LAW PUNDITS

Course Material

INTERNATIONAL INVESTMENT LAWS

Meaning of Investment under international investment law

The definition of investment in international investment law is of fundamental importance to the question of whether a tribunal has jurisdiction *ratione materiae* (that is, jurisdiction over the subject matter of the dispute). In brief, the definition of investment helps to define the scope of bilateral investment treaties (BITs) and multilateral investment treaties (MITs), under which a tribunal may seek to exercise its jurisdiction. Disputes as to whether an asset constitutes an investment usually arise when a respondent challenges a tribunal's jurisdiction.

There is no general definition of the term "investment" under international investment law. When considering the definition of investment under the applicable investment treaty, ICSID tribunals have to consider whether a given activity constitutes an investment within the meaning of Article 25(1) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (*ICSID Convention*).

The definition of investment varies between investment treaties but it is possible to discern certain common characteristics, as discussed below. In particular, tribunals seeking to construe the meaning of investment under the ICSID Convention frequently refer to the test established by the tribunal in *Salini Costruttori SpA v Morocco (ICSID Case No ARB/00/4 (Decision on Jurisdiction))*, which provides that the following must all be present for there to be an investment:

- A contribution or commitment by the investor.
- Performance of the project for a certain duration.
- Existence of a risk for the investor.
- A significant contribution to the economic development of the host state.

In addition it has been suggested that there needs to be a certain regularity of profit and return. However, tribunals have not generally accepted that this is a criterion for determining the existence of an investment.

The application of the *Salini* criteria to the definition of investment outside the framework of the ICSID Convention should be approached with caution. When applying principles derived from previous awards, it is important to consider whether the tribunal in question considered the definition of investment under the ICSID Convention or another investment instrument.

Note that, in practice, an "investment" may consist of a bundle of interrelated rights and obligations, and need not relate to a single contract (see *Inmaris Maritime Services GmbH and ors v Ukraine (ICSID Case No ARB/08/8*). Investments should not be viewed as certain aspects of a party's arrangements, but as the entire substance of a venture or contract (see H&H Enterprise Investments v Egypt (*ICSID Case No ARB/09/15, Decision on Jurisdiction, at paragraphs 41-43*).

The lack of a definition of investment in the ICSID Convention

One key consideration of the jurisdiction *ratione materiae* of an ICSID tribunal is the existence of an investment within the meaning of Article 25(1) of the ICSID Convention and the applicable investment treaty.

Article 25(1) provides as follows:

"The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally."

The meaning of "legal disputes", "arising directly out of" and "an investment" is discuss in the following few paragraphs.

Legal disputes

The Convention does not define legal disputes. However, it is understood that the provision is intended to exclude conflicts of interest, as opposed to conflicts of legal rights, from ICSID's jurisdiction. The Report of the Executive Directors on the ICSID Convention makes clear that:

"The dispute must concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation." (*World Bank, Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1965, 1 ICSID Rep 28.*)

The practice of arbitral tribunals has shed further light on the meaning of "legal disputes". In particular, *Continental Casualty v Argentina (ICSID Case No ARB/03/9 (Decision on Jurisdiction))* and *Suez et al v Argentina (ICSID Case No ARB/03/17 (Decision on Jurisdiction))* highlight that a legal dispute will be:

- Evidenced by the claimant presenting its case as a breach of legal rights.
- Based on legal arguments.
- Seeking legal remedies.

Arising directly out of

The requirement that the dispute arise directly out of an investment means that the dispute must be sufficiently closely connected to an investment. It is clear that the reference to directness relates to the proximity of the dispute to the investment, and not to the question of whether the claimant had made a direct investment (see *Fedax v Venezuela (ICSID Case No ARB/96/3 (Decision on Jurisdiction))*; *CSOB v Slovakia (ICSID Case No ARB/97/4 (Decision on Jurisdiction))*; and *CMS v Argentina (ICSID Case No ARB/01/8 (Decision on Jurisdiction and Decision on Annulment))*). It follows that a dispute may arise directly out of an indirect or a direct investment (see *Siemens v Argentina (ICSID Case No ARB/02/8 (Decision on Jurisdiction))*).

