



BEIJING BRUSSELS CHICAGO DALLAS FRANKFURT GENEVA HONG KONG LONDON LOS ANGELES NEW YORK SAN FRANCISCO SHANGHAI SINGAPORE TOKYO WASHINGTON, D.C.



**Understanding International Investment and Trade Rules:
How Global Companies Use Rules to Open Markets
and Address Regulatory Problems**

**Daniel M. Price
Andrew W. Shoyer
July 2006**

Overview

- Global companies use rules found in
 - World Trade Organization
 - Free trade agreements
 - Bilateral investment treaties

to create leverage and change negotiating dynamic with foreign regulators

- Companies incorporate rules into business strategy
 - when planning a transaction/investment, as well as
 - to resolve disputes when problems arise
- . . . and Japanese companies can do the same!

Agreements cover all types of economic activity that crosses borders . . .

- Export and import of heavy machinery
- Cross-border asset management services
- Foreign direct investment in power plant
- Licensing of copyrights in music

. . . and all types of government activity

- Taxation
- Environmental and labor regulation
- Government procurement decisions
- Jury awards in civil litigation

Bilateral Investment Treaties: Market Access, Investment Protection And Dispute Settlement

Japan's Bilateral investment treaties

Bangladesh (1999)

China (1989)

Egypt (1978)

Hong Kong China (1997)

Korea (2003)

Mongolia (2002)

Pakistan (2002)

Russia (2000)

Sri Lanka (1982)

Turkey (1993)

Vietnam (2004)

- plus Mexico, Singapore and Malaysia EPAs

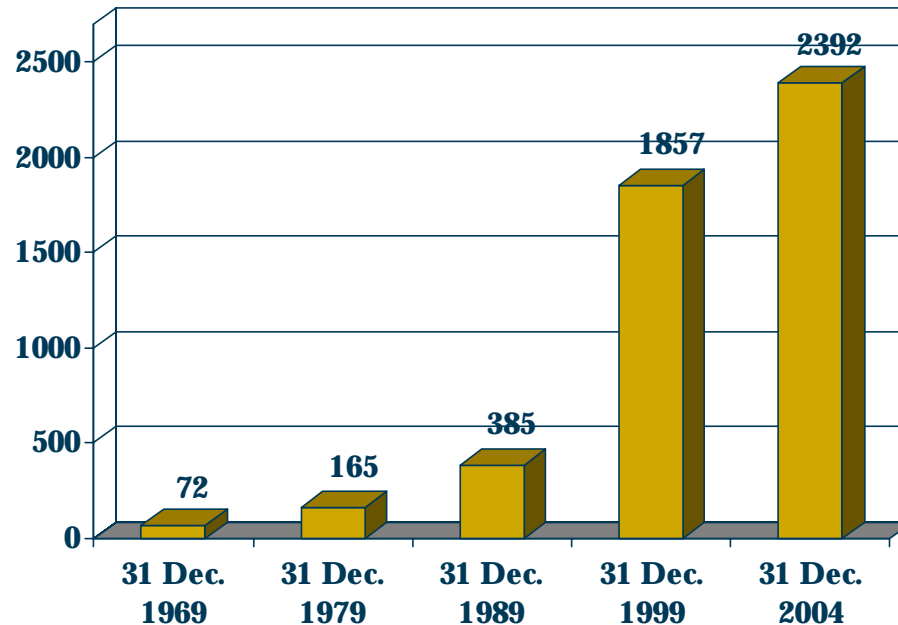
International investment agreements

Core objectives

- Broad protection against government action
 - Any level of government
 - Variety of government actions
- Direct right of action for investors to enforce treaty rights against governments
- Neutral, international fora to arbitrate disputes

Growth in total number of BITs worldwide

- 2,392 bilateral investment treaties (BITs) as of 2004
- Exponential growth in 1990s and 2000-05



Source: UNCTAD

International investment agreements

Examples of leading signatories
(as of June 1, 2005)

- Germany: 135 BITs concluded, 113 in force
- Switzerland: 117 BITs concluded, 105 in force
- United Kingdom: 105 BITs concluded, 92 in force
- France: 98 BITs concluded, 73 in force
- United States: 47 BITs concluded, 36 in force
- **Japan: 11 BITs concluded and in force**

