

Chapter Three

Bilateral Investment Treaties (BITs)

Introduction

- BITs are treaties **concluded between two countries**.
- They are currently the **most important instruments** that govern foreign investment issues.
- BITs were **initially concluded between developed and developing** countries. But now it involves **diversification** in participation and concluded between developing countries, or with countries with economies in transition.

Rapid growth of BITs

- The 1st BIT concluded in 1959 (b/n Germany and Pakistan).
 - Before this there were treaties of friendship and commerce (which address wide range of issues including politics, religion, etc.).
- There were less than 700 BITs between the period 1959 until 1980s.
- The period in the 1990s and onwards rapid increase of BITs (currently over 2900).
- Why?
- One, the failure to formulate multilateral instrument on foreign investment made BITs a necessary solution.
 - BITs are different in that they are made on an ad hoc basis
 - Their ability to give rise to general principles is remote.
 - Such treaties could be negotiated in such a manner as to suit the mutual interests of the parties,

- Two, the lack of a well developed customary international law on foreign investment.
 - In the absence of clear rules developed by custom and confused state of conflicting norms, BITs provided the parties with the opportunity to set out the definite norms.
- Third, dominance of capitalism/change of ideology
 - The states of the old Soviet bloc, desperately short of capital, turning towards a market economy and looked to foreign investment; then begun making BITs with capital-exporting countries.
 - The treaties used as a signal to policy change and assurance of private property and investment/since investors fear to go there due to the long existed antagonization of foreign investment in these countries

- Fourth, the 1980's economic crisis.
 - Shift from loan to investment
- Fifth, many developing countries conclude BITs in the hope that such conclusion would bring about flow of foreign investment by boosting confidence of investors to invest in their territory.
 - The assumption behind is protection lead to increment of flow of foreign capital.

- Is there a co-relation between signing many BITs and flow of foreign investment?
 - The mere fact of concluding BITs does not seem to bring about flow of foreign investment- it is just one factor.
 - There are some other important factors that determine flow of foreign investment.
 - Political stability
 - Economic circumstances such as market, infrastructure
 - The domestic legal framework (laws related to commerce, contract, investment, tax, labor, tort, environment, etc.).

Common Features of BITs

- The **structure** of different BITs has a basic similarity, even though many BITs also share similar features in contents.
1. **Preamble;** provides the **purpose** as to why the countries signing the treaty. **Two** important things;
 - Reciprocal duty (**promotion and protection of investment**). Two way flow of investment (**even** if the BIT is b/n developed and least developed).
 - Reciprocal benefits (to bring economic and other benefits to both the host and home state).
 2. **Definition;** of **investor and investment** (to talk about protection of investment, **first**, it requires to specify the two).
 - It may be defined broadly or narrowly (refer chapter one).

3. Standards of Treatment; BITs provide a variety of standards of treatment.

A. NT; any **privilege/benefit** **accorded** to **domestic/national investor** should also be accorded to foreign investor in like circumstances.

- It seeks to ensure **a degree of competitive equality between national and foreign investors/** a contingent standard based on the treatment given to other investors.

• **Condition for NT** – investors/investments **‘in like circumstances’**.

- **How to determine** it? No clear and straightforward meaning.
- However, it can be determined having regard to the **type or the amount/size of investment**. Yet, the differentiation should not be to create discrimination, but, with **genuine objective**.

- Exceptions - strictly applying NT **may contradict with the national policy** of host state. For instance, it may want to grant advantages/privileges to domestic enterprises in order to stimulate their growth and competitiveness.
- **To this end** BITs provide exceptions to NT.
 - **General**; typically based on **public health, public order and morals, and national security**.
 - **Specific**; '**development clause**'. For instance, it may be agreed that a host state has a right to provide better protection for domestic investors in a specific sector. But if the protection cover many sectors it totally goes against NT.

B. MFN; a benefit accords to one foreign investor should also be accorded to the other foreign investor in like cases.

- It seeks to prevent discrimination against investors from foreign countries on grounds of their nationality. MFN is crucial for the establishment of equality of competitive opportunities between investors from different foreign countries.
- Condition for MFN – ‘like circumstances’.
- Exceptions - MFN sets certain limits upon host countries with regard to their present and future investment policies by prohibiting them from favoring investors of one particular foreign nation over those of another foreign country.

- **General**; to maintain public order, public health, public morality, or national security.
- **Specific**; regional integration agreements (treatments accorded to members of the regional agreement is better than non-members). Otherwise, it will create free-riders (without objective claiming favourable treatment).

C. Fair and Equitable Treatment; mostly used in BITs, along with NT and MFN.

- One of the challenges in this regard is to identify the main elements of this standard.

4. **Repatriation of Capital**; remittance of capital from the host state to home state or any other third country.

- Investors may repatriate;
 - Their **profit** from investment activities;
 - The proceeding **from sale** of their enterprise/properties in host state (partially or up on complete withdrawal);
 - Any **other income** (yield legally).
- The **extent of this right** is different from treaty to treaty. Some BITs allowed to repatriate almost all assets that belong to the investor (even capital which does not seem to form part of investment).

- This right includes the right to convert capital from local currency to foreign currency, at prevailing exchange rate.
- It is possible to say that this right is absolute since no limitation/restriction is stipulated in this regard under BITs. This is to assure the maximum confidence for investors.
- Some argued that there should be exception, especially, at the time of serious economic crisis in hosts state (it is a national interest)
 - In such cases, the host state should be given a right to restrict outflow of capital, at least for the time being.

5. Taking of Property and Compensation

- Private property may be taken by a government through, *nationalization and expropriation*.
 - Both are *acts of a government* (a government acting in its sovereign capacity).
 - *Nationalization* is *a transfer of ownership from private to public*, while, in case of *expropriation* ownership may be transferred *either to the public or private*.
 - *Nationalization* generally *covers an entire industry or geographic region* and it typically occurs in the context of a major social, political or economic change. However, *expropriation* targets only *a specific entity*.
- Now a day, the *risk of nationalization is infinitesimal*, but expropriation.

- Expropriation can be;
 - **Direct**- when there is transfer of ownership.
 - **Indirect** - no transfer of ownership but a government impose restrictions which affect to exercise a full right over the property (such as high tax, taking away management power from the investor).
- Expropriation is not prohibited, but required to be lawful.
 - Made to serve public purpose/interest
 - It should be non-discriminatory
 - Payment of fair compensation
- Should there be compensation for indirect expropriation?
Conventionally, it is for direct expropriation.

6. Dispute Settlement Mechanisms

- Every foreign investment transaction entails a **trilateral relationship** involving a **host State**, a **foreign investor** and a **home State**.
- Thus, the dispute settlement mechanisms in BITs can be dealing with;
 - **Investor-to-state** dispute (if the BIT stipulate **investors can sue a state**).
 - This one is **preferable**, since, if it become a state to state dispute, its impact may not limited to that specific investment (affect the relations of states in the other areas).

- **State to state** (mostly if the dispute failed to be settled between the investor and the state)
- The **mechanism to settle** the dispute can be;
 - **Judicial** - not likely the case (**especially domestic courts** are not preferred-unless there is a gap in the BIT)
 - **Arbitration** – widely used
 - **Ad- hoc**
 - **Institutional**