

## Investment Treaty Arbitration: A Primer

***International investors enjoy varying degrees of protection and opportunities to seek compensation, depending on the location and type of investment.***

Public international law, which governs the relations among independent States, contains rules regarding the treatment by States of foreign investments in their territory (including their maritime territory).

### Protections: the Who, What and How?

Foreign investments today enjoy international legal protection through a growing number of investment treaties which require full compensation for direct or indirect expropriation, even if unintended, and for other forms of detrimental interference with investments.

The persons who make foreign investments, and who thus enjoy international legal protection, include companies incorporated and registered in another State and individual investors who are nationals of another State. Investment treaties provide specific legal protection for the investments of those foreign companies and nationals. Investment is broadly defined, and can take a variety of forms, including: shares or other forms of participation in local companies, real and contractual property rights, intellectual property rights, bonds and concession contracts, for example, for the exploitation of mineral or hydrocarbon resources.

### The Forms of International Treaties that Protect Investments

There is as yet no single, comprehensive treaty for the legal protection of foreign investments. Instead, a network of treaties apply between two countries, among a number of countries in a given region or in regard to a specific industry sector such as energy. The five primary types are set out below.

#### Bilateral Investment Treaties

Bilateral investment treaties, or BITs, are a more focused continuation of the practice of concluding bilateral treaties governing “friendship, commerce and navigation”. BITs are intended to promote, encourage and protect investments by nationals of one of the contracting States in the territory of the other contracting State. Virtually every country that benefits from inward foreign investments, from Albania to Zimbabwe, has concluded one or more BITs that provides for the substantive and procedural legal protections.

The first BIT was signed between Germany and Pakistan in 1959. Other Western European governments soon began concluding BITs with selected developing States. Since 1990, however, an explosive growth in the number of BITs worldwide has revolutionized the protection of foreign investments. In addition to the BIT programs established by Western States, developing and transition economy States have

embraced BITs in order to encourage foreign investments, both from industrialized States and among themselves. Today, around 3,000 BITs have been signed, covering countries in practically every region of the world.

### **Free Trade Agreements**

In December 1992, Chapter 11 of the North American Free Trade Agreement (NAFTA) included investment protection provisions similar to those of BITs. Since then, more than 15 other multilateral and bilateral free trade agreements have been concluded throughout the Americas (and beyond) that include substantive and procedural investment protection provisions equivalent to those of BITs. The provisions on investment in many free trade agreements follow the very detailed pattern of NAFTA's investment chapter. The substantive provisions require careful comparison with the rules governing other subject-matters, such as finance and procurement. The procedural provisions include intricate conditions for submitting disputes to arbitration and allow the participation of "non-disputing States" in the arbitration proceedings. Notwithstanding their complexity, the investment provisions of free trade agreements offer a well-trying and effective means for protecting investments.

### **The Energy Charter Treaty**

The 1994 Energy Charter Treaty (ECT) came about as a result of the dissolution of the Soviet bloc and the consequent opening of the energy market in Eastern Europe and Central Asia. ECT provisions on the protection of energy-related investments, which parallel those of BITs, reflect the need for a stable and even legal framework for development in the energy sector. Having entered into force in April 1998, more than 50 States (plus the European Union) are now party to the ECT.

The ECT's investment provisions reflect a common desire for transparency, stability and cooperation in the energy sector. Arbitral tribunals have in several reported cases applied the ECT's investment protections, providing effective remedies.

### **The ASEAN Comprehensive Investment Agreement**

The Association of Southeast Asian Nations (ASEAN) is a regional grouping for cooperation mainly in areas concerning economic development. The 1987 ASEAN Agreement on the Promotion and Protection of Investments was a precursor to other multilateral investment treaties. It has since been superseded by the ASEAN Comprehensive Investment Agreement (ACIA) which entered into force on 29 March 2012.

