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INVESTMENT PROVISIONS IN ECONOMIC INTEGRATION AGREEMENTS

CHAPTER 4

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IV. DIFFERENCES AND SIMILARITIES BETWEEN EIIAS AND WITH OTHER AGREEMENTS

A. Overview

It has been observed earlier (chapter III.B) that EIIAs have been influenced by other investment agreements, notably by BITs and the WTO Agreements.[68] However, BITs and EIIAs typically differ in a number of important respects.

First, except for the BITs concluded by the United States and Canada, BITs generally provide for the treatment and protection of investment once established, but do not provide for a right to establish foreign investment. That is, BITs are usually intended to protect and thereby promote investment. EIIAs, by contrast, seek to integrate economies and thus are more likely to focus on liberalizing investment flows, as well as protecting and promoting investment. They are also more likely to regulate the behaviour of investment, at least insofar as anticompetitive behaviour is concerned.

Second, unlike BITs, certain types of EIIAs do not deal with investment protection issues. As noted earlier, this may be partially explained by the fact that EIIAs were traditionally concluded between countries that shared similar political, economic and social systems. Developed country EIIAs in particular did not spell out protection provisions, as protection could be guaranteed by the parties' national legal systems or under the established general legal review processes (e.g. the European Court of Justice in the EC). On the other hand, other types of EIIAs do include investment protection provisions, including notably North-South and some South-South agreements. In the latter cases, the protection provisions of EIIAs often replicate those of BITs.

Third, with respect to the settlement of investment disputes, EIIAs and BITs differ in one important respect. That is, while recent BITs almost invariably allow for direct settlement of investor-State disputes through international arbitration, certain types of EIIAs — typically those that do not address investment protection issues — do not allow for international arbitration of investor-State disputes, nor do they always address specifically the issue of investment disputes. Instead, investment disputes are often dealt with implicitly in these EIIAs under general provisions for the settlement of disputes arising between the States parties (State-State) that apply to all (or most) aspects of the agreement.

The discussion thus far might be read to suggest that BITs provide a higher level of investment protection, while EIIAs permit more variation, which in turn leads to a weakening of the protections afforded. In fact, however, the existing EIIAs demonstrate that it is possible to obtain a high standard of investment protection and liberalization in agreements that bind multiple States. The distinction between a BIT and an EIIA is not necessarily the distinction between a strong and a weak agreement.

Fourth, EIIAs tend to include mechanisms for consultation, follow-up and implementation that are more elaborate and complex than those found in BITs (if any). EIIAs also often contain

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[68] For example, NAFTA's Chapter Eleven on Investment is based on the United States BIT model of the time, and so is the MERCOSUR Protocol of Colonia (Intra Zone). BIT provisions on investment protection have been replicated in EIIAs that address protection issues. Similarly, the provisions of the WTO TRIMs Agreement have influenced EIIA provisions dealing with performance requirements, while GATS has inspired most trade-in-services provisions or chapters in EIIAs.

specific mandates regarding the further expansion of the agreement, or specific aspects thereof, which are largely absent in BITs. It is also common, especially for regional integration EIIAs, to establish elaborate institutional arrangements, including a permanent secretariat, to deal with the day-to-day administration of the agreement. In the case of highly integrated EIIA groups such as the EC, the institutional machinery may include a parliament and a permanent court of justice. BITs, on the other hand, have tended to rely on informal exchanges and regular diplomatic channels to address questions related to their implementation.

Fifth, while BITs address a more limited number of issues and tend to be quite uniform in their approach to those issues, EIIAs reflect far more variation in their scope and content. Although an EIIA may address relatively few investment issues, as do some of the agreements discussed in this study, they potentially address a much larger range of investment-related issues than the BITs. Thus, an increasing number of recent EIIAs deal very extensively with trade in services, while there are provisions or chapters in them on topics such as competition policy, intellectual property, government procurement, labour, environment, trade in special sectors, temporary entry for business persons, and transparency. The more issues that are addressed, the more complex the agreement becomes, and the greater the likelihood that variations in the text reflecting the special cultural characteristics of countries in different regions must be taken into account. As this suggests, the negotiation of an EIIA may require a higher level of expertise and more preparation than the negotiation of a BIT.

Sixth, the greater variation among EIIAs perhaps presents a better opportunity than do BITs for experimentation with different approaches to addressing development issues. EIIAs, for example, tend to have a larger number of provisions that take into account the special circumstances of developing countries than do BITs. Thus, EIIAs typically contain a broader range of exceptions, safeguards and transitional periods than BITs, which are both general and issue specific. Another set of development-related provisions which tend to be more prominent and detailed in EIIAs than in BITs relates to investment promotion. Many EIIAs, including notably South-South and North-South EIIAs, contain elaborate clauses providing for *inter alia* exchange of information and technical assistance, so as to help improve the investment climate of the less developed countries of the group. Probably the most extensive investment promotion provisions of this type are those in the Cotonou Agreement. Again, it requires more expertise to negotiate a complex agreement with special provisions for developing countries than to conclude a BIT that departs very little from the model negotiating text, but the reward for the effort may be an agreement more carefully tailored to the circumstances of the parties.

The elaboration of EIIAs has also been influenced by earlier EIIAs signed by EIIA partners. In particular, EIIAs signed by the same regional group with different third countries share many common features (as is the case with agreements signed by the EC and EFTA with other European countries, and by ASEAN with other Asian countries). Also, influential individual countries tend to establish a similar pattern for their bilateral EIIAs with different countries (e.g. the bilateral EIIAs signed by the United States and Canada). This applies also to interregional EIIAs, which as a result tend to share many of the features of the regional models established by their more influential partners (e.g. recent interregional agreements signed by the United States are based on the NAFTA model). In addition, recent developing country EIIAs are moving closer towards the North-South approaches. As a result of this cross-fertilization among EIIAs over the years, a certain convergence of patterns regarding EIIA provisions has emerged — amidst many EIIA-specific variations — which often transcend regional lines.

A basic common characteristic of EIIAs — and one that is not found in BITs — is that these agreements typically set in motion a *dynamic process* whereby they will achieve their aims. As the impossibility of implementing an ambitious agenda at the time of conclusion of the agreement is realized, procedures are established with the help of institutional mechanisms that are intended to ensure the implementation of the agreement's objectives over time.

This feature is particularly relevant with respect to the implementation of the investment liberalization commitments adopted by EIIAs. EIIAs typically follow two main patterns in this respect. One is to provide for actual liberalization subject to a list of country exceptions (negative list approach). This pattern is characteristic of, for example, the agreements signed between American countries that follow the model of NAFTA. The second pattern is to provide for the progressive abolition of restrictions on the entry, establishment and operation of investment.[69] With respect to the second pattern, the level of liberalization sought varies considerably amongst different types of EIIAs. Thus, while some agreements commit to achieving full liberalization of investment almost immediately (the EC) or by a particular date (the ASEAN Investment Area), others provide for the process of investment liberalization to be carried out in several stages (the Europe Agreements signed by the EC with Central and South-East European countries). Yet another pattern is to start with an initial agreement that contains a few general obligations and definitions, and provide a framework for future negotiations to liberalize investment (e.g. the Euro-Mediterranean Agreements, the African Economic Community, the ASEAN Agreement with China). In certain cases, the latter approach may resemble the liberalization model established by GATS.

Even when the investment regime on admission and establishment laid out by an EIIA is fairly open, foreign firms may be confronted by a range of internal policy measures that restrict their operations and seek to influence their various effects. Certain categories of issues, including transfer of funds, have been traditionally a part of most EIIAs' investment liberalization schemes as they can be considered "border measures". Others issues started to receive special attention mainly during the Uruguay Round of Trade Negotiations and, since then, have been increasingly included in EIIAs as they are considered important aspects of market access. These include trade in services, performance requirements, employment of managerial and technical personnel, and intellectual property protection.

As the process of investment integration progresses, investment treatment and protection standards after entry increasingly become also an important part of the EIIA. Indeed, as economic integration deepens, national treatment at the point of entry might not suffice to guarantee market access when internal national legislation creates obstacles to the flow of investment. The critical relevance of the national treatment standard for an investment integration process is emphasized as it refers to an entire body of law, not to specific measures. With respect to investment protection issues, one of the most important potential obstacles to foreign investment after entry relates to the non-commercial risks facing foreign firms in host countries, in particular the risks of arbitrary treatment, lack of due process and certain takings of property. Provisions addressing these concerns (notably fair and equitable treatment, conditions for expropriation and settlement of disputes) have become increasingly common in EIIAs moving to advanced stages of investment integration. The main model for investment protection

[69] This pattern has been followed by, among others, the agreements between the European Community and third countries, and the Framework Agreement on the ASEAN Investment Area.

continues to be NAFTA's Chapter Eleven, which in turn is based on the United States and Canadian BIT models of the time, but with the addition of intellectual property protection. While the key protection issues addressed in these types of EIIAs have varied little, a new generation of agreements that follow the NAFTA model — concluded mainly by American and Asian countries — are more comprehensive, detailed and, in the main, rigorous than prior NAFTA-style EIIAs. They reflect the accumulated experience derived from previously concluded EIIAs and BITs, which has identified issues requiring resolution that were not addressed in earlier agreements.

In some cases, the decision to start a process of investment liberalization and integration is preceded by a preliminary stage in which the EIIA partners limit their commitments to establishing a cooperation framework in order to create a policy climate in which investment could flow within the EIIA area. This pattern is followed in cases where the parties' political and economic systems are too far apart for integrating their investment policies. Exchange of information, regular contact, commitments to improve the investment climate and technical assistance measures aimed at institution building are typical ingredients of promotion programmes that seek to prepare the way for more mature mutually-beneficial stages of investment relations. Of course, promotional measures often stand side by side with liberalization commitments in EIIAs as the parties realize in certain cases that liberalization measures alone may not suffice to ensure the flow of investment in both directions.

The actual patterns are of course much more complex than these stylized rough descriptions suggest. Some EIIAs start with few and general investment commitments and move through various stages of increased specificity and depth. Other EIIAs remain fairly static in their original commitments, which may be set at any of the described levels. One important variation is the possibility of allowing certain countries, whether developing countries or economies in transition, to benefit from transitional arrangements. Another variant involves the selective use of "best efforts" clauses to cover some issues of special difficulty. In short, the elaboration of investment rules through EIIAs is advancing at various *tempos* through dynamic and flexible processes that build on previous experience while experimenting with innovative approaches to address new challenges.

Yet another important common characteristic of EIIAs, and one that sets these agreements apart from the other IIAs, relates to their inclusion of trade, investment and other transactions as part of a common normative framework. Here again, as noted in the Introduction (table I.1), the overall approach to investment, as well as the breadth and depth of the investment provisions in an EIIA, does not necessarily parallel (and indeed in many cases it does not) the approaches to, and provisions on, trade or other economic transactions covered under the common framework. Many variations of EIIAs coexist also in this respect. Thus, in many EIIA-driven economic integration processes, investment provisions only enter the picture when a certain level of trade integration has already been achieved. Other EIIAs take a “big bang” approach whereby trade, investment and other liberalization and integration processes start and advance apace. In some cases, trade in services is part of the package, as are labour, knowledge and other production factors, while in other cases, they are not. The accumulation of various normative processes with different conceptual and operational characteristics advancing together but not necessarily at the same speed, or even in the same direction, adds layers of complexity to the already multifaceted nature of EIIAs, as compared with other IIAs. This in turn further complicates the task of gauging the full legal and policy implications of EIIAs.

B. Main Substantive Provisions on Investment in EIIAs: A Comparative Analysis

As has been noted (chapter III.B.2), EIIAs exhibit different degrees of investment integration. The depth of integration of an EIIA in relation to investment is determined by the extent and content of the commitments the parties undertake on specific investment issues. This in turn is directly related to the formulation of its substantive provisions. This section analyses the content of investment provisions in EIIAs. It identifies the most important investment provisions that appear in EIIAs and examines the most common or notable variations in the formulation of these provisions. Section 1 discusses provisions that establish the subject-matter scope of the agreement. Sections 2 through 5 analyse, respectively, substantive provisions that liberalize, protect, promote or regulate investment. As noted above, some provisions may serve more than one purpose, and thus the placement of a provision in one category rather than another is intended principally to facilitate organization of the material.

1. Scope of the Agreement

The subject-matter covered by the investment provisions in an EIIA is established through definitions, through its operational provisions, and through general exceptions and special exceptions.

a. Definitions

Investment provisions in an EIIA typically apply to investment by investors of one party in the territory of another party. Accordingly, the most important definitions in establishing the subject-matter scope of these provisions are of the terms "investment" and "investor." Many EIIAs, however, do not define those terms. These include EIIAs that focus on investment liberalization, such as the EC Agreement and the association agreements signed by the EC with Central European countries as well as the Euro-Mediterranean agreements. Similarly, agreements providing a general framework for further cooperation on investment (including sometimes investment promotion) signed by the EC, EFTA, Canada and the United States with various countries do not include definitions of investment or investor. Whether an instrument explicitly defines key terms or not, its application requires that the parties use some working definition of these terms.

i. Investment

EIIAs that define investment have used three types of definitions:

- **Asset-based definition.** EIIAs that are directed at the protection of investment tend to define "investment" broadly, covering the various types of assets that might need to be protected during the life of the investment. They use an asset-based definition similar to that which appears in BITs. Such agreements tend not to include a right to establish investment and thus the host country can still narrow the scope of the agreement by preventing the establishment of undesirable investment.

- **Transaction-based definition.** This type of definition is found in EIIAs that concern the liberalization of cross-border financial flows through which an investment is made. An example of this approach is the definition used in Annex A of the OECD Code of Liberalization of Capital Movements. The Code does not define investment but lists a number of capital transactions between residents and non-residents that are the subject of liberalization commitments.

- **Enterprise-based definition.** EIIAs that concern the liberalization of investment have tended to define investment in narrow terms, insisting on the element of control over the enterprise as a key element of the concept. An example is the Free Trade Agreement between Canada and the United States (UNCTAD, 2003a, ch. IV; 1999a, pp. 31-32)**.**

Recent practice in EIIAs that seek both to liberalize and to protect investment has moved in the direction of broad asset-based definitions. However, several approaches have emerged that aim at limiting the broad asset-based type of definition, some of which are close to the enterprise-based definition.

The broad, asset-based definition typically defines investment as "every kind of asset" and then adds an illustrative list of assets that are included in the definition. Typical is the definition in article I of the Agreement Establishing the Free Trade Area between the Caribbean Community and the Dominican Republic, which provides that:

(i) Investments: means every kind of asset and in particular though not exclusively, includes:

a) movable and immovable property and any other property rights such as mortgages, liens and pledges;
b) shares, stocks and debentures of companies or interests in the property of such companies;
c) a claim to money or to any performance having a financial value;
d) intellectual and industrial property rights, including rights with respect to copyrights, patents, trademarks, trade names, industrial designs, trade secrets, technical processes and know-how and goodwill;
e) business concessions conferred by law or under contract, including any concessions to search for, cultivate, extract or exploit natural resources.

Occasionally, the list of assets is not illustrative, but exhaustive. For example, article 159 of COMESA provides that:

[f]or the purposes of investment protection, the following activities shall be considered as investment:

(a) movable and immovable property and other property rights such as mortgages, loans and pledges;
(b) shares and any other rights of participation in the management or economic results of a company or a firm, whether incorporated or not, including minority shares, corporate rights and any other kind of shareholding;

(c) stocks, bonds, debentures, guarantees or other financial instruments of a company or a firm, government or other public authority or international organization;
(d) claims to money, goods, services or other performance having economic value;
(e) intellectual and industrial property rights, technical processes, know-how, goodwill and other benefits of advantages associated with a business; and
(f) such other activities that may be declared by the Council as investments.

As this language indicates, the broad definition includes portfolio as well as direct investment.

Some earlier EIIAs dealing only with investment protection have defined investment as an investment that is made in accordance with the laws of the host country, or used other language to the same effect. Local laws may require approval of the investment and the approval may be granted subject to certain conditions. The implication of this type of clause is that an investment which is not made in accordance with the approval requirements and conditions established under the host country's local laws is outside the scope of the agreement and cannot benefit from its provisions. This is explicitly stated in article II of the ASEAN Agreement for the Protection and Promotion of Investments, which provides that:

> *1) This Agreement shall apply only to investments brought into, derived from or directly connected with investments brought into the territory of any Contracting Party by nationals or companies of any other Contracting party and which are specifically approved in writing and registered by the host country and upon such conditions as it deems fit for the purposes of this Agreement.*

Article II was later qualified by the 1996 protocol amending the 1987 Agreement with the insertion of a new Article III-A, which read *"Each Contracting Party shall endeavour to simplify and streamline its investment procedures and approval process to facilitate investment flows".*

A similar approach has been followed by some agreements signed in recent years. For example, the FTA between Australia and Thailand (article 901(a)) provides that:

> *"covered investment" means an investment… which has been admitted by the latter Party … in accordance with its laws, regulations and policies*

Article 908(1)(a)) stipulates that the provisions on protection and promotion of the agreement apply to:

> *covered investments which, if so required, have been specifically approved in writing by the competent authorities concerned of the other Party as being entitled to the benefits of an agreement relating to investments*

Significantly also, the Australia-Thailand FTA applies different definitions of investment to the promotion and protection provisions and to the liberalization provisions, thus avoiding some of the potential definitional difficulties that arise when an EIIA both protects and liberalizes investment flows, since in these cases the host country surrenders a significant part of its ability to exclude undesirable investment. As a result, in such cases, the likelihood increases that the definition of investment will be somewhat narrower.

For example, some host countries are reluctant to extend treaty protection to portfolio investment because they are concerned that it may not contribute to development, insofar as it may not result in the introduction of technology, and its potential volatility may exacerbate economic instability and, in that way, undermine economic development. Thus, some EIIAs limit the definition of investment to direct investment. For example, article 45 of the FTA between the EFTA States and the United Mexican States provides that:

investment made in accordance with the laws and regulations of the Parties means direct investment, which is defined as investment for the purpose of establishing lasting economic relations with an undertaking such as, in particular, investments which give the possibility of exercising an effective influence on the management thereof.

A footnote added to the definition states that:

Direct Investment embraces operations carried out in the country concerned by non-residents and operations abroad by residents by means of: 1) creation or extension of a wholly-owned enterprise, subsidiary or branch, [or] acquisition of full ownership of an existing enterprise; 2) participation in a new or existing enterprise; 3) a loan of five years or longer.

To similar effect is article 2 of the Framework Agreement on the ASEAN Investment Area, which provides that:

[t]his Agreement shall cover all direct investment other than ... portfolio investment; and ... matters relating to investments covered by other ASEAN Agreements, such as the ASEAN Framework Agreement on Services.

Such definitions, however, are atypical in more recent EIIAs**.** The distinction between direct and portfolio investment is often merely a matter of degree rather than of kind, frequently determined by a somewhat arbitrary percentage of equity shares owned. Thus, in some cases, it is difficult to distinguish between the two in principle. Furthermore, portfolio investment can in fact contribute to development, including the introduction of new technology, because it may provide necessary financing for an enterprise that will create employment, provide training, generate export earnings and transfer technology. A host country may choose, therefore, to allow the definition of investment to include portfolio investment and to address concerns about volatility in other ways, such as through limitations on the right of free transfer of investments.

The broad, asset-based definition also goes beyond the kinds of assets that an economist might traditionally consider to be "investment". For example, it could include short-term contracts and merchandise, the kinds of assets that are usually associated with trade rather than investment. A couple of different approaches have emerged to address this concern. One approach is to utilize an enterprise-based definition, such as that which appears in article 1139 of NAFTA. This definition differs from the broader, asset-based definition in that it limits investment principally to those assets that are associated in certain ways with an enterprise, as opposed to those, for example, that might be present in the territory for purposes of trade, such as merchandise to be sold. It provides that:

investment means:
(a) an enterprise;
(b) an equity security of an enterprise;
(c) a debt security of an enterprise

(i) where the enterprise is an affiliate of the investor, or
(ii) where the original maturity of the debt security is at least three year, but does not include a debt security, regardless of original maturity, of a state enterprise;

(d) a loan to an enterprise
(i) where the enterprise is an affiliate of the investor, or
(ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;

(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

(f) an interest in an enterprise that entitles the owner to share in the assets of the enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);

(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, concessions, or
(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,

(i) claims to money that arise solely from
(i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party; or
(ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or

(j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h).

Thus, while the definition is broad enough to include both direct and portfolio investment, the enterprise-based definition tends to exclude assets that are not related to a long-term investment. This definition also underscores the idea that portfolio investment should be included in the definition of investment if it assists in capitalizing an enterprise that will presumably make a long-term contribution to the economy of the host country.

A second approach is to try to define "investment" in economic terms. This approach is utilized in several recent free trade agreements. For example, Article 10.27 of the Free Trade Agreement between Chile and the United States defines investment as:

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:

(a) an enterprise;
(b) shares, stock, and other forms of equity participation in an enterprise;
(c) bonds, debentures, loans, and other debt instruments;
(d) futures, options, and other derivatives;

(e) rights under contract, including turnkey, construction, management, production, concession, or revenue-sharing contracts;
(f) intellectual property rights;
(g) rights conferred pursuant to domestic law, such as concessions, licenses, authorizations, and permits; and
(h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens and pledges; but investment does not mean an order or judgment entered in a judicial or administrative action.