Other international investment agreements

- Investment chapters of free trade agreements
 - Singapore EPA
 - Mexico EPA
 - Malaysia EPA
- Energy Charter Treaty
 - Multilateral treaty applies to investments in energy sector
 - 52 members include most Western European countries, Kazakhstan, Mongolia, Poland, Romania, Russian Federation, Turkey, and Ukraine

Common features

Broad definition of investment

- Company or enterprise
- Shares, stock, and other forms of equity, and bonds, debentures, and other forms of debt interests, in a company
- Contractual rights
- Tangible/real property
- Intangible property
 - Rights such as leases, mortgages, liens and pledges
- Intellectual property
 - Copyrights, trademarks, patents, and trade secrets
- Rights conferred by law
 - Licenses and permits

Common features

Expansive definition of investor

- National of state that is party to agreement
- Entity organized in state that is party to agreement
- Subsidiary, wherever located, of entity organized in state party to agreement
 - Some treaties do not extend to cover indirect ownership

Common substantive protections

General standards of treatment

- Non-discriminatory treatment: Most-Favored Nation (MFN) and National Treatment (NT)
- Fair and equitable treatment
- Full protection and security
- Treatment in accordance with international law
- No impairment of management, maintenance, use, enjoyment, or disposal of investments through unreasonable or discriminatory measures

Common substantive protections

General standards of treatment

Mexico EPA Article 60 General Treatment

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

Note: This Article prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of the other Party. **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 the customary international law minimum standard of treatment of aliens.** A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.

Common substantive protections

General standards of treatment

- NAFTA tribunals, after three NAFTA countries adopted same standard in 2001, take narrow approach to fair and equitable treatment
 - *Mondev*: “Fair and equitable treatment” and “full protection and security” are elements of “minimum standard of treatment” under international law. Their content evolves, and is measured by current, not historical, standards.
- Compare narrow approach under NAFTA to rulings of BIT tribunals unconstrained by Free Trade Commission’s interpretation
 - *Tecmed*: Fair and equitable treatment provision of relevant treaty is “autonomous, ... according to its ordinary meaning.” To interpret it otherwise would “deprive[] [the provision] of any semantic content or practical utility of its own, which would surely be against the intention of the Contracting Parties.”
- Does tribunal’s view on whether fair and equitable treatment is additive to minimum standard affect ruling on facts?
 - *CMS Gas*: Tribunal did not rule on relationship between fair and equitable treatment and minimum standard because respondent’s act – failure to maintain stable and predictable business environment – violates both standards

Common substantive protections

General standards of treatment

- Umbrella clause
 - Example: Article 2.3 of Hong Kong BIT provides: “Each Contracting Party shall observe any obligation it may have entered into with regard to investments of investors of the other Contracting Party.”
 - Governments must meet their contractual obligations
 - Governments must not abuse their sovereign powers to invalidate or avoid their obligations
 - May be explicit treaty provision or may be implied in general provisions like “fair and equitable treatment”

Common substantive protections

Specific prohibitions

- Expropriation or nationalization (including regulatory takings and repudiation of contracts) except:
 - For public purpose
 - On non-discriminatory basis, and
 - With prompt, adequate compensation, generally equivalent to real value of investment under normal conditions before expropriation

Common substantive protections

Specific prohibitions

- What is an expropriation?
 - Direct seizure of property
 - Nationalization
 - Arbitrary termination of a contract or concession
 - Regulatory taking
 - Creeping expropriation
- What is *not* an expropriation?
 - Bona fide, non-discriminatory use of police power

Common substantive protections

Specific prohibitions

- Restraints on free convertibility
- Performance requirements

Growth in Investor-State Disputes

- According to the United Nations, at least 229 treaty-based cases through end of 2005
 - Over 2/3 filed after 2001
 - 48 treaty-based cases brought in 2005
- 135 cases brought before World Bank's International Centre for Settlement of Investment Disputes (ICSID)

Common contexts of investment disputes

- Privatization
- Creeping expropriation through series of measures that destroy value of investment
- Repudiation or wrongful termination of government contracts and concessions
- Discrimination *de jure* or *de facto*
- Regulatory measures that impair arbitrarily the value of an investment

Examples of investment disputes

- Lanco v. Argentina
- Impregilo v. Pakistan
- PSEG v. Turkey
- Cargill v. Poland
- ADM and Tate and Lyle v. Mexico
- Fireman's Fund v. Mexico
- Lucchetti v. Peru
- CAA and Vivendi Universal v. Argentina