The ACIA contains most of the legal protections typically included in BITs, along with the right of investors to submit investment disputes to the International Centre for Settlement of Investment Disputes (ICSID) for arbitration. However, this carefully drafted treaty includes a number of limitations, in particular by requiring, where applicable, specific approval by the competent State authority and by limiting the possibility of "treaty shopping" (by anticipating the possibility of States to deny the benefits of the treaty to certain types of investments). Investors intending to invoke the protection of this treaty accordingly need to take particular care to ensure that their investments fall within the scope of protection under this treaty.

### **Human Rights Treaties**

All investments will engage some form of property right on the part of the investor. The protection of investments thus overlaps with the protection of the right to the peaceful enjoyment of property, as recognized in various human rights treaties. This right will be engaged whenever property has been expropriated, in fact or in law, without sufficient compensation. Thus, for example, the European Convention on Human Rights guarantees the peaceful enjoyment of possessions to corporate entities just as it does to individuals.

Other human rights guarantees that are relevant in the context of international investments include those that call for due process of law and those that prohibit unfair discrimination.

## **Investment Treaties' Substantive Protections**

Virtually all investment treaties contain a broad definition of investment. Most of the time, the definition is open-ended, covering "every type of asset" or "every form of investment," supplemented by a series of illustrative examples. Typically, treaties will cover all assets which make up an investment, whether tangible or intangible, property and contractual rights, and rights of control and management. Importantly, however, most investment treaties protect investments independently of whether or not the investor has a direct contractual relationship with the host State or sub-State entity concerned.

Investment treaties invariably require compensation to be paid in the event an investment is expropriated. Treaties usually require compensation to reflect the full business value of the investment so expropriated, to be expressed in a usable currency and to be paid promptly.

Most investment treaties will incorporate by reference the traditional rules of public international law that require a minimum level of treatment of investments. Typically investment treaties include provisions calling for "fair and equitable treatment" and for "full and constant protection and security" of investments. Investment treaties also commonly provide for the right of investors to repatriate funds derived from the capital and returns of their investments. While this right can be subject to exceptional restrictions, it may not be withdrawn. Some treaties expressly allow investors to transfer funds into the country in which they invest (*e.g.*, to ensure financing).

A number of other legal protections are found in some investment treaties. For example, treaties may: require States to comply with their contractual undertakings as regards investments; limit the imposition of "performance requirements" on investments by the host State; or allow investors to hire top management of their choice regardless of nationality. Treaties may also contain a general provision requiring transparency of local rules and regulations, prompt approval of administrative authorizations or even the admission of investments into the country.

## **Investment Treaties' Procedural Protections: the unilateral ability to start an arbitration against a State**

The legal mechanism for bringing investment treaty claims is found in the investor-State dispute settlement provisions of modern investment treaties. There, each State sets forth its advance consent to submit investment disputes to international arbitration. Once a covered investor provides its own written consent, the State's offer becomes legally binding, and the investor can bring proceedings directly against the State without the need for any additional approval.

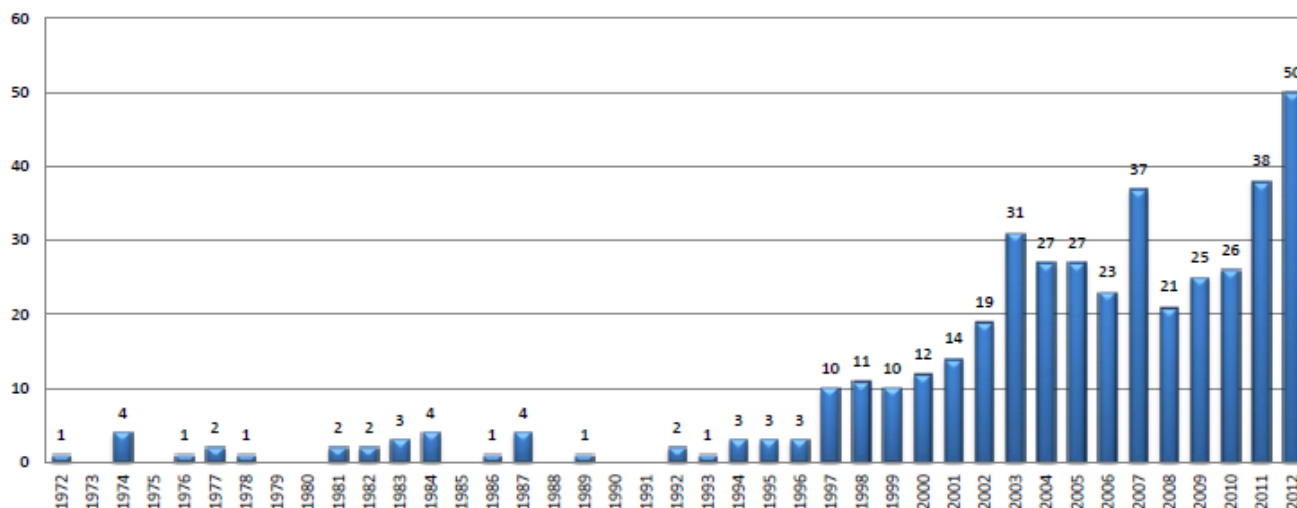
## **International Arbitration and ICSID**