Tribunals have commonly sought to adopt the principle of general unity of the investment operation, according to which the requirement of "arising directly out of" will still be satisfied by disputes arising out of activities ancillary to the main investment, but which are still sufficiently important to the investment and are not shared by conflicts unrelated to the investment (see *CSOB v Slokavia (Decision on Jurisdiction)* and *Tokios Tokelės v Ukraine (ICSID Case No ARB/02/18 (Decision on Jurisdiction))*).

A tribunal is also likely to treat a dispute concerning general measures adopted by a host state (which have directly affected the particular investment, albeit without having been specifically aimed at the latter) as a dispute arising directly out of the investment in question (see *CMS v Argentina (Decision on Jurisdiction and Decision on Annulment)*; *AES v Argentina (ICSID Case No ARB/02/17 (Decision on Jurisdiction))* and *Continental Casualty v Argentina (Decision on Jurisdiction)*).

An investment

The ICSID Convention does not provide a definition of the term investment. One explanation for the absence of this definition is provided by the Report of the Executive Directors on the ICSID Convention, which states:

"No attempt was made to define the term 'investment' given the essential requirement of consent by the parties, and the mechanism through which Contracting States can make known in advance, if they so desire, the classes of dispute which they would or would not consider submitting to the Centre (Article 25(4))." (*World Bank, Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1965, 1 ICSID Rep 23, 28*.)

Investment treaties rarely refer to Article 25(1) of the ICSID Convention for the purposes of defining investment, but rely on their own definitions, to be found in the investment clause. This raises the question of whether the term "investment" in Article 25(1) is subject to the definition included in the relevant investment treaty. Tribunals have held that the meaning of investment under Article 25(1) is separate from the definition in the applicable investment treaty. In other words, the requirement set out in Article 25(1) that the dispute arise directly

out of an investment is an objective condition of ICSID jurisdiction. For example, see *Salini Costruttori SpA v Morocco (Decision on Jurisdiction)*, which at paragraph 52 states:

"ICSID case law and legal authors agree that the investment requirement must be respected as an objective condition of the jurisdiction of the Centre."

As stated above, in considering whether an investment exists for the purposes of the ICSID Convention, a number of ICSID tribunals have adopted the *Salini* criteria, for example:

- *SGS v Pakistan (ICSID Case No ARB/01/13 (Decision on Jurisdiction))*, *at paragraph 133*.
- *Joy Mining Machinery Ltd v Egypt (ICSID Case No ARB/03/11 (Award on Jurisdiction)), at paragraphs 53, 57 and 62*.
- *AES Corporation v Argentina (ICSID Case No ARB/02/17 (Decision on Jurisdiction)), at paragraph 88*.
- *Jan de Nul NV v Arab Republic of Egypt (ICSID Case No ARB/04/13 (Decision on Jurisdiction))*.
- *Bayindir v Pakistan (ICSID Case No ARB/03/29 (Decision on Jurisdiction)), at paragraphs 130-138*).
- *LESI & Astaldi v Algeria (ICSID Case No ARB/05/3 (Decision on Jurisdiction)), at paragraphs 72-73*.
- *Saipem v Bangladesh (ICSID Case No ARB/05/7 (Decision on Jurisdiction)), at paragraphs 99-102, 109-111*.

While adopting the *Salini* test, tribunals have emphasised that the criteria are interrelated and should not be considered in isolation (*Bayindir v Pakistan (Decision on Jurisdiction)* paragraph 130; *Jan de Nul v Egypt (Decision on Jurisdiction)*paragraph 91).

In addition, some tribunals outside of the ICSID system such as in *Ulysseas v Ecuador (UNCITRAL, Final Award, 12 June 2012, paragraph 251)*; *Alps Finance and Trade AG v Slovak Republic (UNCITRAL, Award, 5 March 2011, paragraph 241)*; and *White Industries Australia Limited v India (UNCITRAL, Final Award, 30 November 2011, paragraph 7.4.10)* cite the *Salini* factors favourably.

Beyond Salini

The *Salini* criteria cannot be considered a conclusive definition of investment in ICSID arbitrations. This is demonstrated by the recent trend of tribunals in adopting a more flexible approach, as set out below.

Biwater Gauff v Tanzania

In *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania (ICSID Case No ARB/05/22)*, the tribunal rejected the parties' strict adherence to the *Salini* criteria as the sole means for defining investment under Article 25(1) of the ICSID Convention. It advocated a more flexible and pragmatic approach, taking into account not just the features identified in *Salini*, but also all the circumstances of the case, including the nature of the instrument containing the relevant consent to ICSID (*paragraph 316*).