This definition includes the usual categories of assets that appear in the asset-based definition, but limits the assets to those that have the characteristics of an investment, such as the placement of capital at risk for purposes of gain.

ii. Investor

EIIAs that contain a broad asset-based definition of the term "investment" tend also to define the term "investor", following in this respect the approach of BITs. In addition, EIIAs that deal with investment liberalization tend to include a definition of companies or firms for the purpose of determining the scope of the rights of establishment they confer.

Two issues typically arise with respect to the definition of an investor. The first is to determine the types of entities that can be investors. The second is to determine the nationality of the investor, since typically an investor must have the nationality of a treaty party to have rights under the treaty.

Investors generally include natural persons and juridical entities, sometimes referred to generically in the EIIAs as "companies." A common approach is to include virtually every type of juridical entity within the definition. For example, Article 1 of Chapter IV of the Agreement between the United States and Vietnam on Trade Relations defines "company" as:

any entity constituted or organized under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, branch, joint venture, association, or other organization.

Given that often the EIIA also includes a broad definition of "investment", the broad scope of juridical entities that may be considered "investors" is perhaps not surprising. Certain types of investments are likely to be associated with certain types of juridical entities. For example, small businesses may take a different corporate form than large, publicly-traded multinational enterprises. Investments in the service sector often make use of partnerships, which are less common in the manufacturing sector. A strategic alliance between a foreign and a domestic investor may take the form of a joint venture. A host country that excludes certain juridical entities from treaty protection may unintentionally exclude certain desired investments. That said, the issue of the legal form of a juridical entity is not a matter of indifference to a host country. Different types of juridical entities, for example, shield the beneficial owners from liability for the acts of the entity to differing degrees. Nevertheless, EIIAs that define "investor" tend to do so quite broadly.

Some agreements, however, limit the definition of "companies" only to those that are organized for profit. An example is article 48 of the European Community treaty, according to which:

> *'Companies or firms' means companies of firms constituted under civil or commercial law, including cooperative societies and other legal persons governed by public or private law, save for those which are non-profit-making.*

The nationality of natural persons generally is determined by domestic law. In other words, a natural person is a national of the home country if the laws of the home country so state. An issue that occasionally arises is how to ascribe the nationality of a person who has the nationality of more than one country. Some EIIAs address that issue explicitly. For example, article 10.20 of the Free Trade Agreement between Singapore and the United States provides that:

> *investor of a Party means a Party or state enterprise thereof, or a person of that Party, that attempts to make, is making, or has made an investment in the territory of the other Party; provided, however, that a natural person who is a dual national shall be deemed to be exclusively a national of the State of his/her dominant and effective nationality.*

Most EIAs, however, do not address the issue explicitly. If this issue is one that concerns a treaty party, it would be advisable to include language resolving it.

The nationality of juridical entities in most investment agreements is usually determined by one of three tests. These tests base nationality on the State under the laws of which the entity is organized (the place of organization); the State where the entity has its headquarters or main facility (the place of the seat); or the State whose nationals own or control the entity (the place of ownership or control).

The place of organization is the easiest test to administer, because it can usually be determined with certainty and is unlikely to change. This test, however, allows the ultimate, beneficial owners of the investment to acquire treaty protection even without having any genuine economic link to the home country. The home country may be concerned about this result because the application or interpretation of its treaty may be driven, particularly if the investor-to-State dispute resolution provision is invoked, by persons who have no allegiance to the home State. The host country may also be concerned about this result because it means that it is extending treaty protection to beneficial owners whose own state of nationality does not extend reciprocal protection to investors from the host country. Furthermore, the place of organization test exposes the host country to the risk that unforeseen investors with no link to the home country at the time the treaty was concluded may later acquire the nationality of the home country through incorporation there, thus expanding the group of investors protected by the agreement beyond those contemplated during the negotiations.

The place of ownership or control presents the opposite situation. Ownership or control can be difficult to ascertain if the company is publicly traded and it may change over time, with the result that investment can lose or gain treaty protection as ownership or control changes. However, the place of ownership or control has a strong and genuine economic link to the company.

The place of the seat is a compromise between the two: it is easier to ascertain than ownership and control, and represents more of an economic link than the place of organization.

The place of organization test might be thought to be the most liberal of the tests, because it seeks an efficient mechanism for establishing corporate nationality, rather than concerning itself with whether the State of nationality will truly benefit from the extension of its protection to the investor and the investment. Perhaps not surprisingly, many EIIAs use the place of incorporation as the test for corporate nationality. Typical is the Free Trade Agreement between CARICOM and the Dominican Republic. Article I(ii) defines an investor as:

> *any corporation, company, association, partnership, or other organization, legally constituted under the laws of a Party, whether or not organized for pecuniary gain, or privately, or governmentally owned or controlled.*

Other EIAs, however, seek to ensure that the home country has a genuine economic link to the investor. For example, article I(b) of the ASEAN Agreement for the Protection and Promotion of Investments defines "company" as:

> *a corporation, partnership or other business association, incorporated or constituted under the laws in force in the territory of any Contracting Party wherein the place of effective management is situated.*

This definition ascribes corporate nationality on the basis of both the place of incorporation and the place of the seat, and brings an entity within the definition of "investor" only if both places are the same. Similarly, article 37 of the Free Trade Agreement between EFTA and Singapore defines "investor of a Party" as *"a company constituted or organized under the applicable law of that Party and carrying out substantial business activities there"*. Thus, incorporation must be accompanied by "substantial business activities", a link that is weaker than the requirement that the investor have its seat in the home State, but that nevertheless requires a substantial economic link with the state of nationality. A similar approach is followed in the European Community Treaty. Article 48 states:

> *Companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community shall, for the purposes of this Chapter, be treated in the same way as natural persons who are national of Member States.*

The Treaty Establishing the Caribbean Community uses a definition of nationality for juridical persons which encompass all the three tests. Thus, article 35 dealing with establishment provides:

For the purpose of this Article and Articles 36 and 38 of this Annex:
(a) a person shall be regarded as a national of a Member State if such a person
(i)…
(ii)…
(iii) is a company or other legal person constituted in the Member State in conformity with the law thereof and which that States regards as belonging to it, provided that such company or other legal person has been formed for gainful purposes and has its registered office and

central administration, and carries on substantial activity within the Common Market and which is substantially owned and effectively controlled by persons falling under (i) and (ii) above.

Some regional integration groups have created "regional corporations" to which a special status is granted.[70] In the case of developing countries, the creation of regional corporations is typically linked to the establishment of regional industrialization programmes.[71] The definition of a regional corporation usually involves a number of criteria. For example, article I of Decision 292 of the Commission of the Cartagena Agreement defines the Andean Multinational Enterprise as follows:

For the purposes of this Code, an Andean Multinational Enterprise shall be a company fulfilling the following requirements:

a) Its principal domicile shall be in the territory of one of the Member Countries of in that where the enterprises is transformed or merged.

b) It must be constituted as a corporation in accordance with the procedures contemplated in the corresponding national legislation and it shall add to its name the words "Andean Multinational Enterprise" … .

c) Its capital must be represented by nominal shares of equal value that confer on the shareholders equal rights and impose equal obligations.

d) It must have contributions of property from national investors from two or more Member Countries that together are greater than sixty percent of the capital of the company.

e) ….

f) The sub-regional majority of the capital must be reflected in the technical, administrative, financial and commercial management of the company in the judgment of the corresponding national competent entity.

g) … .

Some EIIAs, presumably influenced by the GATS, have also used a "commercial presence" test for determining corporate nationality. For example, the Free Trade Agreement between Colombia, Venezuela and Mexico allows a private entity to establish nationality in either of two ways. First, under article 17-01, an investor may be *"an enterprise constituted, organized, or protected in accordance with the laws of that Party"*. Thus, it uses the place of incorporation test. Under that same article, however, an investor may also be *"a branch located in the territory of that Party that engages in commercial activities therein"*. This last test does not fall within any of the three categories. Rather, an entity becomes a national of a State by having a commercial presence in the territory of that State. The test has the virtue of being relatively easy to apply, but also represents a genuine economic link between the investor and the State of nationality.

The variety of tests increases the likelihood that an investor will have multiple nationalities. For example, an investor may be incorporated under the laws of one State, but

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[70] An example is the European company or SE created by the European Company Statute, adopted by the EC in 2001.

[71] Examples include Decision 292 of the Commission of the Cartagena Agreement (Andean Pact) adopting the Uniform Code on Andean Multinational Enterprises, the Revised Treaty of the Economic Community of West African States (ECOWAS), the Revised Basic Agreement on ASEAN Industrial Joint Ventures and the Charter on a Regime of Multinational Industrial Enterprises in the Preferential Trade Area of Eastern and Southern African States.

have a commercial presence in another State, thus being able to claim the nationality of both and being able to assert the protection offered by the EIIAs of any State of which it is a national. Among other things, this has significant implications for the settlement of investment disputes as it allows an investor potentially to submit the same dispute to the dispute resolution mechanism provided by each of the agreements.

Finally, EIIAs that deal with trade in services often include a number of definitions, such as "commercial presence", that are relevant for investment in the services sector. For example, article 20 of the Free Trade Agreement between the EFTA States and the United Mexican States defines "commercial presence" as follows:

(i) as regards nationals, the right to set up and manage undertakings, which they effectively control. This shall not extent to seeking or taking employment in the labour market or confer right to access to the labour market of another Party;

(ii) as regards juridical persons, the right to take up and pursue the economic activities covered by this Section by means of the setting up and management of subsidiaries, branches or any other form of secondary establishment.

* * * * *

Policymakers have a number of choices when deciding on the scope of the investment rules of an EIIA. In particular, this raises questions about which types of investment should be covered by the agreement. All forms of investment can, in principle, contribute to the economic development of participating host countries and so there is no form of investment that from a developmental perspective should always be excluded. However, certain forms of investment raise concerns that others do not. Portfolio investment, for example, raises concerns about its potential volatility. These concerns can be addressed by excluding certain types of investment/investor from the scope of the agreement, but that can send a less favourable signal to investors. Also, efforts to exclude certain types of investment/investor can lead to uncertainty concerning the scope of the agreement.

Alternatively, concerns about certain types of investment/investor may be addressed not by excluding those investments from treaty coverage, but by drafting the substantive provisions in a way that alleviates the concerns. For example, concerns about the volatility of portfolio investment may be addressed by placing limitations on the right to transfer investments out of the territory of the host State under certain circumstances. The ability, however, to take account of potential problems through the substantive provisions requires a somewhat higher level of expertise on the part of the negotiating States, since they must be able to anticipate some of the most important problems and craft language to avoid them.

As a third possibility, concerns about the potentially adverse effects of certain investments can be addressed by limiting the liberalization achieved by the agreement and reserving the right to exclude those investments entirely, although the maintenance of an elaborate screening mechanism can undermine to some extent the rationale for entering into an EIIA.

A fourth possibility would be to adopt a hybrid of both broad and narrow definitions for different purposes in an agreement. Thus a broad asset-based definition can be used for protecting investment and a narrow transaction-based for dealing with cross-border investment liberalization. In short, concerns about the scope of the agreement can be addressed through the definitions provisions, through the liberalization provisions or through the investment protection provisions, but each approach presents its own difficulties.

With respect to the definition of investors, an important task for negotiators is to avoid using definitions that would permit legal persons from non-EIIA parties to benefit from the provisions of the agreement on a "free rider" basis. Thus, they need to ensure that the companies covered under the treaty have a real link with the home country, and to avoid giving legal protection to companies that have no substantial business activities in that country. In the present era of globalization, no single test for attributing corporate nationality can guarantee appropriate coverage of foreign investors. In these circumstances, using several tests together may provide a more reliable method of defining foreign companies for the purposes of treaty protection. (UNCTAD, 1999a**,** p. 66; 1998a, pp. 38-41).

b. General exceptions

EIIAs often include provisions that permanently exclude certain actions by the parties from the application of the agreement. These provisions limit the substantive scope of the agreement and typically are intended to maintain regulatory flexibility for the host country. Thus, general exceptions are usually structured in such a way as to insulate from the application of the treaty those regulatory activities of the host country that are of special importance to that host country and that seem potentially to be affected by the application of treaty rules.

Two common exceptions are for measures taken by a host country to preserve public order or to protect national security. Some EIIAs exclude measures to enforce the criminal laws of the parties. The Free Trade Agreement between Colombia, Venezuela and Mexico includes all three of these exceptions. Article 17-02 provides that:

> *[n]othing in this Chapter shall be construed to prevent a Party from adopting or maintaining measures for preserving its national security or public order, or implementing the provisions of its criminal laws.*

Most EIIAs do not provide any definition of public order. An exception is the Free Trade Agreement between Australia and Singapore, which provides in a footnote to article 18 that *"[t]he public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society."*

In some cases, the national security exception is quite detailed. For example, article 34 of the Free Trade Agreement between the EFTA States and Singapore provides that:

> *Nothing in this Agreement shall be construed:*
> *(a) to require a Party to furnish or allow access to information the disclosure of which it considers contrary to its essential security interests;*
> *(b) to prevent a Party from taking any action which it considers necessary for the protection of its essential security interests:*
> *(i) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;*
> *(ii) relating to fissionable and fusionable materials or the materials from which they are derived;*

(iii) taken in time of war or other emergency in international relations; or

(c) to prevent a Party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

Some EIIAs have exceptions for measures to protect the environment or the cultural patrimony. Article 9.02(b) of the Free Trade Agreement between Central America and the Dominican Republic provides that:

[t]his chapter shall not apply to measures that a Party adopts to restrict the participation of the investments of investors of the other Party in its territory, for reasons of national security or public order, the protection of the cultural and environmental patrimony, and the conservation of the environment.

The environmental exception is sometimes more detailed. Article 10.15 of the Free Trade Agreement between Panama and Taiwan Province of China provides that:

1. *Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken under its ecological or environmental laws.*

2. *The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor. If a Party considers that the other Party has offered such an encouragement, it may request consultations with the other Party.*

These regulatory exceptions typically permit the host country to protect certain non-economic interests that might otherwise have been incidentally affected by the economic provisions of the EIIA. However, their language in some cases could be interpreted to allow Governments broad discretion as regards regulatory actions. If one compares, for example, the environmental exception in the agreement between Central America and the Dominican Republic with that in the agreement between Panama and Taiwan Province of China, it can be seen that the latter permits a party to adopt measures that "*it considers appropriate*" to preserve the environment, language that is absent from the former provision. An issue arises as to whether this additional language renders a party's determination that a measure is necessary to preserve the environment conclusive, or whether a measure undertaken purportedly to protect the environment, but perhaps in reality to protect a local investment against foreign competition, could be challenged through the dispute resolution mechanisms of the agreement.

Not all general exceptions are intended to maintain regulatory discretion on certain special activities. Some are intended to preserve the ability of the host country to provide social services to its people. For example, article 3.02 of the Treaty on Investment and Trade in Services between Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua provides that:

[n]o provision of this chapter shall be interpreted in the sense of preventing a Party from providing services or performing functions related to law enforcement, correctional

services, pension or employment security or social security services, social welfare, public education, health and child care.

EIIAs that contain provisions to liberalize trade in services may include additional general exceptions that are inspired by general exceptions found in the GATS. Illustrative of these EIIAs is the Free Trade Agreement between the European Community and Chile, article 135 of which provides that:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between the Parties where like conditions prevail, or a disguised restriction on trade in services, financial services or establishment, nothing in this Title shall be construed to prevent the adoption or enforcement by either Party of measures:

(a) necessary to protect public morals or to maintain public order and public security;
(b) necessary to protect human, animal or plant life or health;
(c) relating to the conservation of exhaustible natural resources if such measures are applied in conjunction with restrictions on the domestic supply or consumption of services or on domestic investments;
(d) necessary for the protection of national treasures of artistic, historic or archaeological value;
(e) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Title including those relating to:
  (i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
  (ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts; or
  (iii) safety.

Another version of this provision, reflecting somewhat different concerns, appears in the Free Trade Agreement between Singapore and the United States, article 13.4 of which states that:

1. *Nothing in this Chapter shall be construed to prevent either Party from imposing or enforcing measures:*

   (a) necessary to protect public morals, order, or safety;
   (b) necessary to protect human, animal, or plant life or health;
   (c) necessary to protect intellectual property; or
   (d) relating to products or services of handicapped persons, of philanthropic institutions, or of prison labor, provided that such measures are not applied in a manner that would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade.

2. *The Parties understand that paragraph 1(b) includes environmental measures necessary to protect human, animal, or plant life or health.*

* * * * *

The scope of an EIIA in relation to investment may be determined — in addition to by defining key terms — through exclusion by the general exceptions that take certain actions on the part of the parties outside the application of the agreement. Parties have excluded a wide variety of matters from the coverage of EIIAs, including matters relating to national security, the preservation of public order, preservation of the environment and protection of the cultural patrimony. Certain social welfare programmes have also been excluded. Broad exceptions can undermine the efficacy of the agreement. However, certain interests can be important enough to justify exceptions to the treaty's general provisions.

c. Special exceptions

The scope of the investment commitments in an EIIA is also determined by a variety of special exceptions, often included to address specific developmental concerns. The underlying theoretical assumption of an EIIA, of course, is that implementation of the general rules of the agreement on investment will promote economic development. EIIAs, however, sometimes adopt the position that *not* implementing the general rules of the agreement in certain cases will promote economic development. Thus, EIIAs often contain provisions allowing all or certain parties to deviate from the treaty's general rules on investment, or from specific provisions thereof, in certain circumstances. These provisions are intended to preserve for host country parties, in particular for the less developed parties, sufficient discretion to pursue developmental objectives in ways that otherwise may be difficult to reconcile with treaty obligations. Some approaches used in existing EIIAs are described below.[72]

One approach is to allow special transitional periods during which less developed parties to an EIIA assume obligations gradually**.** Thus transitional periods may be different for different countries, depending upon the relative state of their development vis-à-vis other parties. For example, article 7(3) of the Framework Agreement on the ASEAN Investment Area, as amended in 2001, provides that:

> *the Temporary Exclusion List for the manufacturing sector shall be progressively phased out by all Member States by 2003, except the Kingdom of Cambodia, the Lao People's Democratic Republic and the Socialist Republic of Vietnam which shall do so not later than 2010.*

Another example is Decision 439 of the Commission of the Andean Community establishing a General Framework of Principles and Rules for Liberalizing Trade in Services in the Andean Community. This Decision includes a provision for preferential treatment for Bolivia and Ecuador regarding temporal exceptions. Article 22 provides that:

> *[p]referential treatment for Bolivia and Ecuador shall be given consideration during such negotiations as are carried out in the context of this General Framework, with regard to deadlines and temporary exceptions for compliance with their obligations, in keeping with the provisions of the Cartagena Agreement.*

A second approach is to allow existing exceptions to the principles of the EIIA to remain in place. An example of this approach is article 52 of the Partnership and Cooperation

[72] For a detailed discussion of special exceptions used for development purposes see UNCTAD (2000a).

Agreement between the European Community and the Russian Federation. This article introduces free movement of capital between residents of the Community and residents of the Russian Federation in the form of direct investment. Article 52(3) authorizes the Russian Federation to apply pre-existing restrictions on outward direct investment by Russian residents. This approach is also evident in the agreements, discussed elsewhere, in which the right of establishment is made subject to exceptions set forth in an annex to the treaty.

The exceptions may be permitted indefinitely or they may be allowed only for a limited period of time. Thus, in the previous example of the EC-Russian Federation Partnership and Cooperation EIIA, article 52(5) provides that *"Five years after the entry into force of this Agreement the Parties agree to consult over the maintenance of these restrictions …"* The implication of article 52(5) is that, after the transitional period, the Russian Federation might or might not be allowed to continue to maintain the restrictions on outward direct investment by Russian residents.

A third approach is to authorize special and differential treatment for developing countries with respect to the implementation of the substantive obligations of the agreement. This approach goes beyond allowing existing exceptions and contemplates treating some parties differently from others throughout the process of implementing the agreement. Such an approach is found in the Caribbean Community (CARICOM). For example, article 37 of the Treaty Establishing the Caribbean Community provides that:

> *[t]he Council shall examine ways and means for the introduction of a scheme for the regulated movement of capital within the Common Market giving particular attention to the development needs of the Less Developed Countries and shall recommend to Member States proposals for the establishment of such a scheme.*

Article 85(1) of the partnership agreement between the African, Caribbean and Pacific States and the European Community similarly provides that:

> *[t]he least-developed ACP States shall be accorded a special treatment in order to enable them to overcome the serious economic and social difficulties hindering their development so as to step up their respective rates of development.*

A fourth approach is to establish permanent exceptions that permit all parties to deviate from the principles of the treaty on a temporary basis. The most common such provision is one allowing denial of the right of free transfers in the event of balance-of-payments difficulties. For example, article 34 of the Agreement on Trade, Development and Cooperation between the European Community and South Africa provides that:

> *[w]here one or more Member States of the Community, or South Africa, is in serious balance of payments difficulties, or under threat thereof, the Community or South Africa, as the case may be, may, in accordance with the conditions established under the General Agreement on Tariffs and Trade and Articles VIII and XIV of the Articles of Agreement of the International Monetary Fund, adopt restrictions on current transactions which shall be of limited duration and may not go beyond what is necessary to remedy the balance of payments situation. The Community or South Africa, as the case may be, shall inform the other Party forthwith and shall submit to it as soon as possible a timetable for the elimination of the measures concerned.*

Similar provisions are included, for instance, in the context of the Economic Partnership Agreement between the EC and Mexico,[73] and in some of the Euro-Mediterranean agreements. The Free Trade Agreement between Colombia, Mexico and Venezuela also provides for the possibility of temporarily limiting transfer on a non-discriminatory basis in case of balance-of-payments difficulties. Similarly, the FTA between the EFTA States and Mexico provides, in article 50(1), for the possibility of adopting restrictive measures that *"shall be equitable, non-discriminatory, in good faith, of limited duration and may not go beyond what is necessary to remedy the balance of payments situation"*. The free trade agreements between Mexico and El Salvador, Guatemala and Honduras and between Central America and the Dominican Republic provide that the measures have to be compatible with internationally acceptable criteria.