The 1965 Washington Convention created the ICSID, a specialized organization for administering investor-State arbitration proceedings.

Proceedings conducted under the Washington Convention are entirely international, from beginning to end. Except if the parties agree, local courts or local procedural law are not involved at any stage of the proceedings. Without the parties' agreement, arbitrators cannot be nationals of either party's State. Arbitration awards rendered under the Washington Convention can only be invalidated through the annulment procedures provided for in the Convention itself.

ICSID also administers proceedings under its Additional Facility Rules for certain disputes which fall outside of the Washington Convention (for example, if the disputing State is not a party to the Convention). Unlike proceedings under the Washington Convention, Additional Facility proceedings are potentially subject to the procedural law and courts of the “seat” of the arbitration.

Most investment treaties make available one or both forms of ICSID arbitration to covered investors. As a result of the growing number of BITs, the number of ICSID arbitration proceedings has sharply increased in recent years, as investors begin to make use of their right to enforce the protections investment treaties provide them.



Total number of ICSID cases registered by calendar year (source: The ICSID Caseload – Statistics 2013)

## Other Forms of Dispute Settlement

Investment treaties often provide investors a choice between various forms of arbitration for the purpose of settling disputes with host States. The most frequent alternative to ICSID proceedings is “ad hoc” (or non-administered) arbitration in accordance with the stand-alone set of Arbitration Rules drafted by the United Nations Commission for International Trade Law (UNCITRAL). These rules allow greater flexibility to the parties and tribunal, which can be beneficial when used properly. For example, the parties could agree to appoint a specific institution to administer the proceedings. In a number of recent cases, the Permanent Court of Arbitration in The Hague has been appointed for this purpose.

In addition, investment treaties sometimes make available more traditional forms of administered or “institutional” arbitration. For example, the Arbitration Institute of the Stockholm Chamber of Commerce — well-known for managing cases involving former “Eastern bloc” countries — and the International Court of Arbitration of the International Chamber of Commerce, based in Paris.

## Conclusion

Investment treaty protection and investment arbitration have become cornerstones of international investment law. Together they provide an effective web of protections and recourse to international investors. It is increasingly important that international investors understand these protections, both when structuring their foreign investments and when they face interference by a host State.

---

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

**Claudia T. Salomon**

+1.212.906.1230  
[claudia.salomon@lw.com](mailto:claudia.salomon@lw.com)  
New York

**Sebastian Seelmann-Eggebert**

+49.40.4140.3259  
[sebastian.seelmann@lw.com](mailto:sebastian.seelmann@lw.com)  
Hamburg

**Charles Claypoole**

+44.20.7710.1178  
[charles.claypoole@lw.com](mailto:charles.claypoole@lw.com)  
London

---

*Client Alert* is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the lawyer with whom you normally consult. A complete list of Latham's *Client Alerts* can be found at [www.lw.com](http://www.lw.com). If you wish to update your contact details or customize the information you receive from Latham & Watkins, visit <http://events.lw.com/reaction/subscriptionpage.html> to subscribe to the firm's global client mailings program.