RSM v Grenada

In *RSM Production Corporation v Grenada (ICSID Case No ARB/05/14)*, the tribunal emphasised that the *Salini* criteria are but "bench marks or yard sticks to help a tribunal in assessing the existence of an investment", which must be adopted with sufficient flexibility by any tribunal (*paragraph 241*).

Phoenix Action v Czech Republic

In *Phoenix Action Ltd v Czech Republic (ICSID Case No ARB/06/5)*, the tribunal said that the *Salini* criteria should be supplemented by two further criteria:

- That the assets in question were invested in accordance with the laws of the host state.
- That the investment of the assets was in good faith.

The tribunal found that the requirement of compliance with host state law was satisfied in this case. However, its consideration of the good faith criterion was more complex. The tribunal looked at various factors, including the:

- Timing of the investment.
- Basis of the initial request for arbitration submitted to ICSID.
- Timing of the claim.
- Substance of the transaction.
- True nature of the claimant's operation.

It concluded that the claimant had made an investment for the sole purpose of bringing an international claim against the respondent, and not for the purpose of engaging in economic activity. Therefore, the investment was not a protected investment within the meaning of Article 25(1) of the ICSID Convention or the applicable BIT.

Saba Fakes v Turkey

In *Saba Fakes v Republic of Turkey (ICSID Case No ARB/07/20)*, the tribunal identified three criteria which it considered needed to be satisfied for there to be an investment, namely a contribution, which was of certain duration and which had an element of risk. It did not consider that a contribution to the economic development of the host state was necessary

Malaysian Historical Salvors v Malaysia

In *Malaysian Historical Salvors SDN BHD v Government of Malaysia (ICSID Case No ARB/05/10 (Decision on the Application for Annulment))*, the tribunal had denied jurisdiction under Article 25(1) of the ICSID Convention:

- based on a strict application and interpretation of the *Salini* criteria; and
- without considering the definition of "investment" in the UK-Malaysia BIT.

The tribunal held that the resources expended by the investor to salvage a shipwreck did not constitute an investment in Malaysia. An ad hoc committee annulled the award, holding that the tribunal had erred in not considering whether there was an investment as defined in the UK-Malaysia BIT, as well as under Article 25(1)of the ICSID Convention. The ad hoc committee held that there was an investment under the UK-Malaysia BIT, and that the award was incompatible with the intentions of the UK and Malaysia. This was because they had comprehensively defined the term "investment" and therefore could not have intended recourse to arbitration to be precluded by a restrictive definition of that term, which was deliberately undefined in the ICSID Convention.

The committee also supported the tribunal's approach in *Biwater Gauff*, holding that the *Salini* criteria do not constitute a fixed test for the definition of investment. According to the committee, the test should not be applied so strictly so as to automatically exclude assets or transactions which would fall within the definition of investment under the applicable BIT, but which, because of a failure to satisfy all of the *Salini* criteria, would not constitute an investment under Article 25(1). The ad hoc committee also disagreed with the tribunal's decision to:

- elevate the *Salini* criteria to jurisdictional conditions; and
- interpret the requirement for a contribution to the economic development of the host state in a highly restrictive manner so as to exclude small contributions and contributions of a cultural or historical nature.

Contribution to host state's economic development

The *Salini* requirement of contribution to the host state's economic development has proven to be controversial. In certain instances, it has been determined that this requirement is fundamental to the existence of an investment. For example, in *Mitchell v Congo (ICSID Case No ARB/99/7 (Decision on Annulment))*, an ad hoc committee annulled the final award on the ground that the activities of a US law firm in the Congo did not contribute to the state's economic development and did not therefore constitute an investment under the ICSID Convention.

The tribunal in *Phoenix Action* also adopted a broad interpretation of this requirement, similar to that of the ad hoc committee in *Malaysian Historical Salvors*. It stated that, rather than looking at whether an investment has contributed to the host state's development (which was impossible to ascertain), the issue should be whether an investment has contributed to the economy of the host state (see *paragraph 85*).

