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Bird's eye view of investor-state arbitration
Part II – Protections under IIA

Introduction

In this series of short publications, we provide a bird's eye view of the introductory aspects of investor-state arbitration. In part I, we examined the source of investor's right to arbitrate, the scope of "investor" and "investment" in the international investment treaties and common pre-conditions for investor-state arbitration. In this publication, we will look at some of the most common protections provided to investors under the international investment agreements ("**IIA**"), and for each of these protections, we will provide a brief explanation of the standard of protection, examples of clauses from IIAs and examples of claims in the form of reported cases.

Substantive protections provided to investors

IIAs (such as bilateral investment treaties or multilateral investment treaties) are developed to protect foreign investors when investing in another country, to promote a sound investment climate, and ultimately to promote foreign investments in the host state. One of the key features of IIA is that it sets out the various protections provided to foreign investors. If, as an investor, your investment is affected by the conduct of the host state (e.g. the international sanctions and countersanctions imposed by Russia as a consequence of the Russia-Ukraine war) you may wonder whether you can rely on the relevant IIA to bring a claim against the host state.

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Each IIA is different, but generally there are similarities amongst them in the protections provided to foreign investors such as the right to be compensated for the unlawful expropriation of their investments, the right to fair and equitable treatment, and most notably the right to bring a claim on the basis that these protections have been breached. Some of the most common protections available to foreign investors are discussed below[1].

Protection against unlawful expropriation

Most IIAs protect foreign investors from expropriation or measures tantamount to an expropriation that is not done (1) for a public purpose; (2) in a non-discriminatory manner; (3) in accordance with due process; and (4) against payment of prompt, adequate and effective compensation (which is often further defined as market value). To put in a simple manner, expropriation is the taking by the state of private property for public purposes, normally without proper compensation. Investors may bring expropriation claims in relation to: (i) direct expropriation, which is when the host state seizes investor's property or transfers title of the property to another; or (ii) indirect expropriation, which is when there is a complete or near complete deprivation of the investor's investment without transfer of title or physical seizure.

IIAs may refer to both direct and indirect expropriations in one way or another. For example, the Japan-Lao People's Democratic Republic BIT[2] 2008 refers to indirect expropriation by the use of phrases such as "equivalent to" or "tantamount to" (as shown below).

"Neither Contracting Party shall expropriate or nationalise investments in its Area of investors of the other Contracting Party or take any measure ***equivalent to*** *expropriation or nationalisation (hereinafter referred to as "expropriation") except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) upon payment of prompt, adequate and effective compensation pursuant to paragraphs 2, 3 and 4; and (d) in accordance with due process of law and Article 5."*

[1] Japan does not have a model of standard terms or language that it uses in its IIAs therefore each bilateral investment treaty must be individually examined as to what types of protection are available and what conditions have to be satisfied under the treaty.
[2] Bilateral investment treaty

Funnekotter v Zimbabwe[3] provides a straightforward example of direct expropriation. The arbitration tribunal held that when the government of Zimbabwe through a land acquisition programme took over certain farmland, it had expropriated the investor's investments in farmland equipment without compensation. A famous example of an indirect expropriation claim, which was determined in favour of the investor is the Yukos Universal v. Russia[4] case. In that case, the arbitration tribunal determined that a series of measures taken against Yukos by Russia, which included tax payment investigations, criminal prosecution of business managers, additional taxes, auctions/bankruptcy proceedings of core sectors, etc., caused "drastic" consequences for Yukos, which amounted to indirect expropriation.

Fair and equitable treatment

Frequently, IIAs impose an obligation on host states to accord foreign investments fair and equitable treatment (**FET**). An example of the FET clause can be seen in the Agreement between Japan and the Republic of the Philippines for an Economic Partnership (2006), which provides as follows:

> *"Each Party shall accord to investments of investors of the other Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."*

This is the treaty obligation that is "most frequently invoked" in investor-state arbitration and the one "most frequently found to be breached"[5]. However, there is no standard definition of FET, and the substantive content of the FET standard has been fleshed out by arbitration tribunals on a case-by-case basis. Arbitration tribunals usually have considerable discretion in determining the "fairness" of state's actions by taking into account all the facts and circumstances of the case. From the various case laws, the following concepts, among others, have emerged as relevant to the FET standard:

- Denial of justice – This standard requires the host states to offer basic protection in their internal judicial systems. When alleging denial of justice, an investor must prove that the decision or the conduct of a court of the host state has violated the relevant international standard. Four types of conduct may constitute a denial of justice: (1) when state courts refuse to entertain a suit; (2) when state courts

