determine whether it was broadcasting without appropriate authorisation. As a result, the shareholders of CNTS agreed to replace CET 21's contribution of the exclusive use of the licence with the exclusive use of the *know-how* of the licence. CET 21 and CNTS then concluded a service agreement which defined CET 21 as the licence holder and operator of TV NOVA. According to that agreement, the licence was neither transferable nor required a contribution from CET 21 to CNTS. These changes satisfied the Czech Media Council and the administrative proceedings were abandoned. In 1997, CME, a Dutch company in which Mr Lauder was the principal shareholder, acquired 99 per cent of CNTS. About a year later CET 21 began to purchase programming from sources other than CNTS without CME's consent.

As a result, in 1999, Mr Lauder initiated arbitral proceedings in London against the Czech Republic pursuant to the 1991 Czech-US BIT. He claimed that the Czech Republic had an obligation to provide fair and equitable treatment to foreign investors, as well as the obligation to provide full protection and security to foreign investments. Six months later, in 2000, CME started an arbitration against the Czech Republic in Stockholm under the 1991 Czech-Netherlands BIT, claiming that the Czech Media Council was responsible for the fall in the value of the CNTS shares. Mr Lauder sought compensation of US$ 500 million.

The London Tribunal rejected Mr Lauder's claim that the Czech Republic had violated its obligations under the Czech-US BIT.[35] It recognized that the Czech Republic could be held responsible for the discriminatory and arbitrary measures imposed by the Czech Media Council in requiring CNTS to be established when it had already approved CEDC's direct investment in CET 21. However, the Tribunal rejected the claim that the Czech Media Council's actions constituted an expropriation or any other breach of international law. It noted that the Czech Government was not obliged to protect foreign investments from possible loss of value. In order to obtain compensation, Mr Lauder had the burden of proving that the discriminatory conduct for which the Czech Republic was responsible was in fact the proximate cause of the drop in the value of the CNTS shares. The Tribunal determined that Mr Lauder had not discharged this burden of proof.

By contrast, the Stockholm Tribunal in *CME* v. *Czech Republic* held, by a majority, that the Czech Republic had violated its treaty obligations in all respects, as claimed by CME. It found that the Czech Republic was responsible

35 See *supra* note 21.

for the harm caused to CME even if this was not the sole cause of the damage sustained by the investor. The fact that the nefarious actions of CET 21 were the primary cause of the damage to CNTS did not absolve the Czech Republic from responsibility for action that was apparently politically motivated. A substantial award was made against the Czech Republic.

Commentators have expressed widely divergent opinions on the relative merits of the two awards, and the present authors do wish to not add to that debate. The interesting aspect in the present context is whether 'forum shopping' of the kind employed in this saga is an abuse of process, or an abuse of right. It is a difficult question to answer. At one level it may be stated that where potential claims are created by a number of different BITs and/or contractual obligations, a claimant has an inherent right to pursue all of them, at least up to a point that has been described as the 'fork in the road'. At another, broader level this can hardly be considered to be in the medium-to-long term interest of foreign investment in the world's poorest countries. A new, and more restrictive, approach to the definition of an 'investment' might solve the problem; but, equally, it might deter commercial investors from entering 'risky' countries.

The extraordinary *Himpurna* v. *PLN* case can hardly be ignored in the context of the abuse of rights even if it was not strictly an 'investment dispute' in the sense of being founded on a BIT or other international treaty.[36] In this case, a US claimant had entered into contracts, including an Energy Sales Contract (the ESC), with the Indonesian State electricity corporation PT. (Persero) Perusahaan Listruik Negara (PLN) to explore and develop geothermal resources in Indonesia. These contracts provided for the construction of a power plant by the US corporation and the sale of the electricity produced to PLN. In 1997 an economic crisis struck South East Asia and PLN failed to purchase the electricity produced by the plant.

Himpurna started an arbitration under the dispute resolution provisions in the ESC, seeking an award of US$ 2.3 billion. The Tribunal found that PLN had breached the contract in a number of respects, including wrongful purported

36 *Himpurna California Energy Ltd.* v. *PT. (Persero) Perusahaan Listruik Negara*, Final Award of 4 May 1999, (1999) 14:12 *Mealey's International Arbitration Report* A-1–A-58. The case became famous for the alleged 'kidnapping' of a member of the tribunal. This remarkable story is recounted in the *Himpurna California Energy Ltd.* v. *Republic of Indonesia*, interim award of 26 September 1999 and final award of 16 October 1999, respectively (2000) 15:1 *Mealey's International Arbitration Report* B-1–B-38 and (2000) 15:2 *Mealey's International Arbitration Report* A-1–A-20.

termination of the ESC, failure to issue standby letters of credit and/or pay invoices, and preventing *Himpurna* from finishing the construction of some additional units.