However, in *LESI v Algeria (ICSID Case No ARB/05/3 (Decision on Jurisdiction))*, the tribunal held that the requirement of a contribution to the economic development of the host state was not relevant to the determination of the existence of an investment. In particular, it considered that this requirement was not only difficult to establish, but in any event, was implicit in the remaining three requirements of an investment set out in the *Salini* test (*paragraph 72*). In *Deutsche Bank AG v Sri Lanka (ICSID Case No ARB/09/02)*, the majority of the tribunal held that a contribution to the host state's economic development was not a necessary element of an investment. It considered that this criterion was unworkable owing to its subjective nature. By contrast, the dissenting arbitrator took the view that a contribution to economic development is implicitly recognised in the other *Salini* criteria. .

The majority and the dissenting opinion in *Abaclat and others v Argentina* came to a vastly different interpretation of whether sovereign bonds contribute to economic development. In response to Argentina's argument that the claimant's investment was not made in Argentina, the majority found that the funds generated through the bonds issuance process served to finance Argentina's development. However, because the majority of the tribunal rejected the *Salini* criteria, the analysis of contribution to economic development was not directly applicable to determining whether an investment occurred. In his dissenting opinion, Professor Abi-Saab criticised the majority opinion's "logical jump" determination that the bonds served to finance Argentina's economic development, when the funds could have been used to "finance wars, even wars of aggression, or oppression measures against restive populations, or even be diverted through corruption to private ends." The dissenting opinion states that contribution to economic development is an object and purpose of the ICSID Convention (as detailed in the Convention's preamble) and this condition is necessary to establish an investment under the ICSID Convention.

Examples of ventures held to constitute an investment under Article 25(1)

Examples of transactions and ventures which have been held to constitute investments within Article 25(1) of the ICSID Convention include the following:

- Construction of highways and road networks (*Salini Costruttori SpA v Morocco; Autopista v Venezuela;* and *Bayindir v Pakistan*).
- The dredging of a canal (Jan de Nul NV v Arab Republic of Egypt).
- The construction of dams (Impregilo SpA v Pakistan (ICSID Case No ARB/03/3)).
- The operation of hotels (AMCO v Indonesia (ICSID Case No ARB/81/1)).
- The conversion of equipment for fishing vessels (Atlantic Triton Group v Guinea (ICSID Case No ARB/84/1)).
- Pre-shipment inspection services (SGS v Philippines (ICSID Case No ARB/02/6)).
- Promissory notes (Fedax NV v Republic of Venezuela).
- Loans (CSOB v Slovak Republic).
- Sovereign debt securities (bonds) (Abaclat and others v Argentina; Ambiente Ufficio S.p.A v Argentina (ICSID Case No ARB/08/9)).
- An option to buy land and property, together with a management and operation contract (H&H Enterprise Investments v Egypt).
- An oil hedging contract (Deutsche Bank AG v Sri Lanka (ICSID Case *No ARB/09/02)*).

The conclusion of a concession contract which contemplated major contributions in the future, even though the contract was terminated before those contributions were made *(Malicorp Limited v The Arab Republic of Egypt (ICSID Case No. ARB/08/18)*.

Examples of ventures held not to constitute an investment under Article 25(1)

There are of course also instances where tribunals have held that a particular asset or transaction does not constitute an investment. For example, the tribunal in *Romak SA v Republic of Uzbekistan (PCA Case No AA280)* held that the claimant's assets, in the form of "contracts and economic relations entered into with Uzbek public entities" for the purposes of wheat supply transactions, did not constitute an investment under the relevant definition in the Switzerland-Uzbekistan BIT.

Although this was not an ICSID arbitration, the tribunal considered previous ICSID awards on the interpretation of investment under Article 25(1) of the ICSID Convention and emphasised that there should not be a different definition of the term under ICSID and BITs. Notably, the tribunal set an objective benchmark against which to assess categories of possible investments which are not listed in the clearly non-exhaustive list of examples of investments in the relevant BIT. It considered that, to constitute an investment, an asset or transaction should have the following characteristics:

- It should extend over a certain period of time.
- It should entail some risk (see paragraph 212 of the award).