As the foregoing examples show, the balance-of-payments exception often includes conditions to limit the impact and duration of measures taken thereunder. Some EIIAs contain detailed provisions in this respect. For example, article 15(1) of the Framework Agreement on the ASEAN Investment Area provides that:

> *[i]n the event of serious balance of payments and external financial difficulties or threat thereof, a Member State may adopt or maintain restrictions on investments on which it has undertaken specific commitments, including on payments or transfers for transactions related to such commitments. It is recognized that particular pressures on the balance of payments of a Member State in the process of economic development or economic transition may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development or economic transition.*

Article 15(3) imposed some restrictions on the measures, however. The measures:

- *a. shall not discriminate among Member States;*
- *b. shall be consistent with the Articles of Agreement of the International Monetary Fund;*
- *c. shall avoid unnecessary damage to the commercial, economic and financial interests of any of Member State;*
- *d. shall not exceed those necessary to deal with the circumstances described in paragraph 1; and*
- *e. shall be temporary and be phased out progressively as the situation specified in paragraph 1 improves.*

A treaty may contain a more general safeguard provision. For example, article 14 of the Framework Agreement on the ASEAN Investment Area authorizes emergency safeguard measures. It provides that:

> *1. If, as a result of the implementation of the liberalization programme under this Agreement, a Member State suffers or is threatened with any serious injury and threat, the Member States may take emergency safeguard measures to the extent and for such period as may be necessary to prevent or to remedy such injury. The measures taken shall be provisional and without discrimination.*

[73] Article 31 of Decision No. 2/2001 of the European Union and Mexico Joint Council of 27 February 2001, Implementing Articles 6, 9 12(2)(b) and 50 of the Economic Partnership, Political Coordination and Cooperation Agreement.

2. *Where emergency safeguard measures are taken pursuant to this Article, notice of such measures shall be given to the AIA Council within 14 days from the date such measures are taken.*

3. *The AIA Council shall determine the definition of serious injury and threat of serious injury and the procedures of instituting emergency safeguard measures pursuant to this Article.*

CARICOM has a similar provision. Article 47(1) of the Revised Treaty of Chaguaramas Establishing the Caribbean Community provides that:

> *[w]here the exercise of rights granted under this Chapter creates serious difficulties in any sector of the economy of a Member State or occasions economic hardships in a region of the Community, a Member State adversely affected thereby may, subject to the provisions of this Article, apply such restrictions on the exercise of the rights as it considers appropriate in order to resolve the difficulties or alleviate the hardships.*

The treaty requires that the appropriate organ of CARICOM be notified of the measures and provides for a review of those measures. Article 47(4) states that:

> *[t]he competent Organ shall give its earliest considerations to the programme, and:*
> *(a) make a determination in respect of the appropriateness of the restrictions and whether they shall be continued; and*
> *(b) where it decides that the restrictions shall be continued, determine:*
> *(i) the adequacy of the programme; and*
> *(ii) the period for which the restrictions should continue.*

The competent Organ, in making a determination under subparagraph (b) of this paragraph, may impose such conditions as it considers necessary.

Article 47 imposes additional restrictions on the measures that may be adopted. For example, they must be confined to those necessary to resolve the difficulties in the affected sectors or to alleviate economic hardships in a particular region. The State imposing them must minimize damage to the commercial or economic interests of the other members, progressively relax them as conditions improve, and maintain them only as long as the conditions justify their application. Article 46 of the EFTA-Singapore free trade agreement permits future reservations as long as they do not "affect the overall level of commitments of that Party under this Chapter" and calls for biennial reviews of the reservations with a view to reducing their number.

In addition to special exceptions based on the specific development needs of EIIA member countries, subject-specific exceptions may be included allowing the parties to exclude certain matters from the application of individual provisions. A typical subject-specific exception relates to taxation. The difference between subject-specific exceptions and those discussed earlier in this section is that the former typically are permanent and apply to all parties, regardless of their development level. These are discussed in the relevant sections below.

* * * * *

The scope of the investment provisions in an EIIA can also be affected by special exceptions that may apply only to certain parties or to certain provisions of the agreement, or for limited periods of time. Such provisions do not seek to take certain subjects outside the scope of the agreement entirely, but rather to define certain circumstances in which the normal application of the treaty will not occur. In many cases, these special exceptions are intended to enhance the development dimension of the agreement by permitting a party to deviate from the normal operation of the latter in order to promote a developmental objective. Such exceptions may be easier to obtain agreement on than general exceptions because they are temporary or applicable in only limited circumstances and thus do not undermine the general structure of the agreement.

2. Investment Liberalization

Investment liberalization provisions are those that reduce or eliminate barriers to the entry, establishment and operation of cross-border investment. EIIAs contain either of two different provisions intended to remove legal and policy barriers to cross-border investment flows. The first is a provision that typically provides for rights of entry and establishment for investment in at least certain sectors of the economy. The second is a market access provision that generally provides for a right to provide services in at least certain sectors through a commercial presence in the host country. Recent EIIAs frequently have both, and this gives rise to the possibility that certain investments will be covered by both provisions.

Some EIIAs also have provisions intended to remove informational barriers to entry. These are transparency provisions that require the host country to make available certain information about the investment climate in its territory.

In addition, EIIAs that seek to liberalize investment flows usually contain provisions intended to grant free transfer of funds related to such investment. Provisions allowing for entry of foreign personnel in relation to the investment, and those proscribing the imposition of performance requirements, are also associated with investment liberalization EIIAs.

a. Admission and establishment of investment

Unlike most BITs, EIIAs often include commitments regarding the entry and establishment of investment with significant liberalization effects for the investment regimes of the parties. Under customary international law, States have the right to decide on the admission of foreign investors in their territory. It is therefore unlikely for a State to grant foreign investors an unrestricted right to invest. Usually a State will regard foreign investment in certain sectors of its economy as contrary to vital national interests, whether they are military, cultural or economic. Thus, when a right of establishment appears in an EIIA, it is generally limited in some way. Three basic approaches are evident.

The strongest approach from the perspective of the foreign investor is to provide that investors originating in other member countries have a right to establish investment in the host member country, though usually subject to exceptions. The European Community and EFTA are typical examples of this approach. In the case of EFTA, article 23 of the EFTA Agreement provides that:

> *[w]ithin the framework of, and subject to, the provisions of this Convention, there shall be no restrictions on the right of establishment of companies, or firms, formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business in the territory of the Member States. This shall also apply to the setting up of agencies, branches or subsidiaries by companies or firms of any Member State established in the territory of any other Member State.*
>
> *The rights of establishment shall include the right to set up, acquire and manage undertakings, in particular companies or firms... under the conditions laid down for its own undertakings by the law of the Member State where such establishment is effected....*

Article 23(3) authorizes the parties to set forth exceptions to the right of establishment in an annex and provides that the parties *"shall endeavor to eliminate gradually remaining discriminations..."* The parties also agree to review the annexes within two years *"with a view to reducing, and ultimately eliminating, the remaining restrictions"*. Article 23(4) prohibits the introduction of new restrictions on the right of establishment.

The European Community's exceptions to the right of establishment are set out in articles 45 and 46 of the Treaty of Rome, as amended. Article 45 states that:

> *The provisions of this Chapter shall not apply, so far as any given Member State is concerned, to activities which in that State are connected, even occasionally with the exercise of official authority.*
>
> *The Council may, acting by a qualified majority on a proposal from the Commission, rule that the provisions of this Chapter shall not apply to certain activities.*

Article 46 adds that.

> *The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals or on grounds of public policy, public security or public health.*

Language similar in effect to that in the EC and ETA agreements appears in the Framework Agreement on the ASEAN Investment Area, article 7(1) of which provides that *"[s]ubject to the provisions of this Article, each Member State shall ... open immediately all its industries for investments by ASEAN investors."* The remainder of the article, however, provides the list of temporary exclusions from the right of establishment, which is to be phased out gradually by 2010. The right of establishment is further qualified by an emergency safeguard measure in article 14, which provides that:

> *[i]f, as a result of the implementation of the liberalization programme under this Agreement, a Member state suffers or is threatened with any serious injury and threat, the Member State may take emergency safeguard measures to the extent and for such period as may be necessary to prevent or remedy such injury. The measures taken shall be provisional and without discrimination.*

This approach to granting rights of establishment — which is also used in the OECD Code of Liberalisation of Capital Movements — has been followed by other EIIAs signed by developing countries. The CARICOM Agreement specifically mentions right of establishment in article 35. This provision was later amended by a protocol prohibiting new restrictions on the establishment of nationals of other member countries, and obliging member countries to remove existing restrictions in accordance with a programme to be determined. A similar approach is followed in a number of African EIIAs[74] that proclaim the granting of rights of establishment as a general principle, although they have yet to formulate the operational provisions that will give effect to such rights. The Community Investment Code of the Economic Community of the Great Lakes Countries (CEPGL) also contains provisions on rights of entry and establishment (article 6). However, these are preceded by a detailed regime for what are termed "joint enterprises" and "Community enterprises" (articles 2-5). In order to benefit from various advantages such classes of enterprises are subject to an authorization process. (UNCTAD,1999b**,** pp. 24-25).

A second common approach is to provide for national and MFN treatment with respect to the right of establishment, again with a negative list of sectoral exceptions. For example, article 1102 of NAFTA provides that:

1. *Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.*

2. *Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.*

Most-favoured-nation treatment with respect to the right of establishment is provided for in article 1103, which states that:

1. *Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.*

2. *Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.*

[74] These include, for example, the Treaty Establishing the African Economic Community (AEC), the Treaty Establishing the Common Market for Eastern and Southern Africa (COMESA), the Treaty Establishing the East African Community, the Revised Treaty of the Economic Community of West African States (ECOWAS), the Treaty for the Establishment of the Economic Community of Central African States (ECCAS), and the Joint Convention on the Freedom of Movement of Persons and the Right of Establishment in the Central Africa Customs and Economic Union.

Article 1108, however, provides that these grants of national and MFN treatment are subject to exceptions listed in an annex. The NAFTA model has been followed by more recent agreements, especially those involving NAFTA signatories, but also increasingly between developing non-NAFTA countries.[75]

A number of EIIAs concluded by the EC with third countries also follow this approach. The Agreement Establishing an Association between the European Economic Community and the United Republic of Tanzania, the Republic of Uganda, and the Republic of Kenya of 1969 (the first EC association agreement, which has since been superseded) provided already for a right of establishment based on MFN treatment. Since the 1990s, association agreements and partnership and cooperation agreements concluded by the EC with European economies in transition have also addressed establishment issues and provided for national treatment with regard to the establishment and operation of companies and nationals. These commitments are generally subject to transitional periods. Some agreements include a list of reservations to the establishment obligations. Some partnership and cooperation agreements, such as the one with the Russian Federation, provide only for MFN treatment in the pre-establishment phase (article 28), although the importance of moving towards the granting of national treatment is recognized.

The scope of the right of establishment depends on how "investor" is defined. This is because the right to national or MFN treatment with respect to establishment of investors from member countries is linked to the treatment provided to investors of the host country party, or any other party, or a non-party country/s. For example, if the definition of “investor” is broad enough to include State entities, covered investors with a right of national treatment with respect to establishment would have the right to establish investment in sectors of the economy in which the host country/s has itself made investments. This, again, illustrates the critical role that the definitions provisions play in determining the content of substantive provisions.

Note that neither of the approaches described typically provides for an unlimited right of establishment. They typically provide for a general right, subject, in some cases, to limited exceptions and, in most cases, to a negative list of exceptions included in an annex, which in theory can be as extensive as the parties wish. Indeed, the negative list could be so extensive as to effectively eliminate any right of establishment, and, as a practical matter, the compilation of a lengthy negative list could prompt objections from another party to the EIIA, which could delay or even prevent the eventual conclusion of the agreement. Either of these approaches also could be utilized with a “positive list,” so that the right would apply only in those sectors listed in an annex. Admission and establishment provisions in existing EIIAs, however, have most commonly used the negative list approach. As will be shown below, the positive list, by contrast, is more often utilized in market access provisions for trade in services, which in fact overlap with admission and establishment investment provisions. It appears, however, that some recent EIIAs are moving closer to the positive list approach also with respect to their investment liberalization commitments (see below).

A third approach is simply to provide for future liberalization. For example, the Euro-Mediterranean agreements concluded by the European Community call for future creation of a

[75] This is the case, for example, of the Canada-Chile Free Trade Agreement, the Mexico Singapore FTA, the FTA between Mexico and El Salvador, Guatemala and Honduras, the Agreement between the United States and Viet Nam on Trade Relations. A similar approach was also followed by the Agreement between New Zealand and Singapore on Closer Economic Relationship.

right of establishment and opening of the services market to foreign competition. Article 31 of the agreement with Morocco provides that:

1. *The Parties agree to widen the scope of this Agreement to cover the right of establishment of one Party's firms on the territory of the other and liberalisation of the provision of services by one Party's firms to consumers of services in the other.*

2. *The Association Council will make recommendations for achieving the objective described in paragraph 1....*

3. *The Association Council will make a first assessment of the achievement of this objective no later than five years after this Agreement enters into force.*

This third approach does not result in any liberalization upon entry into force of the agreement. Its significance depends entirely upon the actions of the parties in the future. A number of EIIAs created by developing countries follow a combination of this approach and the first approach. Thus, as noted earlier, the COMESA Agreement (article 164) and the Treaty Establishing the African Economic Community provide, as a general principle, for the right of establishment for investors from signatory countries, and then make commitments to give effect to these rights at a future date through the conclusion of protocols. Similarly, the ECOWAS Revised Treaty, in articles 3(2) and 55, commits members to the removal of obstacles to the right of establishment within five years of the creation of a customs union between member States.

The admission and establishment of investment provisions, like those prescribing the scope of the EIIA, determine the reach of the agreement as a practical matter. If an EIIA grants no right of establishment, investment can be established in a host country party, and thereby become subject to the protection of the treaty, only if the host country permits the investment under its local law, which it may change at any time. As investments are permitted or forbidden, the reach of the agreement as a practical matter changes. Thus, an EIIA may address some of the concerns of its members about the advisability of protecting investment from other parties by allowing individual members to retain the right to exclude investment and thereby prevent investment from being established. This approach is typical of EIIAs that provide for investment protection but not liberalization. For example, the ASEAN Agreement on the Reciprocal Promotion and Protection of Investments provides for MFN and fair and equitable treatment after entry**.** This provision is modelled on the traditional European BITs, in which the admission of investments is to be decided by the parties in accordance with the national laws.

An alternative approach is to permit investment, but subject to certain restrictions the existence of which serves to allay the host country concerns about the investment. For example, under Decision 24 of the Commission of the Andean Pact (superseded by Decision 291), article 38, member countries were explicitly allowed to reserve sectors of economic activity for its private or public national undertakings and decide whether joint undertakings could participate in them. The article further allowed the Commission of the Cartagena Agreement, on a proposal of the Board, to determine the sectors that all member countries should reserve for national public or private undertakings, and decide whether joint undertakings might participate in them. To qualify as a joint undertaking, Article 1 of Decision 24 required that the undertaking:

is established in the recipient country and between 51 and 80 percent of which capital belongs to national investors; provided that in the opinion of the competent authority this

> *proportion is reflected in the technical, financial, administrative and business management of the undertaking.*

These restrictions, however, had to be consistent with the provisions of the treaty. A ban on performance requirements or a guarantee of national treatment could prevent the host country from imposing certain restrictions on the investment, leaving it with the choice of allowing the investment without the desired restrictions or excluding it. Decision 292 of the Commission of the Cartagena Agreement, revising the preferential regime for Andean Multinational Enterprises, provides, in article 14, that Andean enterprises may participate in economic sectors reserved for national companies in accordance with the respective legislation of the member States. Thus Andean countries were given broad discretion with respect to granting rights of establishment within the Andean Community on a national treatment basis. To qualify for Andean multinational company status, the property contributions from national investors from two or more Andean countries had to exceed 60 per cent of the company's capital.

Yet another alternative to limiting the right of establishment is to agree only to a narrow definition of investment, which would have the effect of excluding from treaty protection certain investments permitted by the host country (see section IV.A.1.a). This approach, however, could discourage the establishment of some desirable investments.

As noted earlier, another approach to the right of establishment is for it to be granted only when a party makes commitments on liberalization of specific industries and measures. This approach is similar to the positive list approach of the GATS in relation to services. The FTA between Australia and Thailand provides in article 904:

> *In all sectors inscribed in Annex 8, and subject to any conditions and qualifications set out therein, each Party shall accord to investments of the other Party treatment no less favourable than it accords, in like circumstances, to its own investors, with respect to the establishment and acquisition of investments in its territory.*

The recently adopted agreement between ASEAN and China commits the parties to enter into negotiations in order to, *inter alia*, progressively liberalize their investment regimes. While there are no firm commitments as yet on specific liberalization negotiations, the wording of this clause suggests that future liberalization of investment under this agreement would take an approach similar to the *positive list liberalization model* represented by GATS. A similar approach is also found in the South Asian Free Trade Agreement, and in the BIMSTEC framework agreement.

Thus far the discussion has focused on approaches to the liberalization of investment between the members of an EIIA. However, as noted before (chapter III.B.3), some EIIAs explicitly address the admission of foreign investment by non-members. The admission provisions in these cases are typically more restrictive than their intra-EIIA counterparts. Thus, as was noted earlier, while the MERCOSUR Protocol on Protection and Promotion of Investments within MERCOSUR allows rights of establishment to firms within the subregion, on the basis of national and MFN treatment, the MERCOSUR Protocol on Protection and Promotion of Investments from Third Parties provides that investments from non-MERCOSUR members must be admitted in accordance with the members' local laws.

Some early EIIAs, such as the Andean Pact Commission Decision 24 (superseded by Decision 291), subjected the entry of investment from third countries to strict controls. Thus article 2 of Decision 24 required that all investment from third countries be subject to previous authorization by the competent national authorities, which should assess whether the application met the development priorities of the receiving country.

Yet other agreements explicitly adopt an open door policy with respect to cross-border movements of capital from third countries. The European Community Treaty, for example, provides in article 56(1) that "all restrictions on the movement of capital…between Member States and third countries shall be prohibited". Article 56(2) provides that "all restrictions on payments…between Member States and third countries shall be prohibited". Article 57 *et seq.* allow certain narrow exceptions.

Finally, yet other agreements commit to grant rights of establishment for investments from third countries at a future date. In the Framework Agreement on the ASEAN Investment Area, the date for liberalizing the establishment of investments from non-member countries of ASEAN is set for the year 2020, subject to exceptions provided for in the Agreement (article 4(6)).

* * * * *

A country entering an EIIA has a number of options concerning the extent, if any, of investment liberalization to be provided by the treaty. The treaty can provide for future liberalization or it can incorporate liberalization commitments that take effect at the time of entry into force of the agreement. Assuming that liberalization will be an element of the treaty, the parties will need to decide whether they wish to grant broad rights of establishment subject to a limited set of exceptions, or to employ a positive or a negative list approach to determine the sectors or measures to which liberalization commitments apply or do not apply under the agreement. In the event that the negative list approach is selected, the country must be prepared to specify the sectors to be excluded from the liberalization obligation. If the positive list approach is selected, typically commitments will be added sector by sector over time. The negative list approach requires greater effort during treaty negotiations since the list must be compiled before the treaty can be concluded, and would seem to require a higher level of expertise and preparation than a positive list approach, under which liberalization commitments are made incrementally over a long period of time. Furthermore, a party may raise objections if it perceives that another party is preparing a negative list that is too lengthy and undermining the purpose of the liberalization commitments. A positive list approach, on the other hand, is likely to result in less liberalization initially and the host country may find that, once the agreement is concluded, opposition from affected industries may make it difficult to add sectors to the positive list in the future, with the result that inefficient industries are protected and an important purpose of the EIIA, namely to promote the competitiveness of the local economy, is thereby undermined.

Liberalization provisions, by opening the borders to certain investments, along with the definition provisions, determine the scope of investments that ultimately will be covered by the treaty. Countries that are concerned about the effect of certain protection provisions may curtail the extent of their liberalization obligations so as to preserve the right to exclude investments that they are not prepared to protect fully. Exclusion of an investment, however, denies the host country all benefits attributable to that investment. An alternative is to accept broad liberalization commitments while limiting the effect of the protection provisions, by drafting them narrowly, by creating exceptions to them, or by including reservations in a positive list of sectors in which liberalization is to be achieved.

b. Market access for services

During the Uruguay Round of trade negotiations, many EIIAs began to include provisions on trade in services. Because one of the modalities by which services are delivered is through a commercial presence, and because a commercial presence usually falls within even a narrow definition of investment, agreements regarding trade in services very often affect investments. In other words, many agreements that liberalize trade in services provide what, in effect, is a right of establishment in the services sector that potentially overlaps any right of establishment of investment set forth elsewhere in the agreement.

Five general approaches are evident with respect to providing market access for services.