[3] Bernardus Henricus Funnekotter and ors v Republic of Zimbabwe, Award, ICSID Case No. ARB/05/6, IIC 370(2009)
[4] Yukos Universal Limited (Isle of Man) v. The Russian Federation (PCA Case No. 2005-04/AA227)
[5] Nigel Blackaby et al., *Redfern and Hunter on International Arbitration*, Sixth edition (Oxford University Press, 2015), Paragraph 8.96.

subject the suit to undue delay; (3) when state courts administer justice in a seriously inadequate way, or (4) when state courts clearly and maliciously misapply the law. However, the test for denial of justice sets a high threshold as the standard requires "the demonstration of 'a particularly serious shortcoming' and egregious conduct that 'shocks, or at least surprises, a sense of judicial propriety'"[6]. In fact, in White Industries Australia Limited v India[7], while the arbitration tribunal agreed that there was undue delay by the Indian courts (the claimant had spent nine years trying to enforce an award in India), the delays did not reach the high standard required for a claim of denial of justice.

- Lack of procedural fairness and transparency – Arbitration tribunals have found that violation of due process in legislative or administrative proceedings may give rise to a breach of the FET standard. Lack of transparency such as the absence of a clear rule regarding the application and/or granting of state construction permit has also been found to give rise to a breach of the FET standard[8].

- Coercion or harassment of investors – Exerting undue pressure on the investor by way of coercion or harassment has also been held as a violation of the FET standard. For example, in Stati and others v Kazakhstan[9], a series of investigations conducted following an order by the President of Kazakhstan were found to amount to co-ordinated harassment in breach of the FET standard.

National treatment

Some IIAs provide that foreign investors should be treated no worse than local investors and seek to ensure that host states do not favour the interests of their own investors over foreign investors. IIAs have defined the standard of national treatment in two main ways. One requires a strict standard of equality of treatment between national and foreign investors. The other offers the possibility of granting more favourable treatment to foreign investors. The Japan-Myanmar BIT (2013) provides an example of equality of treatment between national and foreign investors as follows:

"Each Contracting Party shall in its Area accord to investors of the other Contracting Party and to their investments treatment ***no less favourable*** *than the treatment it accords in like circumstances to its own investors and to their investments with respect*

[6] Chevron Corp and another v Ecuador, ICSID Case No. ARB(AF)/99/2, Paragraph 127.
[7] White Industries Australia Ltd v The Republic of India (UNCITRAL, Award, 30 November 2011)
[8] Metalclad Corp v Mexico (NAFTA) (Award, 30 August 2000)
[9] Ascom Group S.A., Anatolie Stati, Gabriel Stati and Terra Raf Trans Traiding Ltd. v. Republic of Kazakhstan(SCC Case No. 116/2010)

to investment activities."

An illustration of the breach of the national treatment standard can be seen in the case of Olin Holdings Ltd. v. Libya[10], in which Olin Holdings brought a claim against Libya for expropriation of Olin's factory in Tripoli. Among other breaches, the arbitration tribunal found that, Libya had also breached the national treatment standard as Olin had been treated less favourably than Libyan competitors who were exempted from the expropriation.

Most favoured nation treatment

The most favoured nation (**MFN**) treatment, together with national treatment, is widely accepted as the most important standards of treatment for investors and their investments. This standard requires the host state to provide investors with treatment no less favourable than it is required to afford investors under other investment treaties to which the state is a party.

A common situation when an investor seeks the protection of the MFN clause is when the host state provides tax concessions to investors of a certain country for a specific industry (e.g. French investors in the oil industry) but not to investors from other countries in the same industry (e.g. British investors in the same industry). In those circumstances, the British investor could rely on the MFN clause to claim the same treatment or compensation for the loss suffered as a result of the discrimination. White Industries Ltd. v India[11] is a well-known case about breach of MFN treatment, in which after nine years of unsuccessfully trying to enforce an ICC award in the Indian courts, the Australian investor successfully used the MFN clause in the Australia-India BIT by relying on India's obligation to provide effective means of asserting and enforcing rights contained in the India-Kuwait BIT.

Other protections

In addition to the protections discussed above, other common ones include protection from non-discriminatory measures, which often overlap with the FET standard, right to freely transfer funds, which is essentially protection from currency control regulations or freezing of funds in the host state, and umbrella clauses, which provide that the host

[10] Olin Holdings Limited v. State of Libya (ICC Case No. 20355/MCP)
[11] White Industries Australia Ltd v India (UNCITRAL, Award, 30 November 2011)

states must comply with their obligations undertaken in respect of the investments from foreign investors.

After assessing whether the host state has breached its substantive obligations, the next step would be for the foreign investor to consider which dispute resolution forum to commence its action, and the appropriate remedies to seek, both of which will be discussed in our next publication.

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