It decided that the claimant's assets did not meet any of these requirements as its rights were embodied in and arose out of a sales contract, which was a one-off commercial transaction

Definition of investment under bilateral investment treaties

A common characteristic of most BITs is the structure of their definition of investment. The definition usually constitutes a general opening phrase, followed by a non-exhaustive list of particular categories of claims which constitute an investment. For example, the UK's Model BIT (2005) provides as follows:

"For the purposes of this Agreement:

(a) 'investment' means every kind of asset and in particular, though not exclusively, includes:

i. Movable and immovable property and any other property rights such as mortgages, liens or pledges;

ii. Shares in and stock and debentures of a company and any other form of participation in a company;

iii. Claims to money or to any performance under contract having a financial value;

iv. Intellectual property rights, goodwill, technical processes and know-how;

v. Business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources."

Similarly, the Chinese Model BIT (2003) contains the following definition of investment:
"For the purposes of this Agreement,
1. The term 'investment' means every kind of asset invested by investors of one Contracting Party in accordance with the laws and regulations of the other Contracting Party in the territory of the latter, and particularly, though not exclusively, includes:
a. Movable and immovable property and other property rights such as mortgages, pledges and similar rights;
b. Shares, debentures, stock and any other kind of participation in companies;
c. Claims to money or to any other performance having an economic value associated with an investment;
d. Intellectual property rights, particularly copyrights, patents, trademarks, trade-names, technical process, know-how and good-will;
e. Business concessions conferred by law or under contract permitted by law, including concessions to search for, cultivate, extract or exploit natural resources.
Any change in the form in which assets are invested does not affect their character as investments provided that such change is in accordance with the laws and regulations of the Contracting Party in whose territory the investment has been made."
By contrast, the US Model BIT (2004) adopts a more precise definition of investment, the opening paragraph to which reflects the *Salini* criteria:

"'Investment' means 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, other debt instruments, and loans;
(d) futures, options, and other derivatives;

(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;

(f) intellectual property rights;

(g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and

(h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges."

In relation to paragraph (c), the US Model BIT explains that:

"Some forms of debt, such as bonds, debentures, and long-term notes, are more likely to have the characteristics of an investment, while other forms of debt, such as claims to payment that are immediately due and result from the sale of goods or services, are less likely to have such characteristics."

Further, the US Model BIT clarifies the meaning of paragraph (g):
"Whether a particular type of license, authorization, permit, or similar instrument (including a concession, to the extent that it has the nature of such an instrument) has the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder has under the law of the Party. Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law. For greater certainty, the foregoing is without prejudice to whether any asset associated with the license, authorization, permit, or similar instrument has the characteristics of an investment."

In addition:
"The term 'investment' does not include an order or judgment entered in a judicial or administrative action."
In considering the application of these formulae to the facts of a case, tribunals will be hesitant to rely solely on the broad opening definition, and will consider certain characteristics of the investment discussed below. Tribunals may also read certain criteria into the definition of investment under the applicable BIT, such as duration, contribution and

risk (*Alps Finance and Trade AG v Slovak Republic, (Award (redacted version), paragraphs 229-247*).

Definition of investment under multilateral investment treaties

MITs such as the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT) define investment in a similar fashion to BITs.

NAFTA

Article 1139 of Chapter 11 of NAFTA (which entered into force on 1 January 1994) defines investment as:

"(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 years,

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 that 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, or 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)."

The meaning of investment under NAFTA is discussed in *Bayview Irrigation District v Mexico (ICSID Case No ARB(AF)/05/1)* in which the tribunal considered that investment refers to foreign investments, even though this is not specified under Chapter 11 of NAFTA. The tribunal did not put forward a comprehensive definitive test of what constitutes an investment but stated that a salient characteristic would be that it is primarily regulated by the law of a state other than the investor's home state. In *Bayview*, Mexico argued that the objective of NAFTA, as set out in Article 102(1)(c), is to: "increase substantially investment opportunities in the territories of the Parties".

The tribunal upheld this as the clear and ordinary meaning for opportunities for foreign investment in the territory of each party made by investors of another party.

Energy Charter Treaty (ECT)

The ECT defines investment as:

"every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

(a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;

(b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;

(c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;

(d) Intellectual Property;

(e) Returns;

(f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

A change in the form in which assets are invested does not affect their character as investments and the term 'Investment' includes all investments, whether existing at or made after the later of the date of entry into force of this Treaty for the Contracting Party of the Investor making the investment and that for the Contracting Party in the Area of which the investment is made (hereinafter referred to as the 'Effective Date') provided that the Treaty shall only apply to matters affecting such investments after the Effective Date."