The first approach is to include a general commitment to future liberalization of trade in services. Typical of these agreements are many of the free trade agreements concluded by EFTA with transition economies and other States. For example, article 27 of the agreement with the former Yugoslav Republic of Macedonia provides that:

> *[t]he Parties recognize the growing importance of services and investments. In their efforts to gradually develop and broaden their co-operation, in particular in the context of European integration, they will co-operate with the aim of further promoting investments and achieving a progressive liberalization and mutual opening of markets for trade in services, taking into account on-going work under the auspices of the WTO.*

That article also provides that the parties will review developments in the services sector with a view to considering liberalization measures.

The association agreements between the European Community and various transition economies go several steps further in their commitment to liberalize investment in services. For example, article 56 of the agreement with Romania provides that:

> *[t]he Parties undertake in accordance with the provisions of this Chapter to take the necessary steps to allow progressively the supply of services by Community or Romanian companies or nationals who are established in a Party other than that of the person for whom the services are intended taking into account the development of the services sector in the Parties.*

A stronger and more elaborate provision for future liberalization appears in the ASEAN Framework Agreement on Services. Article III provides that:

> *[m]ember States shall liberalize trade in services in a substantial number of sectors within a reasonable time-frame by*
>
> *(a) eliminating substantially all existing discriminatory measures and market access limitations amongst Member States; and*
> *(b) prohibiting new or more discriminatory measures and market access limitations.*

Article IV(1) provides that the members shall enter into negotiations *"directed toward achieving commitments which are beyond those inscribed in each Member State's schedule of commitments under the GATS and for which Member States shall accord preferential treatment to one another* *on an MFN basis"*. These commitments are to be set out in a schedule. Under Article X, they may be modified or withdrawn after three years, provided that compensatory adjustments are made. This first approach does not by itself result in any liberalization, but does start the parties on a course towards liberalization in the future.

A second approach, which appears in the Euro-Mediterranean Agreements concluded by the European Community, is to affirm or incorporate the parties' commitments under the GATS. For example, article 29 of the agreement with Egypt "reaffirms" the parties' GATS commitments, particularly those relating to MFN treatment, and also incorporates the exceptions to MFN treatment provided for by the GATS. This second approach also does not result in any liberalization, since it affirms only liberalization that has already occurred under the GATS. This provision is not necessarily without effect, however. To the extent that it incorporates by reference the parties' commitments under the GATS, it could be argued that GATS commitments become commitments under the EIIA as well and that any violation of those GATS commitments would also violate the EIIA and be subject to any applicable dispute resolution mechanism under the EIIA as well as under the GATS. This in turn could result in multiple proceedings to remedy an alleged violation of the obligation.

A third approach is to include in the EIIA a chapter on services that is structured similarly to the GATS. A number of countries, including the United States, Australia, Chile and Singapore, have recently begun to conclude agreements adopting this approach. Illustrative is the Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership. Under article 59, the parties are to inscribe in a schedule commitments to permit market access in certain service sectors with respect to certain modes of supply. Under article 60, the parties may make specific commitments to provide national treatment with respect to measures affecting the supply of services. Article 64 contains disciplines on domestic regulation of trade in services similar to those in the GATS. For example, it provides that domestic regulation of trade in services shall be administered in a reasonable, objective and impartial manner and requires that parties provide judicial or administrative review for decisions affecting trade in services. Article 65 requires the parties to ensure that monopoly suppliers of services in their territories do not act in a manner inconsistent with a party's specific commitments, while article 66 calls for consultations to eliminate business practices that may restrain competition and thereby restrict trade in services. Under articles 67 and 68, restrictions on transfers for current transactions relating to specific commitments are prohibited, subject to an exception for serious balance-of-payments and external financial difficulties.

A fourth approach is to include market access commitments structured differently from those that appear in the GATS. Illustrative of these EIIAs is the NAFTA, in which articles 1202 and 1203 guarantee national and MFN treatment with respect to the supply of services, subject to exceptions contained in an annex. Article 1208 requires the parties to set forth in an annex their commitments to liberalize quantitative restrictions, licensing requirements, performance requirements or other non-discriminatory measures. The NAFTA has separate chapters dealing with telecommunications and financial services. The NAFTA approach is to create a general rule of market access in all service sectors, subject to exceptions contained in an annex, often referred to as the "negative list" approach. This differs from the third approach described above, as well as the approach used in the GATS, under which liberalization occurs only in those sectors listed in the annex, the so-called positive list approach.

As noted earlier (in relation to admission and establishment of investment), the fourth (negative list) approach tends to provide greater liberalization than the third (positive list) approach, since it presumes liberalization in all sectors not listed. This is likely to be an approach selected by countries considering an immediate, large-scale liberalization of trade in services, as opposed to the more incremental approach of the positive list. The negative list approach also requires a much greater level of preparation to negotiate, inasmuch as the parties must be able to list all sectors in which liberalization is not desired at the time they prepare the negative list. The positive list approach allows the parties to identify over time those sectors in which liberalization is or is not desired and then to add them to the list only as appropriate.

A fifth approach is to provide freedom of movement of services subject to some exceptions, which are applied in a restrained manner. The European Community Treaty (consolidated text) represents this approach. It establishes an internal common market characterized by *inter alia* the free movement of services between the member States. This principle is given effect by article 49, which provides that:

> *Within the framework of the provisions set out below, restrictions on freedom to provide services within the Community shall be progressively abolished during the transnational period in respect to nationals of Member Estates who are established in a State of the Community other than that of the person for whom the services are intended.*

One important complement to the provision of market access for supply of services is the recognition of the professional qualifications of service providers. Article 47(1) of the European Community Treaty (consolidated text) provides for the issuance of directives for the mutual recognition of diplomas, certificates and other evidence of formal qualifications, although the stated purpose is to facilitate self-employment rather than employment in connection with an investment. The agreements of association between the European Community and some of the transitional economies contain a similar provision, though without an explicit link to the goal of self-employment. For example, article 47 of the treaty with Romania, which falls within Title IV on Movement of Workers, Establishment and Supply of Services, provides that:

> *[i]n order to make it easier for Community nationals and Romanian nationals to take up and pursue regulated professional activities in Romania and the Community respectively, the Association Council shall examine which steps are necessary to be taken to provide for the mutual recognition of qualifications. It may take all necessary measures to that end.*

* * * * *

In the light of the GATS, the issue whether to include a commitment to provide market access for services may well arise in the context of an EIIA negotiation. If so, the parties must consider how market access commitments in the EIIA interact with commitments made in the GATS and how they interact with other commitments in the EIIA, particularly those relating to establishment and treatment of investment as well as dispute resolution.

c. Transparency

EIIAs tend to include general transparency provisions imposing obligations on EIIA members to disclose certain types of governmental information relevant to investment relations.

Sometimes these provisions are included in a separate chapter on transparency that applies to the entire agreement.[76] Generally, provisions in a transparency chapter tend to be broader and more detailed than transparency provisions included in an investment chapter. In relation to investment, transparency provisions found in EIIAs are of two types.

The first type of transparency provision essentially requires the host State to make certain kinds of existing information available. This type of provision may impose a variety of specific obligations. One is to make public, or at least available, a party's laws and perhaps other information concerning investment. For example, article III-B of the ASEAN Agreement on the Promotion and Protection of Investment provides that:

> *Each Contracting Party shall ensure the provision of up-to-date information on all laws and regulations pertaining to foreign investment in its territory and shall take appropriate measures to ensure that such information be made as transparent, timely and publicly accessible as possible.*

Another obligation is to provide information to the other parties. For example, article 11(2) of the Framework Agreement on the ASEAN Investment Area provides that:

> *[e]ach Member State shall promptly and at least annually inform the AIA Council of the introduction of any new or any changes to existing laws, regulations or administrative guidelines which significantly affect investments or its commitments under this Agreement.*

This first type of transparency provision often appears in EIIAs as a form of cooperation to promote investment, with information sharing seen as one element of that cooperation. For example, the Euro-Mediterranean agreement between the European Community and Egypt includes a title on economic cooperation covering an entire range of matters, including education, science and technology, industrial cooperation, investment promotion and tourism. Article 46, on investment promotion, lists among the modalities of investment promotion

> *– appropriate means of identifying investment opportunities and information channels on investment regulation;*
>
> *– providing information on European investment regimes (such as technical assistance, direct financial support, fiscal incentives and investment insurance) related to outward investments and enhancing the possibility for Egypt to benefit from them;*

Transparency provisions of this type may also feature in EIIAs in the context of the implementation of their liberalization or other commitments. For example, the Treaty Establishing the Caribbean Common Market, as regards establishment, provides in article 35(3) as follows:

> *A Member State shall notify the Council within such period as the Council may decide of particulars of any restrictions which it applies in such a way that persons belonging to another Member State are accorded in the first-mentioned State less favourable treatment in respect of matters set out in paragraph 1 of this Article that is accorded to persons belonging thereto.*

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[76] An example of this approach is the Agreement between the United States and Viet Nam on Trade Relations.

Similarly, the OECD Code of Liberalization of Capital Movements provides in article 11(a):

> *a. Members shall notify the Organization, within the periods which the latter may determine, of the measures of liberalization which they have taken and of any other measures which have a bearing on this Code, as well as of any modifications of such measures.*

The second type of transparency provision imposes on the parties a general obligation of transparency in their dealings with investors. In some cases, the obligation is defined in relatively general terms. For example, article 39 of the EFTA free trade agreement with Singapore states that :

> *[e]ach Party shall, in accordance with the provisions of this Chapter, create and maintain stable, equitable, favourable and transparent conditions for investors of other Parties to make investments in its territory.*

Also, Article 159 of the Treaty Establishing the Common Market for Eastern and Southern Africa provides that member States shall *"create and maintain a predictable, transparent and secure investment climate..."* Although this type of clause at first glance may seem weak because it imposes no very specific obligation, it is potentially the most sweeping of the transparency provisions because it could apply to a wide variety of circumstances. This second type of provision thus requires not simply making existing information available, but also a certain mode of behaviour by the host State in dealing with covered investments. For example, this provision might be cited by an investor as a basis for requesting an explanation of a government decision affecting its investment or a right to participate in some way in government decision-making processes.

In other cases, the obligation is defined in much more specific terms and explicitly includes a right to participate in decision-making. Thus, a few recent EIIAs contain transparency obligations with respect to draft laws and regulations. These obligations usually require parties to make public or notify their proposed laws or regulations with a view to affording interested parties the possibility of commenting on such laws before they are formally adopted. For example, NAFTA article 1802 provides that:

> *to the extent possible, each Party shall*
> *(a) publish in advance any such measure it proposes to adopt ; and*
> *(b) provide interested persons and Parties a reasonable opportunity to comment on such proposed measures.*

Similarly, article 3 of Chapter IV on "Transparency-related Provisions of the Free Trade Agreement between the United States and Viet Nam" also provides to nationals of the parties, and not only to the parties themselves,

> *the opportunity to comment on the formulation of laws, regulations and administrative procedures of general application that may affect the conduct of business activities covered by this Agreement.*

Transparency requirements that tend to enhance the level of participation of foreign actors in national legislative processes have recently been extended to national administrative proceedings. Thus, article 19.5 of the Free Trade Agreement between Singapore and the United States requires each party to ensure that in its administrative proceedings:

> *(a) wherever possible, persons of the other Party that are directly affected by a proceeding are provided reasonable notice, in accordance with domestic procedures, when a proceeding is initiated, including a description of the nature of the proceeding, a statement of the legal authority under which the proceeding is initiated, and a general description of any issues in controversy;*
> *(b) such persons are afforded a reasonable opportunity to present facts and arguments in support of their positions prior to any final administrative action, when time, the nature of the proceeding, and the public interest permit; and*
> *(c) its procedures are in accordance with domestic law.*

The Singapore-United States agreement also provides for a right of review and appeal of administrative decisions regarding matters covered by the agreement. Article 19.6 provides that:

> *[e]ach Party shall ensure that, in any such tribunals or procedures, the parties to the proceeding are provided with the right to:*
> *(a) a reasonable opportunity to support or defend their respective positions; and*
> *(b) a decision based on the evidence and submissions of record or, where required by domestic law, the record compiled by the administrative authority.*

Although these provisions are included in the chapter entitled "Transparency," they expand upon the traditional concept of transparency, which is essentially access to information. By providing not only for notice of certain proceedings, but also an opportunity to be heard and a right of appeal, the Singapore-United States free trade agreement stretches the concept of transparency to include elements of due process.

The expansion of the traditional concept of transparency to include due process rights is significant because of the presence in some agreements of general obligations of transparency. These general obligations of transparency may be interpreted in the future to include not only an obligation to allow access to information, but also a right to participate in decision-making and a right to a decision of a certain quality.

Often, investors are required to meet transparency obligations under EIIAs. Some EIIAs explicitly include an obligation to that effect. For example, Article 17-09 of the Free Trade Agreement between Colombia, Mexico and Venezuela provides that each party may require an investor of another party, notwithstanding national and MFN obligations, to provide information about the particular investment, consistent with applicable laws in the State party. Similarly, article 111 (2) of NAFTA grants each party the right:

> *to require an investor of another party or its investment in its territory, to provide routine information concerning that investment solely for informational or statistical purposes.*

* * * * *

Transparency provisions allow participants in the investment process to obtain information from each other in order to make informed decisions and meet obligations and commitments. Transparency provisions in EIIAs are usually formulated in general terms, imposing obligations on all parties to the agreement. Similarly, transparency obligations can be extended to investors. A second key issue relates to the degree of intrusiveness of transparency obligations in EIIAs. Clearly, the deeper the integration between national economies, the greater the impact that such obligations will have on national policies.

From the perspective of developing countries, as a matter of practical importance, the question arises of the costs involved in determining the scope of transparency provisions. Where transparency obligations demand a broad range of items and tight procedures, some developing countries may encounter problems. In these situations, less developed countries may be allowed additional time to adapt to the requirements of compliance. At the same time, provisions on transparency are important for fostering institutional strengthening and the promotion of the rule of law, especially in developing countries.[77]

d. Transfer of funds

Provisions granting free transfer of funds are among the most common in EIIAs seeking to liberalize and/or protect investment. A typical provision guarantees to investors the right to transfer their investment and any returns from their investment into a freely convertible currency. This provision typically specifies the payments the transfer of which is protected. Many EIIAs protect the transfer out of the territory of any payments related to an investment, including both the original investment and any returns on that investment. Some EIIAs, particularly when they include a right of admission of investment, also protect transfers into the territory of the host country. EIIAs generally prescribe a minimum standard of treatment to be afforded to such payments, including specification of the currency into which transfer is to be permitted and the rate of exchange to be used.

A typical approach is that taken by NAFTA. Article 1109(1) of NAFTA specifies that all transfers relating to an investment must be freely permitted, but then includes an illustrative, non-exclusive listing of transfers that must be permitted. It provides that:

> *[e]ach Party shall permit all transfers relating to an investment of an investor of another Party in the territory of the Party to be made freely and without delay. Such transfers include:*
> *(a) profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment;*
> *(b) proceeds from the sale of all or any part of the investment or from the partial or complete liquidation of the investment;*
> *(c) payments made under a contract entered into by the investor, or its investment, including payments made pursuant to a loan agreement; (d) payments made pursuant to Article 1110 [relating to compensation for expropriation];*
> *(e) payments arising under Section B [relating to investor-state dispute resolution].*

Section 1109(2) specifies the currency and the exchange rate. It states that:

> *[e]ach Party shall permit transfers to be made in a freely usable currency at the market rate of exchange prevailing on the date of transfer with respect to spot transactions in the currency to be transferred.*

[77] For an in-deep discussion of transparency issues in IIAs, see UNCTAD (2004a).

In some cases, the specified transfers are described in general terms. For example, article 46 of the Free Trade Agreement between the EFTA States and the United Mexican States provides that:

> *[t]he EFTA States and Mexico shall with respect to investments in their territories by investors of another Party guarantee the right of free transfer, into and out of their territories, including initial plus any additional capital, returns, payments under contract, royalties and fees, proceeds from the sale or liquidation of all or any part of an investment.*

Some EIIAs apply only to certain specified transfers. The specification in these cases tends to be rather detailed. For example, article VII of the ASEAN Agreement on the Promotion and Protection of Investment provides that:

1) *Each Contracting Party shall, subject to its laws, rules and regulations, allow without unreasonable delay the free transfer in any freely-usable currency of:*
   a) *the capital, net profits, dividends, royalties, technical assistance and technical fees, interests and other income, accruing from any investments of the nationals of companies of the other Contracting Parties*
   b) *the proceeds from the total or partial liquidation of any investments made by nationals or companies of the other Contracting Parties;*
   c) *funds in repayment of loans given by nationals or companies of one Contracting Party to the nationals or companies of another Contracting Party which both Contracting Parties have recognized as investments;*
   d) *the earnings of nationals of the other Contracting Parties who are employed and allowed to work in connection with an investment in its territory.*

2) *The exchange rate applicable to such transfers shall be the rate of exchange prevailing at the time of remittance.*

The use of general language similar to that appearing in NAFTA is clearly more inclusive than more specific language since it refers to *all* transfers. On the other hand, EIIA transfer provisions that apply only to specific transfers are usually quite broad and include most types of payments that an investor would wish to repatriate. Indeed, given that the list of covered payments is usually rather broad, it might be questioned whether there is much additional risk for the host State in specifying that the provision applies to all transfers.

The phrase “all transfers relating to an investment” or similar language appears to be broad enough to apply to transfers into as well as out of the host State. That is, it creates a right not only to repatriate capital, but also to bring capital into the host State’s territory. Once an investment has been established, the investor has the right, under this language, to transfer funds relating to the investment into the territory, which could permit the investor otherwise to circumvent host State regulations on admission of investment.

On the other hand, provisions that list the types of payments covered generally refer only to payments that would be transferred out of the territory. Of course, the general language in NAFTA, and similar provisions in other agreements, could be modified so that it applies only to transfers out of the territory of the host State, thus preserving its generality, but making clear that it applied to outward, not inward, transfers. This would appear to be relevant in particular in cases where an EIIA grants a right to free transfer of funds but does not provide for rights of establishment. Such is the case, for example, with the Euro-Mediterranean agreements, which include a prohibition on future restrictions on movements of capital and current payments, with some exceptions, but their commitments to grant rights of establishment for investments are postponed to a future date.

Transfer provisions in EIIAs may raise concerns on the part of host countries. One concern is that an investor may seek to transfer a large sum at a time when foreign exchange reserves are low, thereby depleting exchange reserves needed for other purposes. Another concern is that permitting free transfer might result in massive capital flight during times of economic difficulty, thus exacerbating the host country's problems. For these reasons, EIIAs often limit the right of free transfers in some way.

One approach is to implement the right of free transfer gradually. This approach is typical of the association agreements and the partnership and cooperation agreements between the European Community and economies in transition. These agreements often explicitly recognize that the transition economies are still in a process of gradual liberalization and provide for implementation over time of the obligation to ensure free transfer of payments related to an investment. For example, article 60 of the EC agreement with Bulgaria, dealing with current payments, provides that:

> *The Contracting Parties undertake to authorize, in freely convertible currency, any payments on the current account of balance of payments to the extent that the transaction underlying the payments concern movement of goods, services or persons between the Parties which have been liberalized pursuant to this Agreement.*

Article 61(1), dealing with capital movements, provides:

> *[w]ith regard to transactions on the capital account of balance of payments, from the entry into force of this Agreement, the Member States and Bulgaria respectively shall ensure the free movement of capital relating to direct investments made in companies formed in accordance with the laws of the host country and investments made in accordance with the provisions of Chapter II of Title IV [dealing with competition policy] and the liquidation or repatriation of those investments and of any profit stemming therefrom.*
>
> *Notwithstanding the above provision, such free movement, liquidation and repatriation shall be ensured by the end of the first stage referred to in Article 7 for all investments linked to establishment of branches and agencies of Community companies and of Community nationals establishing in Bulgaria as self-employed persons...*

Article 61(2) prevents the introduction of new restrictions on capital or current payments, although this obligation is phased in for Bulgaria. It provides that:

> *Without prejudice to paragraph 1, the Member States, as from the entry into force of this Agreement, and Bulgaria as from the end of the fifth year following the entry into force of the Agreement, shall not introduce any new foreign exchange restrictions on the movement of capital and current payments connected therewith between residents of the Community and Bulgaria and shall not make the existing arrangements more restrictive.*

This provides the host country with the ability to maintain existing currency restrictions for a period of time, while also reassuring investors with the promise of the eventual elimination of those restrictions. This approach, however, does not provide flexibility for the host State once the transitional period has ended.