Resolution of investment disputes

Consent of the parties

- State parties consent to dispute settlement by signing the BIT - a “standing” offer to arbitrate
- Investor consents through submission of claim in the forum of its choice

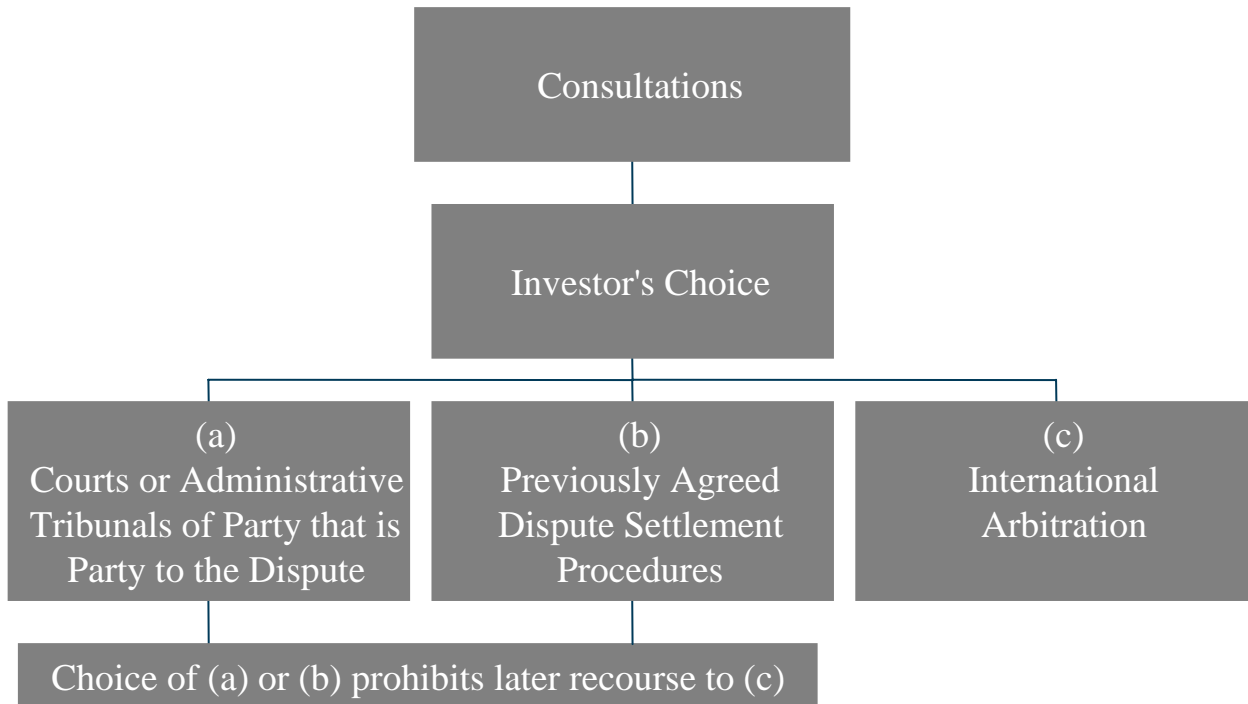
Resolution of investment disputes

The “fork in the road”

- Investor may pursue dispute:
 - (1) In courts or administrative tribunals of host country
 - (2) In accordance with any applicable, previously agreed dispute settlement procedures
 - (3) Through international arbitration
- Typically, choice of (1) or (2) precludes later recourse to (3)

Resolution of investment disputes

The “fork in the road”



Resolution of investment disputes

International arbitration

- If investor pursues international arbitration, investor may submit dispute for binding arbitration:
 - To International Centre for Settlement of Investment Disputes (ICSID), if available
 - To Additional Facility of Centre, if Centre is not available
 - In accordance with UNCITRAL Arbitration Rules
 - To any other arbitration institution or in accordance with any other arbitration rules, if agreed by both parties to the dispute

Resolution of investment disputes

Enforcing investment obligations

- Compels arbitration in international forum (*e.g.*, ICSID, UNCITRAL) under international law
- Money damages
- ICSID Convention has self-contained enforcement mechanism
 - Article 53: “Each party shall abide by ... the terms of the award”
 - Article 54: “Each Contracting State shall recognize an award ... as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State”
 - Failure to comply constitutes breach of bilateral and multilateral treaty obligations (*i.e.*, BIT and ICSID Convention)

Resolution of investment disputes

Annulment of awards

- Annulment procedure narrower than appeal
 - Remedies only procedural and due process-type errors
 - Does not correct errors in law or fact
- ICSID Convention, Article 52(1)

Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:

- (a) that the Tribunal was not properly constituted;
- (b) that the Tribunal has manifestly exceeded its powers;
- (c) that there was corruption on the part of a member of the Tribunal;
- (d) that there has been a serious departure from a fundamental rule of procedure; or
- (e) that the award has failed to state the reasons on which it is based.