(*Article 1(6), ECT*).

Importantly, the above definition limits investments to:

"any investment associated with an Economic Activity in the Energy Sector and to investments or classes of investments designated by a Contracting Party in its Area as 'Charter efficiency projects' and so notified to the Secretariat."

Specific issues

Pre-investment expenditure

Following several consistent decisions of tribunals, it is widely accepted that pre-investment expenditures by themselves do not constitute an investment. However, where a project proceeds, pre-investment expenditures are likely to form part of the investment. This principle will prevail in the absence of any specific provision stating otherwise in the applicable BIT.

The leading case on the issue of pre-contract expenditure is *Mihaly International Corp v Republic of Sri Lanka (ICSID Case No ARB/00/02)*. In determining the respondent's challenge to its jurisdiction, the tribunal had to decide whether or not Mihaly's expenditure following the execution of certain pre-contract letters constituted an investment. The tribunal held that there was no investment under Article 25(1) of the ICSID Convention on the basis that, although these letters conferred exclusivity on Mihaly, they did not create a contractual

relationship. Further, not only did the grant of exclusivity fail to mature into a contract, but it was clear from the letters that the respondent would not accept that a contractual relationship had been established and an investment made until a contract was executed.

Not long after the publication of the decision in *Mihaly*, the issue of pre-investment expenditure was addressed in *Zhinvali Development Ltd v Republic of Georgia (ICSID Case No ARB/00/1)*. Relying on the reasoning in *Mihaly*, the tribunal concluded that the development costs incurred by the claimant did not constitute an investment within the meaning of the Georgian foreign investment law. Those costs did not satisfy that law's definition of investment and the respondent did not expressly or impliedly agree to undertake state responsibility for such costs as a qualifying investment under Georgian law. As the development costs did not qualify as an investment under the Georgian foreign investment law, the tribunal had no grounds for deciding that these costs qualified as an investment under Article 25(1).

Timing of the investment

Issues of timing are relevant to the definition of investment in three principal respects:

- Whether an investment must have been made after the relevant BIT entered into force.
- Whether investment protection continues after an investment has ended.
- Whether investment protection continues after the termination of the BIT.

Timing issues after the BIT enters into force

Many BITs include a specific provision regarding the scope of their application. This clause will usually provide that the BIT applies to investments made before and after its entry into force. It is not common for the definition of investment to require the investment itself to have been made after the relevant BIT has entered into force.

In *Nykomb Synergetics Technology Holding AB, Stockholm v Republic of Latvia* (an arbitration under the ECT, under the rules of the Arbitration Institute of the Stockholm Chamber of Commerce), the tribunal held that, although the investment contract had been

entered into before the entry into force of the ECT, the claimant's claims occurred after the ECT's entry into force. Therefore, there was no question of the retroactive effects of the ECT.

Timing issues once the investment has ended

Even after an investment has ceased to exist, it may still benefit from the protection afforded by the relevant BIT. Two cases demonstrate that the definition of investment does not require that the investment itself continues to exist at the time of the dispute arising under the applicable investment treaty:

- In *Mondev International Ltd v United States of America (ICSID Case No ARB (AF)/99/2)*, the tribunal held that the claimant's claims involved an investment which existed at the date of entry into force of NAFTA. In the tribunal's view, once an investment existed, it remained protected by NAFTA even if the investment fails.

- In *Jan* de *Nul*, Egypt argued that there had to be an investment at the time when the dispute arose. The tribunal rejected that argument, agreeing with the claimants that it was not stated anywhere that an investment should still be in existence when the dispute arises. If that were the case, it would defeat the logic of investment protection treaties.

Timing issues following termination of the BIT

Most BITs provide for an initial term of ten years. For example, Article 14 of the UK Model BIT (2005) provides that:

"This Agreement shall remain in force for a period of ten years. Thereafter it shall continue in force until the expiration of twelve months from the date on which either Contracting Party shall have given written notice of termination to the other. Provided that in respect of investments made whilst the Agreement is in force, its provisions shall continue in effect with respect to such investments for a period of twenty years after the date of termination and without prejudice to the application thereafter of the rules of general international law."