A second approach is to include an exception to the transfer provision during periods of balance-of-payments difficulties (see also under "Specific Exception", chapter IV, A.3). Such a provision is fairly common in EIIAs. They typically allow a party to restrict transfers when foreign currency reserves reach low levels, provided that certain conditions are met. Examples of such conditions are that the restrictions be no greater in scope or duration than is necessary, be progressively eliminated and be applied on a non-discriminatory basis. One relatively elaborate such provision is article 12 of chapter 08 of the Free Trade Agreement between Australia and Singapore, which provides that:

> 1. *In the event of serious balance of payments and external financial difficulties or threat thereof, a Party may adopt or maintain restrictions on payments or transfers related to investments. It is recognized that particular pressures on the balance of payments of a Party in the process of economic development may necessitate the use of restrictions to ensure, inter alia, the maintenance of a level of financial reserves adequate for the implementation of its programme of economic development.*
>
> 2. *The restrictions referred to in Article 12.1 shall:*
>   *(a) be consistent with the Articles of Agreement of the International Monetary Fund;*
>   *(b) avoid unnecessary damage to the commercial, economic and financial interests of the other Party;*
>   *(c) not exceed those necessary to deal with the circumstances described in Article 12.1;*
>   *(d) be temporary and be phased out progressively as the situation specified in Article 12.1 improves;*
>   *(e) be applied on a national treatment basis and such that the other Party is treated no less favourably than any non-Party.*
>
> 3. *Any restrictions adopted or maintained under Article 12.1, or any changes therein, shall be promptly notified to the other Party.*
>
> 4. *The Party adopting any restrictions under Article 12.1 shall commence consultations with the other Party in order to review the restrictions adopted by it.*

A third approach is to explicitly subordinate the right of transfer to the parties' exchange restrictions. Agreements in the African region sometimes adopt this approach. For example, article 2 of the Common Convention on Investments in the States of the Customs and Economic Union of Central Africa provides that:

> *[w]ithin the framework of their exchange regulations, the member States of the Union shall guarantee the free transfer of:*
> *(a) Capital;*
> *(b) Profits lawfully acquired;*
> *(c) Funds arising from the transfer or winding-up of business activities.*

The Community Investment Code of the Economic Community for the Great Lakes Countries subordinates the right to existing regulations. Article 8 provides that:

> *[s]ubject to compliance with existing legislation governing exchange regulations, the CEPGL member States shall guarantee the freedom to transfer capital accumulated in regulated markets, duly earned profits and funds arising from share transfers or from the cessation of business by an enterprise.*

EIIAs may contain provisions on the transfer of funds applicable to both capital and current accounts. For example, the Euro-Mediterranean Agreement between the European Community and Egypt includes three separate articles on this issue. Article 31 addresses current payments. It provides that *"[s]ubject to the provisions of Article 33, the Parties undertake to authorize, in fully convertible currency, any payments to the current account"*. Article 32 addresses transfers concerning direct investment. It states that:

> *[t]he Community and Egypt will ensure . . . the free circulation of capital for direct investments made in companies formed in accordance with the laws of the host country, and the liquidation or repatriation of the investments and of any profits stemming therefrom.*

The agreement also includes a balance-of-payments exception. Article 33 allows any party, when facing "*serious difficulties concerning balance of payments,*" to take restrictive measures with respect to current payments if such measures are *"strictly necessary"*.

Some earlier EIIAs specifically restricted the free movement of capital and transfer of funds, including through "fade out" provisions that mandated third-party investors to transfer their investments to investors within the region over a period of time. This is the case with regard to Decision 24 of the Commission of the Cartagena Agreement. Decision 291 removes the restrictions on transfer of funds, and obligates member countries to permit foreign investments and subregional investors to remit net profits from foreign direct investment and the proceeds from the sales or liquidation of such investment. However, Decision 291 does not tackle the issue of balance of payments.

* * * * *

Transfer of funds provisions are among the investment liberalization/protection provisions that often give rise to the greatest concerns on the part of developing host countries. The adverse consequences of capital flight can be severe, at least in the short run. Sudden infusions of large amounts of capital can also have adverse economic consequences. Thus, an initial policy question is whether the transfer provision should apply only to outward flows or to inward flows as well. The question of whether to include inward flows is necessarily linked to the extent of investment liberalization provided by the agreement, although it is not exclusively an issue of investment liberalization. An existing investment may wish to transfer payments into the country to use in its operation. Thus, a right to transfer payments into the territory may also be seen as an investment protection issue.

Free transfer of payments out of a host country's territory raises concerns when foreign exchange reserves are low. Some EIIAs address this issue by including exceptions to the right of free transfer when exchange reserves are at low levels. As noted above, the concern may also be addressed by excluding more volatile forms of investment, such as portfolio investment, from the coverage of the treaty, or by restricting the right to establish such investments in the first place. In other words, concerns about outward transfers also can be addressed through limitations on inward transfers.[78]

f. Performance requirements

Host countries sometimes impose requirements on foreign investment that are intended to shape the economic consequences of the investment. For example, in order to ensure that the investment contributes to employment or has a favourable impact on the balance of payments, the host country may seek to require the investment to hire local employees, purchase its inputs locally or export at least some percentage of its product. Such requirements are often referred to as “performance requirements”. In many cases, performance requirements are imposed as a condition for permitting the investments to be established. Often also, these requirements are imposed as a condition to qualify for certain incentives.

Such requirements introduce barriers that may interfere with the investor’s ability to manage its investment and may impair the value of the investment. Apart from their impact on a particular investment, performance requirements may also distort trade by preventing the importation of goods or services that would otherwise occur or by requiring the exportation of goods or services that otherwise would not occur. For these reasons, the WTO Agreement on Trade Related Investment Measures (TRIMs) prohibits certain performance requirements that are inconsistent with the requirement of national treatment or the prohibition on quantitative restrictions under articles III(4) and XI(1) in the General Agreement on Tariffs and Trade (GATT).

Upon the adoption of the WTO TRIMs Agreement, negotiated during the Uruguay Round of Trade Negotiations, EIIAs dealing with investment liberalization began to include prohibitions on certain performance requirements. In fact, some EIIAs, such as the Free Trade Agreement between Canada and the United States, did so before the adoption of the TRIMs Agreement.

The concept of a performance requirement is potentially quite broad and not well defined. Thus, EIIAs that address this issue do not prohibit performance requirements generally. Rather, they generally prohibit certain specific performance requirements. The list appearing in, for example, the Free Trade Agreement between Colombia, Mexico and Venezuela covers the same measures identified in TRIMs Agreement. The list that appears in NAFTA and in other recent FTAs concluded by the United States based on NAFTA goes beyond the measures listed by the TRIMS Agreement. NAFTA. Article 1106 provides that:

> *No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:*
> *(a) to export a given level or percentage of goods or services;*
> *(b) to achieve a given level or percentage of domestic content;*

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[78] For an in-depth discussion of the issues arising with respect of transfer of funds provisions, see UNCTAD (2000b).

(c) *to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;*
(d) *to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;*
(e) *to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the value or value of its exports or foreign exchange earnings;*
(f) *to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement, or*
(g) *to act as the exclusive supplier of the goods it produces or services it provides a specific region or world market.*

Recognizing, however, that performance requirements may be regarded by some host countries as an important element of their economic development policy, NAFTA allows the parties to specify in an annex, and to maintain, exceptions to the prohibition on performance requirements. It should be noted that while performance requirements are often prohibited as a condition on the establishment of investment, the NAFTA provision prohibits them whether they are imposed as a condition of establishment or subsequent to establishment. In addition, the NAFTA provision, unlike the TRIMs Agreement, covers trade in goods as well as trade in services. Furthermore, NAFTA prohibits performance requirements imposed even on investments of non-parties, although it does not provide a mechanism by which an investment of a non-party or a non-party can enforce the prohibition.

EIIAs that follow NAFTA have included provisions that in some cases are more complex than the NAFTA provision, but that are quite similar conceptually. These may prohibit certain performance requirements that are imposed directly or, in some cases, required as a condition of receiving a benefit; they may apply the prohibition to performance requirements imposed on investments of investors of non-parties as well as of parties; and they may allow the parties to specify exceptions to the general prohibition. An example is article 15.8 of the Free Trade Agreement between Singapore and the United States.

As a result of the TRIMs Agreement prohibitions, some EIIAs, particularly those concluded by the European Community, require one or both parties to abide by the TRIMs agreement. For example, article 73 of the Association Agreement between the European Community and Estonia provides that *"Estonia shall honour the rules on Trade-Related Aspects of Investment Measures (TRIMs)"*. To similar effect is the Free Trade Agreement between CARICOM and the Dominican Republic, which provides at annex III, article VII, that:

> *[n]o Party shall impose any performance requirements which are contrary to the World Trade Organisation Agreement on Trade Related Investment Measures as a condition for establishing, expanding or maintaining investments.*

A similar approach was followed in the United States-Viet Nam agreement (article 11(1)). This article is unusual because it establishes special time limits for its application. In article 11(2) the parties agree:

To eliminate all TRIMs (including those contained in laws, regulations, contracts or licenses) which fall under sub-paragraphs 2(A) (trade balancing requirements) and 2 (B) (foreign exchange controls on imports) of the List by the time this Agreement enters into force. Viet Nam shall eliminate all other TRIMs no later than five years after the date of entry into force of the Agreement, or the date required under the terms and conditions of Viet Nam's accession to the WTO, whichever occurs first.

To the extent that the parties affected are already parties to the TRIMs Agreement, these provisions impose no further obligations on them. They do, however, incorporate the existing obligations into the EIIA and thus make those same obligations enforceable through any dispute resolution mechanism contained in the EIIA, and not only the WTO dispute resolution procedures.

Unlike the case of the TRIMs Agreement, some EIIAs, following the United States BIT model in this regard, allow performance requirements which are otherwise prohibited, provided that they meet certain conditions. One is that they are granted as conditions for the receipt of an advantage. For instance, NAFTA article 1106(4) explicitly allows the parties to condition the receipt of an advantage to:

Locate production, provide a service, train or employ workers construct or expand particular facilities, or carry out research and development.

Moreover, article 1106(3), referring to the list of performance requirements covered under article 1106(1), singles out a number of them that cannot be linked to incentives, implying that the remaining measures on the list may be allowed when linked to advantages.

Another approach to the issue of performance requirements associated with incentives is exemplified in earlier EIIAs that established industrial regional industrialization programmes, often creating a "regional enterprise" to carry out these programmes. Thus, under the Charter on a Regime of Multinational Industrial Enterprises in the Preferential Trade Area for Southern African States, the benefits accorded to an enterprise established according to the rules of the Charter were balanced by a number of obligations, including performance requirements, such as the increase in local value-added of products, export support, training, minimum volume or supply for the national market and supply of information.[79]

Some EIIAs do not go as far as prohibiting performance requirements but discourage their imposition through a “best effort” clause. Thus, article 3 of the Framework Agreement on the ASEAN Investment Area calls for the progressive reduction or abolition of:

investment regulations or conditions which may impede investment flows or the operation of investment projects in ASEAN.

Finally, some EIIAs make explicit reference to measures that could be considered performance requirements but that are excluded from the prohibition. An example is article 1006(2) of NAFTA, which explicitly excludes the mandating of the use of certain technologies as being considered a performance requirement under the Agreement. Another example is article

[79] Similar examples can be found in the Protocol on Cooperation in the Field of Industrial Development of COMESA, Decision 292 of the Andean Pact creating the "Andean Multinational Enterprise", the Revised Treaty of ECOWAS and the Revised Basic Agreement on ASEAN Industrial Joint Ventures.

17-04 (2) and (3) of the Free Trade Agreeement between Colombia, Mexico and Venezuela mentioned above. In particular, article 17-04 (3) specifies that:

> *Nothing in the provisions of this article shall be construed as preventing a Party from imposing, with regard to any investment in its territory, requirements to locate production, generate jobs, train workers, or carry out research and development.*

Under other EIIAs, the freedom to impose performance requirements linked to incentives has been encouraged. For example, the CARICOM members have issued guidelines encouraging the imposition of performance requirements linked to incentives in the negotiation of BITs.

* * * * *

Prohibitions on performance requirements have begun to appear in EIIAs in recent years, notably since the adoption of the WTO TRIMs Agreement prohibited the imposition of certain trade-related investment measures. In some cases, these commitments are coextensive with those already made in the TRIMs Agreement. In other cases, however, these prohibitions go beyond the TRIMs Agreement and specifically prohibit certain enumerated measures that a State may consider part of its development policy. A country that wishes to balance its desire to attract foreign investors, by making commitments to limit performance requirements, with its desire to retain the right to impose them in some cases, could do so through the inclusion of a provision for exceptions to the performance requirements commitment. Alternatively, that country may wish to exclude certain specific performance requirements from the enumeration in the agreement.80

g. Employment of key personnel

Recent EIIAs that deal with investment and services liberalization often include provisions intended to ensure that investments will be able to employ the key managerial or professional personnel of their choice. These provisions are an important complement to investment liberalization and over the years have become increasingly elaborate, appearing some times in a separate chapter of the EIIA. Several approaches can be identified in this respect.

For example, article 13-07 of the Costa Rica-Mexico free trade agreement provides that "[n]o Party may require that an enterprise of that Party that is an investment of an investor of another Party appoint to senior management positions individuals of any particular nationality". Significantly, however, the provision does not require that the host country allow unlimited immigration of nationals of the home country and thus the investment's choice of senior management personnel necessarily is limited to those persons who can lawfully gain entry into the home country. This provision includes an exception that allows the host country to require that a majority of the board of directors have a particular nationality, provided that the requirement "does not materially impair the ability of the investor to exercise control over its investment". The article is also subject to any exceptions listed in an annex. Similar approaches can be found in other EIIAs following the NAFTA model.

Some EIIAs do make reference to the parties' immigration laws and directly establish eligibility under these laws. An example is the Free Trade Agreement between Jordan and the United States, which addresses the issue of entry of nationals of the other party in relation both to

[80] For an in-depth discussion of performance requirements in IIAs, see UNCTAD (2001a).

trade in services and to investment under the heading of "visa commitments" (article 8), as follows:

> 1. *Subject to its laws relating to the entry, sojourn and employment of aliens, each Party shall permit to enter and to remain in its territory national of the other Party solely to carry on substantial trade, including trade in services or trade in technology, principally between the Parties.*
> 2. *Subject to its laws relating to the entry, sojourn and employment of aliens, each Party shall permit to enter and to remain in its territory nationals of the other Party for the purpose of establishing, developing, administering or advising on the operation of an investment to which they, or a company of the other Party that employs them, have committed or are in the process of committing a substantial amount of capital and other resources.*

Then paragraph 12 of the explanatory notes to the agreement states that:

> *Paragraphs 1 and 2 of this Article render nationals of Jordan eligible for treaty-trader (E-1) and treaty-investor (E-2) visas subject to the applicable provisions of the United States laws and corresponding regulations governing entry, sojourn and employment of aliens. They also guarantee similar treatment for United States nationals seeking to enter Jordan's territory.*

The Australia-Thailand free trade agreement includes a separate chapter on the movement of natural persons (chapter 10) applying to both the trade in services and investment chapters (chapters 8 and 9 respectively) of the agreement. Chapter 10 includes detailed definitions describing various types of functions the persons in question might perform in the host country. It also differentiates between short-term and long-term temporary entry. The granting of temporary entry is made subject to immigration measures (article 1007), provided that:

> *…such measures are not applied in such manner as to nullify or impair the benefits accruing to the other Party under the terms of this Chapter.*

In some cases, the subordination of the right to employ key personnel to the immigration laws is made explicit. For example, article 45(2) of the EFTA-Singapore free trade agreement provides that:

> *[t]he Parties shall, subject to their laws and regulations, permit investors of another Party which have investments in their territories, and investments of such investors, to employ any key personnel of the investor's or the investment's choice regardless of nationality and citizenship provided that such key personnel has been permitted to enter, stay and work in the territory of the other Party and that the employment concerned conforms to the terms, conditions and time limits of the permission granted to such key personnel.*

The Agreement between Japan and Mexico for Strengthening Economic Partnership goes even further and provides, under the general scope and coverage article (article 57), that:

> *4. Nothing in this Chapter shall impose any obligation on either party regarding measures pursuant to immigration laws and regulations.*

Under EIIAs that provide for the free movement of persons, an investor's right to employ key personnel of its choice is guaranteed in principle for individuals having the nationality of one of the member countries. This is the case, for example, in the European Community. However, other EIIAs that grant a right of establishment specifically withhold any obligation on member States to grant freedom of movement of persons from other member States. An example is the CARICOM agreement (article 38).

Other EIIAs do not totally deny investors a right to employ foreign personnel but give preference for employment to experts having the nationality of the host country, followed by employees from within the EIIA area. Article 13 of the Unified Agreement for the Investment of Arab Capital in the Arab States provides that:

> *[t]he State shall assist the Arab investor to secure such Arab labour and Arab or foreign experts as he needs. Where the requisite professional skills are available, priority in filling the relevant vacancies shall go to nationals of the State in which the investment is made, followed by Arab employees and, finally, experts of other nationalities.*

* * * * *

Host countries sometimes require foreign investments to employ their own nationals, both to increase employment and to raise the skill level of the workforce. They may also require that a number of the managers or directors of companies operating in strategic economic sectors be reserved to nationals of the host country, or even be appointed by the host Government itself. This requirement responds to the perception that keeping the management of certain strategic companies under national control facilitates the implementation of their economic policies. However, part of the competitive advantage that allows a foreign investment to succeed in the host country is the managerial expertise or technical knowledge of its employees, which may not be as readily available in the host country. Moreover, restrictions regarding whom the investment employs may undermine the investor’s ability to control its investment. Policymakers need to balance these concerns when considering a provision related to the entry and employment of foreign personnel.

3. Investment Protection

A preliminary question facing policymakers is whether an EIIA should address investment protection issues, or whether these issues should be dealt with in separate agreements (e.g. BITs) or should be left for the national laws of the host country. The introduction of protection standards in an EIIA is likely to further the agreement’s goal of establishing a favourable investment climate, but restricts the parties' future discretion in regulating foreign investment or promoting local investment. As noted before, certain types of EIIAs that contain investment liberalization commitments also include provisions granting legal protection to investments. These include, notably, NAFTA and EIIAs following the NAFTA model. Under other EIIAs, for example the agreements concluded by the European Community with third countries, the question of investment protection remains largely a matter of national policy.[81]

[81] As noted, one possible reason for not including investment protection in EIIAs signed by the EC may be that while the European Commission has authority to negotiate EIIAs, it does not have competence over investment protection issues.

Provisions that protect investment may use either relative or absolute standards. The relative standards generally require non-discrimination as between covered investment and certain other investments.

The absolute standards may be intended to protect investment generally or they may be intended to protect investment against only certain specified actions, such as expropriation or restrictions on intellectual property rights. Typically, these latter standards are intended to protect the ownership or beneficial use of the investment against political risk. Each investment protection provision raises its own policy implications.

a. Non-discrimination

Non-discrimination provisions guarantee investments either treatment no less favourable than that granted to nationals of the host country (national treatment) or treatment no less favourable than that granted to nationals of any third country (most-favoured-nation or MFN treatment). Very often the two non-discrimination standards appear together in an EIIA. However, each of these standards raises complex issues of interpretation and application, some of which are only briefly alluded to here.[82]

Both the national treatment and MFN standards have been widely applied in trade law. In trade matters, national treatment of imported products with respect to internal measures is one of the basic principles of agreements that seek to liberalize international trade. It serves the purpose of ensuring that internal measures are not used to nullify or impair the effect of tariff concessions and other international rules applicable to border measures. In relation to investment, national treatment involves a similar economic aim: foreign and domestic investors should be subject to the same competitive conditions in the host country market, and therefore no government measure should unduly favour domestic investors (UNCTAD, 1999c, p. 8). Similar considerations apply *mutatis mutandis* to the MFN standard with respect to investments from other countries (UNCTAD, 1999d).

At the same time, the relative importance of these two standards is not the same in the case of trade and investment. In the context of multilateral trade, the MFN principle is of fundamental significance. The standard is also particularly relevant to relations arising out of EIIA members with third countries. On the other hand, national treatment has acquired increasing importance with respect to trade in the context of deeper trade integration, and, of course, is of major importance in matters of investment.

Thus, unlike in the case of trade, one of the key questions that arise with regard to the scope of application of the national treatment standard in the investment field is whether the principle shall apply to the entry of foreign investment or only to the treatment of the investment after entry. A number of EIIAs provide both national treatment and MFN, but only after entry. These are agreements that do not pursue the liberalization of investment flows but deal nevertheless with investment protection, guaranteeing after-entry non-discrimination. An

[82] A comprehensive and in-depth discussion of the complex issues raised by the national and MFN treatment standards exceeds the limits of this study. For further details about the national and MFN treatment standards in relation to investment, see UNCTAD (1999c, 1999d and 2005a).

example is the Free Trade Agreement between Colombia, Mexico and Venezuela.[83] Article 17-03 (12) and (2) provides that:

> 1. *Each Party shall accord to investors of another Party, and to their investments, treatment not less favorable than that it accords, in like circumstances, to its own investors and investments.*
>
> 2 *Each Party shall grant investors from another Party, and to their investments, treatment no less favorable to that it accords, in like circumstances, to investors, and their investments of another or of a non-Party.*

In contrast, agreements that pursue both liberalization and protection of investments tend to extend the scope of national and MFN treatment to the pre-entry and post-entry phases of the investment. This is the case with NAFTA and many EIIAs that follow the NAFTA model. It is also the case with other types of agreements, such as the MERCOSUR Colonia Protocol for the treatment of investments from other MERCOSUR countries, the Framework Agreement on the ASEAN Investment Area and the Free Trade Agreement between CARICOM and the Dominican Republic. For example, annex III, article III(1), of the Free Trade Agreement between CARICOM and the Dominican Republic provides that:

> *[e]ach Party shall admit and treat investments in a manner not less favourable than the treatment granted in similar situations to investments of its investors except for investments in areas identified in the Appendix to this Annex.*

MFN treatment is guaranteed by Annex III, article III(2), which provides that:

> *[e]ach Party shall admit and treat investments in a manner not less favourable than the treatment granted in similar situations to areas related to Most-Favoured-Nation treatment except for investments in the areas identified in the Appendix to this Annex.*

As noted earlier (section IV.B.1), EIIAs that provide for pre-establishment and post-establishment national and MFN treatment typically provide for country-specific exceptions to these standards to be set forth in an annex.