The WTO and Free Trade Agreements: What They Cover And How They Work

Japan's International trade agreements

- Multilateral
 - Agreement Establishing the World Trade Organization (WTO) (1995)
- Bilateral Economic Partnership Agreements (EPAs)
 - Singapore (2002)
 - Mexico (2004)
 - Malaysia (2005)
 - Thailand
 - Indonesia
 - Korea
 - Philippines
 - Chile
- Plurilateral EPAs
 - ASEAN (2003 framework)

General approach in using treaty rules to solve commercial problems

- 1 Is a government measure impeding market access or distorting conditions of competition?
- 2 Is there an agreement in place with rules that address the measure?
- 3 If so, then generate claims, pursue enforcement action
- 4 If not, then use negotiating dynamic to create rules or secure solution

Elements of trade law

- Transparency/procedural fairness in trade regime
- Access to markets
- Fair conditions of competition within market (non-discrimination = national treatment)
- Exceptions to
 - preserve non-trade-motivated regulation
 - permit temporary “escape” in emergencies

Overview of WTO Agreement

- WTO “Charter”
- General Agreement on Tariffs and Trade
 - specialized agreements on trade in goods
- General Agreement on Trade in Services
- TRIPS Agreement
- Dispute Settlement Understanding

FTAs and the WTO

- WTO obligations require all members to grant WTO members MFN treatment
- WTO allows exceptions to MFN treatment for certain regional trade agreements (RTAs)
- Different RTAs
 - FTA - zero barriers on intra-zone trade
 - customs union - FTA plus common external trade regime
 - common market - customs union plus integration

Legal Structure of FTAs

- At a minimum, must eliminate barriers to trade in goods
 - Tariff reduction/elimination schedule
 - Preferential rules of origin
- Nearly always provide “WTO-plus” commitments on IP and services
- Incorporate BIT-like protections of foreign direct investment
- Address “new” subjects: competition; labor; environment

WTO Dispute Settlement: Four Stages

- Consultations (4 months)
 - Panel Proceedings (15 months)
 - Appellate Review (5 months)
 - Implementation (12 months)
- TOTAL TIME UNTIL RESULT: 3 YEARS

Enforcing WTO rights

- Only governments can play
 - Private stakeholder has to convince government to take its case. But active stakeholder can have a big say in framing the claim
- The remedy is compliance
 - No monetary compensation
- The ultimate leverage for compliance is trade retaliation
 - Retaliation can disrupt trade: \$4 billion retaliation by EU in FSC/ETI case

Case #1: China – film

- China maintained extremely high duty rates on photographic film (over 120%), in spite of reduction commitments in WTO accession (42%)
- Approach: Japanese industry expressed concerns to METI; pointing to GATT violation, METI raised bilaterally with MOFTEC (later MOFCOM) officials in Beijing, during APEC Ministerial talks, and in WTO Chinese Transitional Review Mechanism and Market Access Committee meetings

RESULT: China reduced duty rates as of January 2006, maintaining some as specific duties

Case #3: China - pharmaceuticals

- China MOH limits type, number of physicians who can prescribe patented drug
- Approach: Generate WTO arguments for company to use directly with MOH officials
- Reinforce through US Government advocacy

RESULT: Positive change in MOH regulation

Case #2: Argentina - footwear

- Argentina imposes import restrictions on athletic shoes - China, Vietnam, Indonesia
- Approach: Generate WTO claims, used by
 - EC in WTO dispute in Geneva
 - Importers in Argentine court

RESULT: Import restrictions constrained

Conclusions

If . . .

- government “regulation” is at issue, and
- activity has an international character

. . . then consider invoking international trade and investment agreements

- before making transaction or investment, and
 - for protection, after problems occur
- Create leverage - change dynamic