The Tribunal awarded damages for wasted costs and lost profits, but only to the extent of about 10 per cent of the sums claimed, stating as follows:

> 522. ...it strikes the Arbitral Tribunal as unacceptable to assess lost profits as though the Claimant had an unfettered right to create ever-increasing losses for the State of Indonesia (and its people) by generating energy without any regard to whether or not PLN had any use for it. Even if such a right may be said to derive from explicit contractual terms, the Arbitral Tribunal cannot fail to be struck by the fact that the Claimant is seeking to turn the ESC into an astonishing bargain in circumstances when performance of the Contract would be ruinous to the Respondent. (A US$ 2.3 billion return – including the unpaid invoices – would represent a 630% profit on a US$ 315 million investment.) What troubles the Arbitral Tribunal is less the level of profitability in and of itself than its contrast with the losses facing PLN. To extract the full benefit of the hard terms of the ESC with respect to investments *not yet made*, in a situation where that benefit will clearly exacerbate the already great losses of the cocontractant, strikes the Arbitral Tribunal as likely to constitute an abuse of right inconsistent with the duty of good faith which is fundamental to the Indonesian law of obligations.
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> 547. To seek to apply the ESC so as to permit the Claimant to reap pure profit by reference to hypothetical *future initiatives* in pursuit of an agreement which has become an instrument of oppression would be like stepping on the shoulders of a drowning man. The Arbitral Tribunal finds that it would be insufferable, and therefore an abuse of right.[37]

The *Himpurna* Tribunal had limited room for manoeuvre because of the classic 'take-or-pay' provision in the contract. The object of such a provision is to ensure that a concessionaire—or, to use modern terminology, exclusive licensee—is given a reasonable opportunity to recover a fair return on his or her initial and continuing capital investments. But it may be assumed that the drafters of such contracts did not foresee that an investment return would be conferred in respect of an investment that would never be made. As the *Himpurna* Tribunal recognised, this is an entirely different proposition from compensating an expropriated investor for non-recovery of an investment that has actually been made, including an appropriate return.

37 *Himpura California Energy Ltd.* v. *PT. (Persero) Perusahaan Listruik Negara*, Final Award of 4 May 1999, (1999) 14:12 *Mealey's International Arbitration Report* at A-51 and A-53.

Conclusions

It is not easy to draw definitive conclusions from published arbitral awards, other than that many of the complaints concerning the apparent inconsistencies between the decisions of different arbitral tribunals are over-simplistic. Much depends on the specific provisions of the relevant international treaty[38] that provides the cause of action. Furthermore, most of the cases reviewed are notably fact-specific, which makes it difficult to draw general conclusions of principle. Nevertheless, in general it seems unfair to criticise the *system* of international arbitration, or the decisions of individual arbitral tribunals in fact-specific cases, where the cause of action was based on the provisions of a specific BIT or contract.

It does appear that some expropriated or disrupted investors have obtained awards of monetary damages, based on a denial of expected future profits over long periods, that seem to be disproportionate in relation to the money or effort expended by the investor concerned. Whether or not the innovative solution adopted by the *Himpurna* Tribunal provides a model that will be followed by future tribunals remains to be seen. However, few impartial observers are likely to favour the present scenario, in which the application of BIT investment definitions and contractual 'take-or-pay' provisions can lead to obvious examples of unjust enrichment or windfalls that fall outside the legitimate expectations of both parties at the time the transaction was made.

At the time of writing it seems that some governments, disillusioned by arbitral awards against them under the investor protection provisions of international treaties, have been considering the option of eliminating provisions conferring direct rights of action on private investors. If implemented, this would presumably involve reverting to the traditional government-to-government processes, under which the private investor must first take the complaint to his or her own government, which will pursue it through diplomatic channels. It would be unfortunate if this were to happen, because it would certainly discourage private investment into the world's poorest countries. Indeed, it might even destroy the best source of hope that the world may find ways to feed its population adequately in the second half of the twenty-first century.

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38 e.g. Art. 25(1) of the Washington Convention; Art. 1139 of the NAFTA; Art. 1 of the Agreement among the Government of Brunei Darussalam, Republic of Indonesia, Malaysia, Republic of the Philippines, Republic of Singapore, and the Kingdom of Thailand for the Promotion and Protection of Investments, signed 15 December 1987 ('ASEAN Investment Agreement'); Article 1 of the US Model BIT, and the provisions mentioned *supra* notes 20 and 21.