The approach followed by the European Community Treaty (as amended) to national treatment goes beyond a general national treatment clause. Other than a general prohibition against discrimination on the grounds of nationality (article 12) national treatment is present in the content of substantive rules rather than in any single statement of the standard. It is indeed a fundamental part of the Community legal order, particularly as regards entry and establishment (articles 43-48). In addition, European Community law applies a wider concept of non-discrimination between nationals of member States to specific policy areas, such as State monopolies (article 31), free movement of workers (article 39(2)), freedom to provide services (articles 49-55), free movement of capital (articles 56-60), competition (article 81(1) (d) and 82 c), State aid (articles 87-88) and discriminatory taxation (articles 90-91), thereby helping to

[83]. Other examples include the Agreement on Promotion, Protection and Guarantee of Investments among Member States of the Organization of the Islamic Conference, the Agreement between the States Members of ASEAN for the Protection and Promotion of Investments (which only provide for MFN treatment), the FTAs between Mexico and Costa Rica, between Mexico and Nicaragua, and between Central America and the Dominican Republic.

harmonize national standards and to develop an integrated single market for trade and investment (UNCTAD, 1999c, p. 17).

At the other end of the spectrum stands Decision 292 of the Commission of the Cartagena Agreement: Uniform Code on Andean Multinational Enterprises. Article 14 of Decision 292, for example, provides that Andean multinational companies may participate in economic sectors reserved for national companies in accordance with the respective legislation of the member countries. Thus, Decision 292 prescribes the national treatment for Andean companies but leaves discretion to its member countries to establish their own rules in this respect. To qualify for Andean multinational company status, a company must meet a number of requirements, including the requirement that at least 60 per cent of the capital of the company be owned by investors from two or more Andean countries.

The application of the national treatment standard raises two main questions. First, what are the factual situations in which national treatment apply? Second, in what manner and to what extent is the treatment of foreign investors assimilated to that of nationals? The first issue defines the scope of factual comparison, while the second deals with the criteria for determining discrimination, the application of which is limited to the factual situations identified in the first question. A related question that arises is whether national treatment covers not only *de jure* treatment (i.e. treatment provided for in national laws and regulations), but also *de facto* treatment, as where the measure in fact works against national treatment. One example may be licensing requirements, which depend on the possession of professional qualifications that can be obtained only in the host country, therefore de facto discriminating against foreigners (UNCTAD, 1999c, pp. 11-12).

Similarly, the MFN treatment standard does not mean that foreign investors have to be treated equally irrespective of their characteristics or activity in the host country. Different treatment is justified vis-à-vis investors from different foreign countries if they are in different objective situations.

To address some of these difficulties in the application of the national and MFN standards, EIIAs often contain an explicit provision according to which the treatment applies only to investments that are in “similar" or "like" situations. Nonetheless, the general terms used in the formulation of these standards leave a substantial degree of discretion for their application and interpretation by tribunals, as a number of arbitration cases under NAFTA have shown.[84]

It is also common — even among groups that have achieved deep levels of economic integration — to include a number of exceptions to the application of the general standards of pre-national and MFN treatment. These exceptions tend to be particularly significant when national and MFN treatment is granted pre- and post-establishment. The use of exceptions enables host countries to exclude certain types of enterprises, activities or industries from the operation of national and MFN treatment. In the example of the Free Trade Agreement between CARICOM and the Dominican Republic, the provisions allow the parties to specify in an annex sectors of the economy to which the non-discrimination provisions do not apply. This modality of exception is quite usual in a non-discrimination provision that applies to the right of establishment. It offers a way by which host countries can provide a generally favourable investment climate while excluding foreign investment from certain sectors of the economy.

[84] For a detailed analysis of arbitration cases dealing with the application of the national treatment and MFN standards in relation to NAFTA, see UNCTAD (2005b, forthcoming).

With regard to MFN treatment, two different versions of this modality may be noted. First, under the GATS type of approach a member may maintain a measure inconsistent with the unconditional MFN clause provided that such measure is listed in, and meets the conditions of, the annex to that clause. The annex typically specifies that the MFN exception should not apply for more than ten years, and is subject to revision in subsequent negotiations. This approach is often followed in the trade in services chapters of EIIAs. (The GATS type approach to national treatment (both pre- and post-establishment) is for it to be granted only when a party makes commitments on liberalization of specific industries and measures (see section IV.B.1.) Another modality, exemplified by NAFTA, article 1108 (1), allows for an exception similar to that found in the GATS (MFN does not apply to non-conforming measures maintained at federal, state or local levels). However, NAFTA permits member countries to adopt new non-conforming measures with both national and MFN treatment in the future, with regard to sectors or activities which a country has set out in a specific schedule (article 1108 (3). This approach is characteristic of the NAFTA-type investment provisions of EIIAs. These two approaches are often found together in the respective chapters of an EIIA dealing with trade in services and investment.

Other exceptions are also specific to MFN treatment regardless of whether the standard is granted at pre- or post-establishment phases. Thus, it is common in agreements guaranteeing MFN treatment to include, in addition to any sectoral exceptions, a general exception for advantages provided to a third party under a customs union or free trade agreement, or treatment afforded under a treaty on taxation. For example, annex III, article III(3), of the Free Trade Agreement between CARICOM and the Dominican Republic provides that:

> *[t]he obligation to grant treatment no less favourable than is granted to third States does not apply to:*
> *(i) any treatment or advantage resulting from any existing or future customs union or free trade area or common market or monetary union or similar agreement to which a Party is a party; or*
> *(ii) any international agreement or arrangement relating wholly or mainly to taxation.*

The first exception, also known as the REIO clause, is needed because it is in the nature of an EIIA to grant special privileges to the other parties in exchange for reciprocal treatment. The first exception ensures that these special privileges are not generalized to other States with which the first State has extended the MFN guarantee but which, unlike the EIIA members, have not promised reciprocal treatment.[85]

This exception is especially important to a developing country that has entered into an EIIA with other developing countries and has granted concessions to those countries that it does not wish to extend to third States. To avoid that result, it should include this exception in any other agreement that it concludes and that contains an MFN commitment. Indeed, it may be useful to include this exception in all of its MFN commitments in order to preserve the ability to enter into future EIIAs with other developing States and to grant other developing States special concessions not granted to third States with which it has an MFN commitment.

Of course, including such an exception opens a developing country to the possibility that its treaty partners will themselves extend more favourable treatment to some third country and invoke the exception to justify not extending it to the developing country. This problem has

[85] For a detailed analysis of the implications of the REIO clause, see UNCTAD (2005a).

been addressed in a few recent EIAs. For example, article 40(2) of the Free Trade Agreement between the EFTA States and Singapore contains an exception to the MFN obligation for treatment extended under a customs union or a free trade agreement, but allows the parties to this agreement to negotiate to obtain the more favourable treatment under the customs union or other free trade agreement. Specifically, the article provides that:

> *[i]f a Party accords more favourable treatment to investors of any other State or their investments by virtue of a free trade agreement, customs union or similar agreement that also provides for substantial liberalisation of investments, it shall not be obliged to accord such treatment to investors of another Party or their investments. However, upon request from another Party, it shall afford adequate opportunity to negotiate the benefits granted therein.*

The second exception is often included because the complexity of tax treaties requires that tax matters be addressed individually with other States through bilateral agreements and that provisions on tax matters not be extended automatically to every other State with which a State has concluded an MFN provision. This exception is not intended to have any special consequences for development. It merely reflects the complexity of tax laws and the need, in many cases, to address tax issues in a specialized agreement.

Some EIIAs include additional exceptions in relation to national and MFN treatment. For example, NAFTA includes national and MFN treatment exceptions with regard to public procurement and subsidies provided by a contracting party or a State enterprise, including government-supported loans, guarantees and insurance (article 1108(7)). In addition, there are national and MFN treatment exceptions in connection with intellectual property rights (article 1108(5)) and MFN exceptions with regard to other international agreements that the parties have set out in their schedule (article 1108 and (6)).

* * * * *

A common standard granted by EIIAs that address investment protection issues is non-discrimination for reason of nationality, meaning MFN treatment, national treatment, or both. MFN treatment raises fewer objections in principle because a country usually has little reason to prefer foreign investors of one nationality to foreign investors of another. Nevertheless, MFN treatment does have a generalizing effect, which means that it offers to all treaty partners the highest level of treatment afforded to any other treaty partner in any other agreement, whether in the past or future. If the host party is not prepared to offer to its EIIA partners the highest form of treatment, provision for exceptions to MFN treatment must be made. Allowing exceptions, of course, will enable the other parties to the EIIA also to withhold their highest level of treatment, although this may be of less concern if investment flows are expected to move in only one direction. Furthermore, potential investors may be discouraged by the possibility that they will be placed at a competitive disadvantage relative to competitors from other countries. This problem can be addressed by a provision for listing exceptions in an annex or by limiting the exceptions to those already in existence, either of which can provide some level of certainty for potential investors.

National treatment, by contrast, raises greater policy concerns because it eliminates the host country's ability to favour local investors over investors from other EIIA countries. Again, these concerns can be addressed through provisions for exceptions. If exceptions can be added at any time in the future, the national treatment commitment as a practical matter may be of very limited value. If exceptions are limited to those that can be identified at the time the treaty is concluded, the commitment retains greater force, but the host country's future discretion is correspondingly diminished.

b. General protection provisions

General protection provisions typically appear in EIIAs that address investment protection issues, such as those following the NAFTA model. They are not included in liberalization agreements such the European Community or the EIIAs signed by the EC. When EIIAs include general protection provisions, the most common ones are guarantees of "*fair and equitable treatment*" or "*full protection and security*." These provisions often appear together. For example, article 909 of the FTA between Australia and Thailand provides that:

> *2. Each Party shall ensure fair and equitable treatment in its own territory of investments.*
> *3. Each party shall accord within its territory protection and security to investments.*

Other agreements guarantee only fair and equitable treatment. Article 159 of the Treaty Establishing the Common Market for Eastern and Southern Africa, for example, provides that

> *[i]n order to encourage and facilitate private investment flows into the Common market, Member States shall . . . accord fair and equitable treatment to private investors .*

These provisions are common to many investment agreements and raise few issues in negotiations. They are intended to signal a favourable investment climate by offering a specific commitment. A country is either willing to make that commitment or not, but there are few variations in the commitment to be found in the agreements.

An issue that does arise is determining precisely what the nature of the commitment is.

Two different views of the "fair and equitable treatment" commitment have emerged. One is that it is synonymous with the treatment of foreign investment required by customary international law — what has become known as the international minimum standard. The other is that "fair and equitable treatment" means something different from the international minimum standard, although there may well be areas of overlap. In this latter view, the fair and equitable treatment commitment probably sets a higher standard than customary international law requires.

Some recent EIIAs have sought to define the commitment as limited to the protection provided by customary international law and to specify at some level what that protection is. For example, article 15.5.1 of the Singapore-United States FTA initially provides that:

> *[e]ach Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.*

Article 15.5.2 goes on to clarify the meaning:

> *For greater certainty, paragraph 1 prescribes the customary international law minimum standards of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection*

and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.

(a) The obligation in paragraph 1 to provide "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and
(b) The obligation in paragraph 1 to provide "full protection and security" requires each Party to provide the level of police protection required under customary international law.

Thus, the text of the agreement explicitly treats fair and equitable treatment as an element of customary international law. Other agreements, however, do not couple the reference to fair and equitable treatment with a reference to international law and thus do not take a position on the relationship between the two. One such agreement is the Australia-Thailand FTA cited above.

The requirement for "full protection and security" is somewhat better defined. It has been understood to mean an obligation on the part of the host State to exercise due diligence or reasonable care to protect foreign investment against injury, including injury by private citizens.

The fair and equitable treatment provision in particular is among those most likely to be relied upon in an investment dispute with an investor. The language is broad enough to apply to virtually any adverse circumstance involving an investment. Thus, developing countries need to weigh the beneficial impact that this assurance can have on the investment climate against the potential for disputes involving its meaning.[86]

At the same time, it should be noted that if a country already has provided this guarantee in at least one BIT, that level of protection must be provided to investors or investments of all other States with which the State has concluded an EIIA with an MFN clause, unless the MFN clause is drafted so as to exclude that provision. Thus, in many cases, it may make no practical difference whether this provision explicitly appears in an EIIA.

* * * * *

General protection provisions of EIIAs, such as a guarantee of fair and equitable treatment, are significant because they are potentially applicable to virtually all host country conduct with respect to covered investments. Such provisions, together with the non-discrimination provisions, are among those that do the most to shape the overall investment climate in the host country , although, because of their breadth of application and vagueness of meaning, they are also among those most likely to trigger disputes.

c. Expropriation

The issue of expropriation was the first and the most important single protection issue addressed in investment agreements. EIIAs that deal with protection issues almost invariably include provisions on expropriation. These provisions recognize the right of the host State to

[86] For analyses of arbitral decisions on investor-State disputes involving the meaning of "fair and equitable treatment", see UNCTAD (2005b).

expropriate investment, but impose conditions that must be satisfied when an expropriation occurs. These provisions raise two principal issues. These issues are not specific to EIIAs but their significance may increase in the context of EIIAs, as these agreements address a wider range of investment-related issues.

(i) Scope of the expropriation provision

The first issue is to define the sorts of host country actions to which the provision applies. In other words, what is meant by an expropriation? EIIAs rarely define the term. Some EIIAs are explicit in stating that an expropriation includes measures "equivalent" or "tantamount" to an expropriation. They may also state that expropriation includes "creeping expropriation". Such language is intended to ensure that the term refers to expropriations that occur through a series of actions rather than by a single act. For example, the Free Trade Agreement between El Salvador, Guatemala, Honduras and Mexico provides in article 14-11 that:

> *No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such investment …*

This provision is typical of EIIAs that follow the NAFTA model. Its language, however, still leaves unclear what degree of interference with the rights of ownership is required for an act or series of acts to constitute an expropriation. The classic example of an expropriation is an act that transfers ownership or possession of the investment to the State. An act that completely destroys the value of an investment is also typically regarded as an expropriation. Acts that only partially devalue an investment, however, may be viewed by the host State as merely routine regulatory acts that are not the equivalent of an expropriation. The issue of what constitutes an expropriation is thus important to host countries because a definition that is too broad could be interpreted to the effect that routine regulatory acts constitute an expropriation, requiring that all investments affected by the regulations be compensated. Until recently, most EIIAs typically did not include language that defined clearly the scope of the expropriation provision. This situation led to investment disputes, mainly in the context of NAFTA, regarding the type of government measures to which the expropriation provision applies (UNCTAD, 2005b).

A few recent FTAs are beginning, however, to address the issue. For example, annex 10-D of the Free Trade Agreement between Chile and the United States states initially that:

> *[a]n action or series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property interest in an investment.*

It then goes on to explain that the expropriation article:

> *…addresses two situations. The first is direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure.*

A separate paragraph attempts to define more carefully what types of actions beyond these traditional forms of expropriation might constitute an expropriation. It states that:

The second situation addressed by [the expropriation article] is indirect expropriation, where an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.

(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:

(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
(iii) the character of the government action.

(b) Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.

The language in paragraph (b) seems to create a presumption that regulatory actions do not constitute an expropriation, but it does not exclude that possibility entirely since:

- The paragraph applies only to regulatory actions that are designed and applied to protect legitimate public welfare objectives.
- The paragraph applies only to non-discriminatory regulations. This presumably reflects the fact that legitimate public welfare regulations would rarely be discriminatory and thus their application only to selected investments would call into question whether they were truly motivated by legitimate public welfare objectives.
- Even a regulation designed and applied to protect legitimate public welfare objectives may still be considered in rare circumstances to be an expropriation, taking into account the character of the government acts, their economic impact and the extent of interference with reasonable, investment-backed expectations.

The factors listed in the annex of the Chile-United States FTA echo some of the considerations that have been utilized in United States constitutional law to determine whether government conduct constitutes a “taking” of property for which the Government must pay “just compensation”. The inquiry seems to focus on the extent of the interference with the property and on whether the investor’s reasonable expectations have been defeated. Recall that the Chile-United States FTA is among those that define investment in economic terms, as involving the commitment of capital and the assumption of risk in the expectation of gain. The core concept behind this definition seems to be that government action that undermines the asset’s character as investment that extensively interferes with the gain that an investor reasonably expected when it put capital at risk is more likely to be considered an expropriation. Other constitutional systems have also influenced the approach of EIIAs to regulatory takings (box IV.1).

Box IV.1. The European Community's approach to regulatory takings

The need to determine the scope of expropriation in relation to regulatory measures arises very often in a purely national context. Governments need to adopt regulations to pursue social, environmental and other goals in the interest of their communities and these can affect, to a greater or lesser degree, the rights of individuals and corporations, including their property rights. The right of individuals to hold, possess and enjoy property is, nevertheless, one of the values most deeply felt in most societies. This is particularly true in market-oriented democratic societies. Thereby, a tension is often created between the duty of the State to protect the private rights of individuals and its obligation to regulate in the public interest. The manner in which these competing rights are balanced depends very much on the mix of cultural and social values upheld by a particular society.

Most European countries uphold the notion that property must serve a social function and that individual rights are subject to the prior right of society to secure the public good. These countries therefore tend to allow wide scope for the exercise of regulatory powers before recognizing these as regulatory takings. Thus, while the right to private property is understood to be a part of the general human rights regime of the Council of Europe, a/ the European Court of Human Rights has addressed the issue of expropriation, and generally has regarded regulatory action without compensation not to be in violation of expropriation rights. b/ Member States of the Council of Europe are seen as having a wide margin of appreciation in these matters, at least so far as such regulatory action affects their own nationals, as opposed to foreign nationals. Crucial here is the need to strike a balance between the right to peaceful enjoyment of possessions guaranteed by article 1 of the First Protocol to the European Convention on Human Rights and the legitimate regulatory aims of the member State concerned. Any interference with these rights must be for a legitimate regulatory aim and be *proportionate* to that aim.

The European Community has approached the question of the right to regulate along similar lines. Although there is no provision in the European Community treaties recognizing the right to property, such right has been recognized as part of the fundamental rights protected by Community law. The European Court of Justice laid down its doctrine on the issue of regulatory takings in its decision of 14 May 1974 in the case of Nold v. Commission (C-4/73). The Court first held that the rights guaranteed by Community law "must be inspired in the common constitutional traditions of the member states, and should not therefore admit measures incompatible with the fundamental rights recognized and guaranteed by the constitutions of these states". The ECJ interpretation of the approach of the constitutions of member States to this matter may be summarized as follows:

– Whereas the constitutional regimes of all member States guarantee the protection of the right to private property, and similar guarantees protect the free exercise of business, work and other professional activities, the protection of such rights, far from constituting an absolute prerogative, must be seen in the light of the social function of the protected assets and activities.

– Consequently, this category of rights is generally guaranteed with the reservation of the limitations established in the public interest.

– It seems also legitimate to maintain certain limitations in the Community regime with respect to these rights as this may be justified by the public interest objectives pursued by the Community, so long as they do not contradict the essence of such rights by reason of being proportionate responses to the objectives being pursued.

/…

Box IV.1. The European Community's approach to regulatory takings (concluded)

It can be deducted from this doctrine that Community regulation altering private property rights is not considered to be subject to a duty to pay compensation in every case. Community law, especially in the field of the Common Agricultural Policy, is constantly altering the property regime of agricultural owners, without its giving rise to compensation, except in cases in which the Commission has created in relation to concrete agricultural owners a legitimate expectation which has been later frustrated. Indeed, Community regulation offers persuasive examples with respect to the *use of property,* especially in the field of environmental and consumer protection, in which it has ordered the destruction of assets or products for ecological or sanitary reasons, without compensation. The ECJ in its Decision of 6 April 1995 in the case of Flip v. Verdegem (C-315/93) established that the Community regulation applicable in the fight against swine fever was to be interpreted in the sense that it did not require the member States to establish a compensation regime for the owners of the pigs slaughtered by order of the authorities.

It follows from the foregoing that under the ECJ jurisprudence the distinction between *deprivation of property* and the *regulation of the use of property* is fundamental for determining whether compensation is required. The former refers to concrete situations in which, as a result of a decision by a public authority taken in the framework of a legal mandate, the property rights are transferred to another subject, whether a public authority or a private beneficiary. In these cases, compensation is a guarantee of the property right. However, in the case of the latter, the limitations on the use of an asset apply generally to all owners and there is no transfer of property. Therefore, there is no requirement to compensate. In this respect, it needs to be taken into account that while the introduction of security measures for the use of certain products or assets involves a public cost, not only does the property in such cases remain in the hands of the private owner, but also the owner directly benefits from a higher level of security or from the increased security in the use that others made of its property.

This doctrine was reflected in the Charter of Fundamental Rights of the European Union, which is included in the Draft Treaty of the European Constitution. The Charter establishes a distinction between measures of individual deprivation of property and general regulation of the use of private goods. It affirms that:

1. *Every person has the right to enjoy the property of the assets acquired legally, to use them, to dispose of them and to bestow them. No person can be deprived of its property except for a public purpose, in the cases and under the conditions prescribed by the law, and in exchange, within a reasonable time, of a just compensation for its loss. The use of property may be regulated by law to the extent that it is necessary in the public interest.*

2. *Intellectual property is protected*.

In conclusion, European Community law, as a result of its interpretation of the constitutional rights of its member states, has established that there is compatibility between, on the one hand, guaranteeing the right to hold private property which, if interfered with will attract compensation, and, on the other hand, imposing on such property obligations of use that are not subject to compensation.

Source: Ortega (2003).

[a] Protocol to the European Convention for the Protection of Human Rights and Fundamental Freedoms, as amended by Protocol No. 11, article 1.

[b] See, for example, the case of Pine Valley Development LTD& Others v. Ireland, 14 Eur. Ct. H.R. (ser. A) 319, 356 (1991); see also Orelemans v. The Netherlands, 15 Eur. H.R. Rep. 561 (1992).

A few recent EIIAs have also sought to exclude explicitly certain interferences with intellectual property rights from the definition of expropriation. For example, article 10.13 of the Free Trade Agreement between Chile and the Republic of Korea provides that the expropriation article:

> *does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, or to the revocation, limitation or creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with the TRIPS agreement.*

Thus, a party may modify intellectual property rights without being required to pay compensation under the expropriation article, but only if the modification is consistent with the TRIPS Agreement. The granting of a compulsory licence for intellectual property rights is also not to be considered an expropriation.

(ii) Conditions for lawful expropriation

The second issue is to define the requisites imposed on a host country for the expropriation to be considered legal. Among those conditions imposed are that the expropriation be for a public purpose, non-discriminatory, in accordance with due process of law, and accompanied by the payment of compensation. These are the conditions recognized by customary international law. The most debated of these conditions is the requirement of compensation. The compensation clause may specify the amount of compensation, the currency in which it is to paid, and the time period within which it is to be paid. The most common standards for determining the amount of compensation required are "fair market value", or simply "fair" or "just" compensation, but in some cases the more specific meaning of these terms is not specified.

As this suggests, the provisions vary in the level of detail with which they prescribe the conditions. Among the most detailed of such provisions is article 1110 of NAFTA, which provides as follows:

1. *No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:*
   (a) for a public purpose;
   (b) on a non-discriminatory basis;
   (c) in accordance with due process of law and Article 1105(1)[requiring treatment in accordance with international law, including fair and equitable treatment and full protection and security);
   (d) on payment of compensation in accordance with paragraphs 2 through 6.

2. *Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.*

3. *Compensation shall be paid without delay and be fully realizable.*

4. *If payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment.*

5. *If a Party elects to pay in a currency other than a G7 currency, the amount paid on the date of payment, if converted into a G7 currency at the market rate of exchange prevailing on that date, shall be no less than if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market of rate of exchange prevailing on that date and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.*

6. *On payment, compensation shall be freely transferable as provided in Article 1109 [the general transfers provision].*

The NAFTA provision requires payment in accordance with the traditional Hull formula of “prompt, adequate and effective” compensation. The Hull formula, named for the former Secretary of State o the United States Cordell Hull, reflects the position of the developed countries concerning what level of compensation should be paid for expropriated foreign investment. Upon further elaboration, these standards have been interpreted to mean that the compensation requires payment of fair market value without delay in a freely convertible currency. The trend among more recent EIIAs has been to incorporate language consistent with the Hull formula.

Another example of a relatively detailed provision is article VI of the ASEAN Agreement for the Protection and Promotion of Investment, which provides that:

> *[i]nvestments of nationals of companies of any Contracting Party shall not be subject to expropriation or nationalisation or any measure equivalent thereto (in this article referred to as “expropriation”), except for public use, or public purposes, or in the public interest, and under due process of law, on a non-discriminatory basis and upon payment of adequate compensation. Such compensation shall amount to the market value of the investments affected, immediately before the measure of dispossession became public knowledge and it shall be freely transferable in freely-usable currencies from the host country. The compensation shall be settled and paid without unreasonable delay. The national or company affected shall have the right, under the law of the Contracting Party making the expropriation, to prompt review by a judicial body or some other independent authority of that Contracting Party in accordance with principles set forth in this paragraph.*

Again, this provision adheres to the standards of prompt, adequate and effective compensation.

Other EIIAs, particularly older ones, use terms such as "fair" or "reasonable", but do not elaborate on the specific level of compensation. For example, article 9 of the Unified Agreement for the Investment of Arab Capital in the Arab States, states that:

> *[i]t shall, however, be permissible to:*

(a) *Seize property for the public benefit in accordance with the authority vested in the State or its institutions to perform their functions in implementing public projects, provided that this is done on a non-discriminatory basis in return for fair compensation and according to general legal provisions regulating the seizure of property for the purposes of the public benefit. The Arab investor shall be given the opportunity to challenge the legitimacy of any dispossession and the amount of compensation before the domestic courts. Compensation shall be made with a period not exceeding one year from the date when the decision to dispossess became final.*

Similarly, article 5 of the Agreement on Investment and Free Movement of Capital Among Arab Countries provides that:

> *[a]dmitting the inalienable right of the state recipient of the capital to nationalize, confiscate and expropriate within the framework of the public interest, the Arab investor shall be entitled in such cases to fair and effective compensation within a reasonable period of time.*

In some cases, the formula seems to reflect the Hull formula at least in part. For example, the Treaty Establishing the Common Market for Eastern and Southern Africa states that member States shall:

(a) *subject to the accepted principle of public interest, refrain from nationalizing or expropriating private investment; and*
(b) *in the event private investment is nationalized or expropriated, pay adequate compensation.*

The term "adequate" appears to be drawn from the Hull formula, but the elements of promptness and effectiveness are omitted. By contrast, article 42 of the Free Trade Agreement between the EFTA States and Singapore provides that:

> *None of the Parties shall take, either de jure or de facto, measures of expropriation or nationalisation against investments of investors of another Party, unless such measures are in the public interest; non-discriminatory; carried out under due process of law; and accompanied by the payment of compensation. The amount of compensation shall be settled in a freely convertible currency and paid without delay to the person entitled thereto without regard to residence or domicile.*

Thus, this agreement does not address the amount of compensation, but does require that it be paid promptly and in a freely convertible currency.

* * * * *

The standard of compensation to be paid upon expropriation has been, and remains, one of the most important issues of expropriation provisions. EIIAs vary in the degree of specificity with which they describe the compensation that must be paid, but to the extent that any detail is provided the formula usually suggests fair market value. Recently, an issue that has raised greater concerns is the scope of the expropriation provision. Host countries may fear that a regulatory action, such as the enactment of environmental regulations, that impairs the value of an investment may be regarded as an expropriation requiring payment of compensation that a developing country in particular may not be able to afford. One potential solution is to craft the expropriation provision so as to clarify its scope, although no formula that is acceptable to all parties is likely to remove all doubt. A second potential solution is to narrow the definition of "investment" so as to limit the types of assets to which the provision might apply, although this has the effect of limiting the applicability of the entire agreement and thus potentially undermining its effectiveness. Another potential solution is to take certain regulatory actions, such as environmental measures, outside the scope of the agreement through the use of general exceptions. Here can be seen the important interaction between the provisions on the scope of the agreement and the substantive provisions. Alternatively, a narrower exception to the expropriation provision alone can be drafted. Whichever approach is adopted, the usual caveats about exceptions apply, although they can undermine the effectiveness of the treaty and create their own uncertainties.

d. Intellectual property

Provisions specifically addressing the protection of intellectual property rights traditionally were not part of the investment protection package granted by IIAs. However, they have become increasingly common in EIIAs since the 1990s. They appear in most types of EIIAs, including agreements that address investment liberalization as well as agreements that cover both liberalization and protection.[87] In some EIIAs, the protection of intellectual property rights is dealt with in a separate chapter with detailed provisions. This is the case of recent NAFTA-type EIIAs, such as the Australia-Thailand and Japan-Singapore agreements.

EIIAs generally have one of three types of provision on intellectual property protection. They may require adherence to international intellectual property protection agreements, require that a certain minimum standard of protection be provided or require non-discrimination with respect to intellectual property rights protection.

The first approach is to ensure that the protection of intellectual property rights meets existing international standards. For example, article 37 of the Euro-Mediterranean Agreement with Egypt provides that:

> *Pursuant to the provisions of this Article and of Annex VI, the Parties shall grant and ensure adequate and effective protection of intellectual property rights in accordance with the prevailing international standards, including effective means of enforcing such rights.*

Annex VI then lists a number of multilateral agreements on the protection of intellectual property which Egypt commits itself to joining within four years, and confirms the importance of the obligations under several additional agreements.

A number of agreements, particularly those negotiated by the EFTA States with transitional economies and North African states, include a similar provision, but also provide for

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[87] For example, intellectual property protection provisions appear in most types of EIIA signed by the European Community and EFTA, and they also appear in the NAFTA and NAFT- type agreements, including recent FTAs signed by the United States, as well as recent bilateral EIIAs signed between developing countries (e.g. CARICOM-Costa Rica, Mexico-Uruguay and Chile-Republic of Korea).

national and MFN treatment, subject to exemptions in accordance with the TRIPS Agreement. For example, article 17 of the agreement with the Slovak Republic provides:

> 2. *The States Parties to this Agreement shall accord to each other's nationals treatment no less favourable than that they accord to their own nationals. Exemptions from this obligation must be in accordance with the substantive provisions Article 3 of the TRIPS Agreement.*
>
> 3. *The States Parties to this Agreement shall accord to each other's nationals treatment no less favourable than that accorded to nationals of any other State. Exemptions from this obligation must be in accordance with the substantive provisions of the TRIPS Agreement, in particular Articles 4 and 5 thereof.*

EIIAs also may create their own substantive rules for the protection of intellectual property rights. For example, the Free Trade Agreement between Australia and the United States requires adherence to certain international conventions, but in a series of articles in chapter 15 sets forth detailed protections that the parties are required to provide with respect to matters such as trademarks, geographical indications, domain names on the Internet, copyright, encrypted program-carrying satellite signals, and patents.

Some agreements do not provide for any absolute standards of protection for intellectual property rights, but do provide for national treatment or non-discrimination with respect to protection of intellectual property. For example, article 5 of the Common Convention on Investments in the States of the Customs and Economic Union of Central Africa provides that:

> *[f]oreign undertakings shall enjoy the same rights and protection regarding trade-marks and patents, trade labels and names and any other industrial properties as undertakings possessing the nationality of the member countries of the Union.*

Intellectual property generally falls within the definition of investment and thus is protected against many forms of host country interference by the various investment protection provisions of the EIIA. Most EIIAs provide only limited protection, however, against private interference. The significance of the specific provisions on intellectual property protection is that they do protect intellectual property against private interference.

As noted in the previous section, a few recent EIIAs have begun to include provisions clarifying the extent to which intellectual property is protected even against host country interference, specifically expropriation. Thus, even while EIIAs are including increasingly elaborate provisions to protect intellectual property rights against private infringement, they are circumscribing slightly the protection against host country interference.

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Provisions for the protection of intellectual property rights may provide only for non-discriminatory treatment in this respect and, if investment is defined to include intellectual property rights, may not provide any more protection than was already provided by the treaty's general provisions on non-discrimination. Alternatively, these provisions may require the parties to adhere to various existing multilateral agreements on investment protection. Whether to adhere to each of these agreements raises its own policy concerns, which can be addressed through the decision to include or exclude such agreements in drafting the list of multilateral treaties to which the parties agree to adhere. It is important to consider, however, whether the parties have agreed to adhere to the other agreements or whether the parties have actually incorporated by reference the content of the other agreements into the EIIA. If the latter is the case, violations of the other agreements may be remediable under the dispute resolution provisions of the EIIAs.

e. Investor-State dispute settlement

EIIAs often provide for the possibility of settling disputes by means of consultations and negotiations between the parties. Some EIIAs (e.g. association agreements and partnership and cooperation agreements concluded by the EC) specifically entrust these consultations and negotiations to the body (e.g. cooperation or association councils) charged with monitoring and implementing the agreement.

Certain EIIAs include provisions authorizing arbitration of disputes involving the treaty between foreign investors and host States without the involvement of the investor's home State. These provisions are found mainly in EIIAs that address investment protection issues only, as well as in EIIAs that address both investment protection and liberalization.[88] However, many EIIAs, particularly those that emphasize investment liberalization rather than investment protection, do not include a right to investor-State dispute resolution. Thus, EIIAs signed by the EC with third countries, for example, do not have special provisions on the settlement of investment disputes. Instead, investment disputes arising from these agreements are dealt with under the general disputes settlement provisions, which are at the State-to-State level. Finally, some highly integrated groups have set up permanent institutions to address and adjudicate on issues relating to the interpretation and application of the EIIA (e.g. the EC European Court of Justice).[89]

Under customary international law, a State is not subject to the jurisdiction of an international tribunal unless the State consents. Moreover, under customary international law foreign investors are subject to the jurisdiction of the host State. For these reasons, typically the investor-State EIIA provision includes the consent of the host State to arbitration of certain investment-related disputes, usually those arising under the investment provisions of the EIIA.

Occasionally, an EIIA contains language that provides for investor-State dispute resolution only upon further agreement of the parties. For example, article 48 of the Free Trade Agreement between the EFTA States and Singapore authorizes international arbitration of disputes between investors and the host State, but only if both parties mutually agree. The agreement authorizes submission of the dispute to ICSID, the Additional Facility of ICSID or an ad hoc tribunal under the UNCITRAL Rules.

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[88] For a comprehensive and detailed discussion of issues involved in investor-State disputes settlement, see UNCTAD (2003b). For a review of investor--State arbitration cases and the issues they raise, see UNCTAD (2005b, forthcoming).

[89] For a comprehensive and in-depth discussion of issues involved in State-State disputes settlement, see UNCTAD (2003c).

Similarly, the Australia-United States FTA includes a provision that calls for consultations in the event that either party wishes to establish an investor-State dispute resolution mechanism. Article 11.16 provides that:

> *[i]f a Party considers that there has been a change in circumstances affecting the settlement of disputes on matters within the scope of [the investment chapter] and that, in light of such change, the Parties should consider allowing an investor of a Party to submit to arbitration with the other Party a claim regarding a matter within the scope of this Chapter, the Party may request consultations with the other Party on the subject, including the development of procedures that may be appropriate…*

It appears from the language that both parties believed that an investor-State dispute resolution mechanism was unnecessary, presumably in the light of the nature of the legal system in the two countries, and thus both parties preferred that disputes be submitted to domestic courts. At the same time, however, a provision was made for creating an investor-State dispute resolution mechanism in the event that the situation changed and either party believed such a mechanism to be desirable.

One issue that arises in this type of provision involves the selection of arbitral mechanisms that may be used. It has become fairly common practice for EIIAs to permit the investor to select from among more than one mechanism. Because EIIAs are often regional agreements, arbitral mechanisms based in a particular region are sometimes identified as a potential dispute resolution mechanism in an EIIA.

For example, the ASEAN Agreement for the Protection and Promotion of Investments provides for arbitration of any dispute between the investor and the host State arising directly out of an investment. Arbitration may be before ICSID, an ad hoc panel under the UNCITRAL Rules, the Regional Center for Arbitration in Kuala Lumpur or any other regional centre for arbitration in ASEAN. Unlike some EIIAs, the ASEAN agreement does not allow the investor to choose the arbitral procedure, but calls for selection through mutual agreement. If agreement cannot be reached, the agreement specifies a mechanism for formation of an ad hoc tribunal that will determine its own procedure.

The most elaborate provision for investor-State arbitration may be found in the NAFTA and some of the recent FTAs that follow the NAFTA model. The NAFTA authorizes the investor to submit claims that the host State has breached the investment chapter of the NAFTA to arbitration before ICSID, the Additional Facility or an ad hoc tribunal under the UNCITRAL Arbitration Rules. The NAFTA provision, which is far too detailed to quote here, addressed a number of issues on which other provisions found in EIIAs are often silent, such as the submission of the same dispute to local courts, the place of arbitration, appointment of experts, remedies available, including interim measures, and finality and enforcement of awards (UNCTAD, 2003b).

Although investor-State dispute settlement provisions originate from BIT practice, several provisions of the NAFTA investor-State dispute resolution provision reflect the fact that an agreement with more than two parties may raise concerns that do not originate from a bilateral investment treaty. Article 1128 allows a party to the treaty that is not a party to the dispute to make submissions to the tribunal on issues involving the interpretation of the agreement, while article 1129 allows any party to obtain copies of the evidence and arguments submitted by the disputants. Article 1126 authorizes the formation of a special tribunal to assume jurisdiction over separate claims that have a question of law or fact in common, a mechanism to promote efficient dispute resolution as well as to avoid inconsistent results.

Recent EIIAs that follow the NAFTA model have added provisions intended to address certain concerns that have arisen over the years as investor-State dispute resolution mechanisms have been applied to resolve disputes. One such concern involves the lack of transparency of the proceedings. Two groups in particular have reason for concern. First, investors protected by the agreement, but not parties to the dispute, as well as the home country (which presumably will also not be a party to the dispute) may be concerned that provisions that affect their interests will be interpreted, without their participation, in ways that will affect them adversely in the future. Second, various groups within the territories of the parties may be concerned that the arbitration could affect their interests, without their participation. For example, an overly broad interpretation of the expropriation provision that restricted the host country's ability to enact environmental regulations could affect adversely the regulatory powers of the home State as well as the host State, and could also affect those interested in protecting the environment in the territories of the parties. In response to such concerns, article 10.20 of the Free Trade Agreement between Chile and the United States, for example, requires the respondent to transmit to the home country and to make available to the public certain documents, including the notice of arbitration, the memorials, the transcripts of hearings and the awards of the tribunal. That article also requires that the hearings be open to the public, although provisions are made for the protection of confidential business information. These provisions do not require the parties to make public any settlement discussions, nor do they interfere with the confidentiality of the tribunal's deliberations. They do, however, ensure that the public has access to the evidence submitted (other than confidential proprietary information), the legal arguments made and the decisions rendered.

The Chile-United States FTA also expands upon article 1128 in the NAFTA, which authorizes the parties that are not involved in the dispute to submit briefs. Specifically, article 10.19 authorizes the tribunal to consider submissions from anyone. Thus, any person can observe the proceedings and potentially make submissions. Transparency provisions serve certain important goals but, like most treaty provisions, impose costs and circumscribe the discretion of the parties (see UNCTAD (2005b, forthcoming).

Another concern that has arisen is the possibility of incorrect or at least inconsistent decisions. Some have proposed that arbitrations be subject to appeal. For example, the same Chile-United States FTA provides in annex 10-H that within three years after entry into force of the agreement, the parties shall consider whether to establish a bilateral appellate body to review awards. Furthermore, article 10.19 provides that if the parties are parties to a multilateral agreement that establishes an appellate body to review awards by tribunals established pursuant to an international trade or investment agreement, the parties shall strive to reach an agreement that would permit that appellate body to review awards under the investor-State dispute resolution mechanism of the FTA. The free trade agreement concluded by the Central American States, the United States and the Dominican Republic goes even further. Annex 10-F provides that, within three months of entry into force of the agreement, the commission created by the agreement shall establish a negotiating group to develop an appellate body to review awards rendered by a tribunal established through the investor-State dispute resolution mechanism. The appellate body *"shall be designed to provide coherence to the interpretation of investment* *provisions in the Agreement"*. The negotiating group is instructed to take into account certain issues, including but not limited to:

(a) the nature and composition of an appellate body or similar mechanism;
(b) the applicable scope and standard of review;
(c) transparency of proceedings of an appellate body or similar mechanism;
(d) the effect of decisions by an appellate body or similar mechanism;
(e) the relationship of review by an appellate body or similar mechanism to the arbitral rules that maybe selected under [the investor-State dispute resolution mechanism]; and
(f) the relationship of review by an appellate body or similar mechanism to existing domestic laws and international law on the enforcement of arbitral awards.

The negotiating group is charged with providing a draft amendment to the agreement within one year of the formation of the group.

A related concern is that the same investment dispute may be submitted to multiple forums, which will thus require the host State to respond to the same claims more than once and raise the possibility of inconsistent decisions. Of special concern is the possibility that the investor may submit a dispute to the domestic courts of the host State and to international arbitration. In the past, this problem has been at least partially addressed in EIIAs by a provision that the dispute may be submitted to arbitration under the investor-State dispute resolution mechanism only if it has not already been submitted to local tribunals. That is, if the investor submits the dispute to the domestic courts, the right to submit it to arbitration under the investor-State dispute resolution mechanism is lost. More recent provisions appearing in the EIIAs attempt to foreclose another approach by investors, which is to submit the dispute to arbitration and then submit it to local courts. For example, article 14.3 of the Australia-Singapore agreement conditions the consent of the host State to arbitration upon the investor's waiving of:

> *"its right to initiate or continue any proceedings (excluding proceedings for interim measures of protection . . . before any of the other dispute settlement fora referred to [this article] in relation to the matter under dispute."* The other forums to which the waiver would apply include *"the courts or administrative tribunals of the disputing Party"*.

Some EIIAs have limited the parties that can file claims, thus potentially reducing the number of claims submitted arising out of the same dispute. For example, article 10.21 of the Free Trade Agreement between Chile and the Republic of Korea provides that an investment may not submit a claim under the investor-State dispute resolution mechanism. Thus, only the investor may submit a claim. Of course, an investment may have many investors, not all of whom have the same nationality. Thus, this provision does not entirely prevent the submission of the same dispute to multiple forums. The provision serves another purpose in any event. Because the investment is made in the territory of the host country, the provision avoids the possibility that a host State will be engaged in an international arbitration with a company that is its own national (though owned by foreign nationals). Investors are covered by the treaty only if they are nationals of the other party, and so the concern does not arise in their case.

Investor-State dispute resolution mechanisms in EIIAs sometimes apply to disputes concerning an investment and are not explicitly limited in their application to disputes arising out of a violation of a provision of the EIIA. Thus, while they may appear in an investment chapter, they could potentially be invoked to enforce provisions of other agreements, including other multilateral agreements, as long as those disputes relate to covered investment.

* * * * *

The negotiation of an EIIA is likely to raise the issue of whether to include a provision for investor-to-State dispute resolution and, in particular, how to define the scope of the provision. No agreement, no matter how well crafted, can anticipate every question that may arise and the spread of foreign investment means that disputes concerning investments are inevitable. Historically, investment disputes were resolved by negotiation or even arbitration between the home and host States, which meant that these disputes could become a political issue between the two States. The investor-State dispute resolution mechanism is intended to remove the home State from the dispute, without depriving the investor of a means of resolving the dispute. Its inclusion, however, also means that the host State's future investment policy decisions may be subject to review by arbitral tribunals formed in cooperation with affected investors. Defining the range of disputes to which the provision applies is an important way of circumscribing the category of policy decisions subject to arbitral review.

Some EIIAs give potentially wide scope to the investor-State dispute resolution mechanism by making it applicable to disputes concerning an investment, which may include disputes that do not arise under the agreement. This gives the broadest assurance to a potential investor, but also opens the possibility that disputes arising under other agreements or even under domestic law will be subject to international arbitration. Other EIIAs limit the scope of the provision to disputes arising under the agreement or, if the agreement involves subjects other than investment, to disputes arising under the investment chapter of the agreement. In that situation, the scope of the investor-to-State dispute resolution mechanism depends upon the scope of the substantive provisions of the agreement. The interactions can be complex. For example, the MFN clause of an investment agreement could entitle an investor of one State to treatment guaranteed to investors of another State by a different agreement, with the result that the investor-State dispute resolution provision could be used ultimately to interpret and apply to the circumstances of an investor commitment made to other States in other agreements. Similarly, to the extent that an EIIA refers to or incorporates obligations under other agreements, such as the GATS, TRIPS or TRIMs agreements, disputes involving the interpretation or application of those agreements could be subject to the investor-State dispute resolution mechanism of the EIIA.

Complexities may also arise where multiple chapters of an agreement apply to the same investment. For example, services that are delivered through a commercial presence could be protected by both the trade-in-services chapter and the investment chapter of an EIIA. A regulatory act by the host State might be alleged to have violated both chapters, thus allowing the investor to invoke the investor-State dispute resolution mechanism of the investment chapter as well as the dispute resolution mechanism applicable to the services chapter. To the extent that the commitments made under the services chapter parallel commitments made under the GATS, the dispute may simultaneously be presented to both the WTO dispute resolution procedures and the investor-to-State dispute resolution mechanism. Countries may wish to incorporate language into the agreement that would require an election of remedies and prevent resolution of the same dispute through multiple processes.

Because EIIAs often have more than two parties, the investor-to-State dispute resolution mechanism can raise policy issues that do not arise under BITs. For example, one party may be involved in an investment dispute that will result in an interpretation of the agreement that will affect the other parties in the future. To protect their interests, all parties may wish to have the opportunity to participate in any dispute resolution procedure involving the interpretation or application of the agreement. Such a provision, however, may limit the ability of the State involved in the dispute to control or maintain the confidentiality of the proceedings.

Numerous policy choices present themselves in the details of the investor-to-State dispute resolution mechanism. One of the most important decisions is the choice of mechanisms that will be available. As noted above, many EIIAs specify arbitration through ICSID or an ad hoc tribunal operating under the UNCITRAL rules, but other alternatives are available and each has its own peculiarities. The parties are also free to agree on matters not covered by the rules of the applicable dispute resolution mechanism. For example, the parties may wish to specify the location of any arbitration, a matter that can affect the cost of arbitration as well as the enforceability of the arbitral decision.

4. Investment Promotion

A fourth set of investment issues addressed in EIIAs concerns investment promotion. A major objective of an EIIA's liberalization and protection provisions is to encourage investment flows between the parties. In addition, many EIIAs, especially EIIAs involving countries at different levels of development, or between developing countries, include provisions requiring the parties to cooperate in promoting investment flows among themselves. This is the case, for example, with the EC partnership and cooperation agreements, Euro-Mediterranean agreements and some EFTA agreements. Other EIIAs only require the parties to engage in cooperation, one aim of which is investment promotion.[90] On the other hand, agreements signed by the United States and involving developing countries do not normally contain specific promotion commitments.

Investment promotion provisions in EIIAs may be analysed according to several characteristics. These include the nature of the obligation assumed, the intended beneficiary of the promotion efforts and the party upon whom the obligation is placed.

The nature of the obligation assumed is generally of one of three types.

The first type is a general commitment to promote investment flows, often stated as part of a larger commitment to economic cooperation. For example, article 3 of the Framework Agreement for Cooperation between the European Economic Community and the Cartagena Agreement provides that.

> *The Contracting Parties, taking into account their mutual interest and medium- and long-term economic objectives, undertake to establish between themselves economic cooperation of the widest possible scope, from which no field of activity is excluded in principle. The aims of such cooperation shall be in particular to... encourage the flow of investment and the transfer of technology and reinforce investment protection....*

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[90] This is the case, for example, with the recent agreements signed between Australia and Japan, between Australia and China, between ASEAN and China, between India and Thailand, between Canada and South Africa, and SAFTA, among others.

The second type of commitment specifies certain activities that the parties may undertake to promote investment flows. These may include, for example, information exchange, technical assistance or encouraging cooperation among private entities. Thus, article 4 of the Cooperation Agreement between the European Community and the Republic of India on Partnership and Development, after stating one of its aims to be to *"encourage the two-way flow of Community-Indian trade and investments"*, lists the following means which the parties:

shall consider. . .to achieve these aims:

- *exchange of information and ideas,*
- *preparation of studies,*
- *provision of technical assistance,*
- *training programmes,*
- *establishment of links between research and training centres, specialized agencies and business organizations,*
- *promotion of investment and joint ventures,*
- *institutional development of public and private agencies and administrations,*
- *access to each other's existing data bases and creation of new ones,*
- *workshops and seminars,*
- *exchanges of experts.*

The third type of provision authorizes preferences for certain covered investors. This type of provision, which is typically too lengthy to be quoted here, is generally found in older agreements among African or Arab States.[91]

EIIAs are often written as if all parties are intended to be the beneficiaries of efforts to promote investment flows. For example, the investment promotion provisions of article 13-16 of the Free Trade Agreement between Costa Rica and Mexico are intended to *"increasing reciprocal investments"*. The same approach is found in many free trade agreements between Latin American countries.

Some agreements, however, specify that the intent of the provision is to promote investment in the territory of one of the parties to the agreement only. For example, article 74 of the association agreement between the European Community and Romania provides that:

1. *Cooperation shall aim to establish a favourable climate for private investment, both domestic and foreign, which is essential to economic and industrial reconstruction in Romania.*

2. *The particular aims of cooperation shall be:*
    - *for Romania to establish a legal framework which favors and protects investment,*
    - *the conclusion by the Member states and Romania agreements for the promotion and protection of investment,*
    - *to implement suitable arrangements for the transfer of capita,*
    - *to bring about better investment protection,*
    - *to proceed with deregulation and to improve economic infrastructure,*

[91] For example, the 1970 Agreement on Investment and Free Movement of Arab Capital among Arab Countries signed by the members of Arab Economic Community , the 1965 Common Convention on Investments signed by the members of the UDEAC, and the 1982 Community Investment Code signed by the members of the Great Lakes Economic Community.

- *to exchange information on investment opportunities in the form of trade fairs, exhibitions, trade weeks and other events.*

Similarly, article 46 of the Euro-Mediterranean Agreement between the European Communities and Egypt provides *that "[c]ooperation shall aim at increasing the flow of capital, expertise and technology to Egypt…"* and then lists a variety of mechanisms to be used.

In these agreements, both parties have assumed an obligation. The obligation, however, is to promote investment flows into the territory of one of the parties only. The Cotonou Agreement provides another example (box IV.2).

Box IV.2. Investment promotion provisions in the Cotonou Agreement

The Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States, of the One Part, and the European Community and Its Member States, of the Other Part does not include substantive provisions on investment liberalization or protection, leaving instead these matters to be developed in future reciprocal partnership agreements. The agreement does include, as part of its cooperation strategies, detailed provisions aimed at encouraging development-oriented private investment flows to the ECP countries.

Investment promotion

In article 75 of the Agreement, the EC and ACP States recognize the importance of private investment in the promotion of their development cooperation and acknowledge the need to take *inter alia* the following steps to promote such investment:

- Implement measures to encourage participation in their development efforts by private investors who comply with the objectives and priorities of ACP-EC development cooperation and with the appropriate laws and regulations of their respective States;
- Take measures and actions which help to create and maintain a predictable and secure investment climate, as well as enter into negotiations on agreements which will improve that climate;
- Encourage the EU private sector to invest and to provide specific assistance to its counterparts in the ACP countries under mutual business cooperation and partnerships;
- Facilitate partnerships and joint ventures by encouraging co-financing;
- Sponsor sectoral investment forums to promote partnerships and external investment;
- Support efforts of the ECP countries to attract financing, with particular emphasis on private financing, for infrastructure investments and revenue-generating infrastructure critical for the private sector;
- Support capacity building for domestic investment promotion agencies and institutions involved in promoting and facilitating foreign investment;
- Disseminate information on investment opportunities and business operating conditions in the ACP countries; and
- Promote national, regional and ECP-EU private sector business dialogue cooperation and partnerships, in particular through an ACP-EU private sector business forum.

Investment guarantees

In article 77 of the partnership agreement, the parties recognize also that investment guarantees are an increasingly important tool for development finance as they contribute to reducing risks and generating private capital flows. They therefore agree that cooperation shall ensure the increasing availability and use of risk insurance as a risk-mitigating mechanism in order to boost investment confidence in the ACP countries.

/…

Box IV.2. Investment promotion provisions in the Cotonou Agreement (concluded)

In addition, they agree that cooperation shall offer guarantees and assist with guarantee funds covering risks for qualified investment. Specifically, cooperation shall provide support to:

- Reinsurance schemes to cover foreign direct investment by eligible investors against legal uncertainties and the major risks of expropriation, currency
- Investors may insure projects for any combination of the four types of coverage;
- Guarantee programmes to cover risk in the form of partial guarantees for debt financing. Both partial risk and partial credit guarantee shall be available; and
- National and regional guarantee funds, involving, in particular, domestic financial institutions or investors, for encouraging the development of the financial sector.

Cooperation shall also provide support to capacity-building, institutional support and participation in the core funding of national and/or regional initiatives to reduce the commercial risks for investors (*inter alia* guarantee funds, regulatory bodies, arbitration mechanisms and judiciary systems to enhance the protection of investments improving the export credit systems).

Cooperation shall provide such support on the basis of complementary and added value with respect to private and/or public initiatives and, whenever feasible, in partnership with private and other public organizations. The ACP and the EC within the framework of the ACP-EC Development Finance Corporation Committee shall undertake a joint study on the proposal to set up an ACP-EC guarantee agency to provide and manage investment guarantee programmes.

Investment protection

In article 78, the ACP and the European Community States affirm, within the scope of their respective competencies, the need to promote and protect each party's investments on their respective territories, and in this context affirm the importance of concluding, in their mutual interest, investment promotion and protection agreements which could also provide the basis for insurance and guarantee schemes.

In addition, in order to encourage European investment in development projects of special importance to, and promoted by, the ACP States, the Community and the ACP States may also conclude agreements relating to specific projects of mutual interest where the Community and the European enterprises contribute to their financing.

The parties also agree to introduce, within the economic partnership agreements, and while respecting the respective competencies of the Community and its member States, general principles of protection and promotion of investments, which will endorse the best results agreed in the competent international forums or bilaterally.

Source: UNCTAD (1996-2005, vol. VI, pp. 452-455).

* * * * *

When negotiating investment promotion provisions, policy issues arise concerning the level of detail at which to specify the parties' obligations, the identity of the parties who are intended to benefit from investment promotion activities, and the identity of the parties who are obligated to engage in the specified activities. For example, where the EIIA is a bilateral agreement between a developed and a developing country or is an agreement between a group of developed countries, such as EFTA, and a developing country, the agreement may call for investment promotion in the developing country. Where the EIIA is a regional agreement among developing countries, all parties are likely to be intended beneficiaries. Among the most critical issues may be whether the agreement creates a mechanism to ensure that investment promotion activities actually occur. This may be done, for example, through the creation of a standing body or through a requirement for periodic consultations.

5. Investment Regulation

A fifth set of policy issues involves investment regulation. EIIAs often include provisions intended to regulate investment. The most common provision of this kind is one intended to limit practices that restrict or distort competition. Provisions regulating restrictive business practices appear in most types of EIIAs signed by the European Community and EFTA countries with third countries, as well as in the recent bilateral free trade agreements that expand and elaborate on the NAFTA model. The breadth and depth of these provisions vary considerably between different types of EIIA.

Provisions on competition in EIIAs can be traced to the Treaty of Rome. Article 81 of that treaty (consolidated text) provides that:

> *[t]he following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which has as their object or effect the prevention, restriction or distortion of competition within the common market and in particular those which:*
>
> *(a) directly or indirectly fix purchase or selling prices or any other trading conditions;*
> *(b) limit or control production, markets, technical development, or investment;*
> *(c) share markets or sources of supply;*
> *(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*
> *(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.*

Article 81 goes on to state that *"[a]ny agreements or decisions prohibited pursuant to this Article shall be automatically void"*. It allows exceptions, however, for some agreements, decisions and practices that contribute to improving the production or distribution of goods or to promoting technical or economic progress. Article 82 requires the parties to prohibit any abuse of a dominant position within a substantial portion of the common market. Additional articles create mechanisms for implementing the principles of articles 81 and 82.

The agreements of association concluded by the European Community with transitional economies in Europe contain a provision on competition that is similar in scope. For example, article 64 of the agreement with Bulgaria declares incompatible with the functioning of the agreement not only decisions, practices or agreements which have as their object or effect the prevention, restriction or distortion of competition and abuses of dominant position, but also any public aid that distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods. Practices contrary to that article are to be assessed on the basis of criteria arising from the application of the provisions of the Treaty of Rome. The agreement establishes a mechanism for adopting rules to implement article 64. The Euro-Mediterranean Agreements take a similar approach.

The EFTA free trade agreements with non-member States have a similar scope, but are different in operation. For example, article 18 of the EFTA agreement with Romania declares as incompatible with the proper functioning of the agreement those decisions, practices and agreements that have as their object or effect the prevention, restriction or distortion of competition and abuse of dominant position. After three years, this provision will also apply to public undertakings and undertakings for which the Parties grant special or exclusive rights insofar as the application of the provisions does not obstruct the performance of the particular public tasks assigned to them. The EFTA provision, however, does not establish a mechanism for adopting directives nor does it declare such activities automatically void. Rather, it allows a party to the agreement to take appropriate measures in the event that it considers that a given practice is incompatible with article 18 and that the practice threatens serious prejudice to the interests of that State or material injury to its domestic industry.

Extensive provisions on competition policy have also begun to appear in recent EIIAs that do not involve a European State, although such provisions typically take a different approach from the European provisions. For example, the Free Trade Agreement between Australia and the United States contains a separate chapter on competition-related matters. Article 14.2 provides *that "[e]ach Party shall maintain or adopt measures to proscribe anticompetitive business conduct and take appropriate action with respect thereto…"* Thus, the Australia-United States agreement does not define as precisely the sorts of conduct to which it applies nor does it declare such conduct unlawful. Rather, it obligates the parties to proscribe *"anticompetitive business conduct,"* without defining the term, and requires each party to maintain an authority responsible for enforcing its national competition laws. Article 14.3 of the Australia-United States agreement permits each party to designate monopolies, although these designated monopolies are subject to certain restrictions. For example, a designated monopoly must act in a manner not inconsistent with the party's obligations under the agreement when exercising any regulatory, administrative or other governmental authority delegated to it, must act solely in accordance with commercial considerations in purchasing or selling the monopoly good or service in the relevant market, must provide non-discriminatory treatment to covered investment and to goods and service suppliers of the other party in purchasing or selling the monopoly good or service, and may not use its monopoly position to engage in anticompetitive practices in a non-monopolized market in its territory where such practices adversely affect covered investment. Under article 14.4, State enterprises may not act in a manner that is inconsistent with the party's obligations under the agreement when exercising any regulatory, administrative or other governmental authority or must accord non-discriminatory treatment in the sale of its goods or services. The agreement, at articles 14.8, 14.9, and 14.10, respectively, requests the parties to make available to the other party upon request certain public information concerning anticompetitive business conduct, to cooperate to promote competition policies and to enter into consultations upon the request of either party. The agreement, however, excludes from any dispute settlement mechanism under the agreement matters arising under article 14.2 (the article that requires the parties to proscribe anticompetitive business conduct).

On the other hand, NAFTA's chapter on competition (Chapter Fifteen) does not directly regulate anticompetitive practices. Instead, article 1501(1) calls upon each party to adopt measures to proscribe anticompetitive business conduct. The article further provides for consultations to discuss the effectiveness of the measures undertaken by each party. Article

1501(2) calls for cooperation and coordination on issues of competition law enforcement, including mutual assistance, notification, consultation and exchange of information relating to the enforcement of competition laws and policies in the free trade area.

The competition provision differs from other EIIA provisions in that, while most other provisions seek to insulate foreign investment from host country regulation, this provision requires the host country (or a competent intergovernmental body) to impose restrictions on the operation of investments. It is also unusual in that, by its terms, it applies equally to foreign and domestic investment, although where the host country fails to restrict the anticompetitive behaviour of a foreign investment, an injured domestic investor often would not have any remedy under the treaty and the investment's home country is unlikely to complain. Thus, despite its even-handed language, the provision in practice may actually be principally a restriction on domestic investors. Of course, in the case of an EIIA with more than two parties, one of the parties other than the home or host State might object if the host State fails to restrict anticompetitive behaviour by a foreign investment. This is one instance in which the practical application of the agreement may be different, depending upon whether or not it is bilateral.

In any event, it is easy to conclude that this provision, despite being structured as a restriction on investment, is intended principally to protect foreign investment against natural or State-created advantages enjoyed by domestic investors. Thus, the competition provisions may be seen as investment protection provisions in that they protect foreign investment against the conduct of private parties. In that sense, they are similar to the intellectual property provisions that have been common in EIIAs. Competition provisions may also be regarded as investment liberalization provisions in that they are intended to remove potential barriers to the entry of foreign investment. They differ from other investment liberalization provisions, however, in that the barriers being removed may be created by private competitors rather than the host country itself. In any event, to the extent that the host country wishes to allow a particular domestic firm to enjoy a monopoly position as part of its development policy, it will need to exclude, or negotiate an exception to, this provision.

* * * * *

In existing EIIAs investment regulation mainly takes the form of provisions to restrict anticompetitive behaviour and they are widely found in agreements with the European Community or with EFTA. The core provisions normally apply to anticompetitive behaviour by investments and to that extent the provisions are nominally even-handed in that they apply to local and foreign investment equally, although local investors may lack the means to enforce the provisions. Some provisions, however, go further and apply to State action, such as public aid, that favours one investment over another, action that may also be inconsistent with the agreement's non-discrimination provisions, depending upon who the recipient of the public aid is. This raises the question whether the host country may wish to preserve the prerogative to spend its tax revenues for the benefit of certain industries in at least some cases, which may require the negotiation of narrower language in the competition provision or the insertion of exceptions.[92] Policy questions also arise concerning how these restrictions are to be enforced, given that they are directed at non-parties to the agreement, namely investments, rather than the States. The EIIA may require that a mechanism be established to enforce the provisions or it may simply

[92] It also raises issues of the relationship between competition provisions and any provisions dealing with subsidies and other incentives contained in the agreement in question.

require consultations in the event that one party believes a violation exists. Some agreements declare certain anticompetitive behaviour unlawful, thus creating the possibility, depending upon the domestic legal system of the State, that a foreign investment might be able to directly challenge the anticompetitive behaviour in local courts on the basis of its illegality under the treaty.[93]

* * * * *

The foregoing comparative analysis of investment provisions in EIIAs confirms the earlier observation that the majority of these provisions have been influenced by previous EIIAs and by other investment agreements, notably by the BITs and the WTO Agreements. At the same time, important differences remain between EIIAs and other investment agreements.

Moreover, while it is possible to identify a number of patterns in relation to the purposes, structures and the approaches to investment in recent EIIAs, even similar types of EIIAs exhibit important variations with respect to the coverage of investment issues and the formulation of specific investment provisions. These variations indicate different degrees of depth in the level of investment integration afforded by EIIAs.

In the final analysis, the scope and content of individual investment provisions of an EIIA depend to a significant extent on their interaction with other provisions of the agreement. The interaction may involve specific provisions on investment among themselves and/or with general provisions of the agreement, as well as with specific provisions on trade or other economic transactions. In turn, these interactions between an expansive set of rules within an EIIA addressing investment as well as other economic transactions, such as trade in goods, services, knowledge and labour, increase the risk of overlaps and inconsistencies. In these circumstances, the interpretation and application of EIIA rules become increasingly difficult and prone to disputes. To avoid or minimize these difficulties, EIIAs have developed a number of devices that are discussed in the next chapter.

At the same time, the proliferation of EIIAs (and other investment agreements) with overlapping membership is creating a multilayered and multifaceted web of interrelated investment rules and commitments (see the "spaghetti bowl", figure I.1. above). This raises a number of policy challenges. In particular, while EIIAs and other agreements may generally be consistent with or complement each other, there may also be cases of overlap and inconsistencies. The next chapter examines also a number of specific issues that arise with the interaction between agreements, and considers various solutions.

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93 For a more elaborate discussion of competition issues in relation to IIAs, see UNCTAD (2004c).