Although BITs will usually provide for either contracting party to give notice to terminate the treaty after the initial term has expired, most will take into account the long term intentions of investors by ensuring that the investors may benefit from extended protection before the date of termination. However, there is some variation between the formulations of this extended protection. For example, Article 13(3) of the Chinese Model BIT (2003) provides for extended protection for ten years after the date of termination, and does not refer to the application of general international law:

"[w]ith respect to investments made prior to the date of termination of this Agreement, the provisions of Articles 1 to 12 shall continue to be effective for a further period of ten years from such a date of termination."

Place of the investment

The territorial scope of investment treaties will usually be limited to investments made within the territory of the host state.

Shareholdings as an investment

Investment treaties typically contain "shares" in their definition of investment. In the absence of exclusionary language, it is generally accepted that protected investments include not only direct shareholdings, but also indirect shareholdings, irrespective of whether the intermediate company is incorporated in the investor's state, the host state or a third state.

If the company in which shares are held is incorporated under the laws of the host state, the company itself will not qualify as a foreign investor itself unless the parties to the investment dispute have agreed, pursuant to Article 25(2)(b) of the ICSID Convention, to treat the company as a national of the investor's state. However, in the absence of any such agreement, the foreign shareholders in the company may bring the claim in their own right as foreign investors under the applicable investment treaty.

In such cases, the investment constitutes the shareholding in the company which is incorporated in the host state. In these circumstances, tribunals have held that the following types of participation may qualify as an investment:

- Direct and indirect shareholdings.
- Minority shareholdings.

Direct shareholding

In respect of loss suffered by a direct subsidiary, the general principle is that an investor may seek to recover damage caused to his investment in the subsidiary as a result of which he has suffered a loss in the value of the shares. This has been the conclusion of numerous tribunals, including:

- *Asian Agricultural Products Ltd (AAPL) v Republic of Sri Lanka (ICSID Case No ARB/87/3).*
- *AMT v Zaire (ICSID Case No ARB/93/1).*
- *Alex Genin, Eastern Credit Ltd, Inc and AS Baltoil v Republic of Estonia (ICSID Case No ARB/99/2).*
- *CMS Gas Transmission Co v Argentina (ICSID Case No ARB/01/8 (Decision of the Tribunal on Objections to Jurisdiction and Decision on Annulment)).*

The claimant in *AAPL* had invested in shares in a local prawn farming enterprise. The tribunal found no barrier to affording the claimant protection under the relevant treaty independently of the affected local enterprise. The treaty protected the value of the claimant's shareholding in the enterprise.

In *AMT v Zaire*, jurisdiction was founded on the US-Zaire BIT, which provided that an investment included: "a company or shares of stock or other interests in a company or interests in the assets thereof".
AMT based its claim on its 94% shareholding in SINZA, a company incorporated under the laws of Zaire. The tribunal rejected the respondent's argument that the claimant did not have a direct investment in its own name. It found that 55% of AMT's shares were owned by US

citizens and therefore AMT was an American company and SINZA was an investment of AMT within the meaning of the BIT.

Similarly, in *Alex Genin*, the tribunal held the claimants' investment in EIB, a financial institution incorporated under the laws of Estonia, to be an investment in "shares of stock or other interests in a company" that was owned or controlled directly by the claimants as the principal shareholders.

The principle of allowing recovery of direct loss was also addressed in *CMS Gas*. The tribunal held that nothing under international law or the BIT bars the claimant from asserting its rights independently as a shareholder of the domestic company. The tribunal also confirmed that the principle of allowing a foreign investor to recover loss in the value of its shares in a (direct) subsidiary incorporated under the law of the host state was now accepted as the general rule.

Indirect shareholding

Tribunals have also allowed claims to recover loss suffered by an indirect subsidiary and have applied the same approach where the company in question was incorporated in the host state and in instances where the company was incorporated in a third state.

The tribunal in *Azurix Corp v Argentina (ICSID Case No ARB/01/12 (Decision on Jurisdiction))* determined the claimant's standing by reference to the inclusion of shares in the definition of investment in the following:

- The USA-Argentina BIT.
- The contractual rights of the subsidiary.
- The wide non-exhaustive definition of "investment" in the BIT.

The tribunal rejected the respondent's argument that the claimant did not have the right to bring a claim under the BIT. It observed that the purpose of the definition of investment in the BIT was precisely to include the type of structure put in place by Azurix for its

investment, in order to protect the real interested party (see paragraph 64 of the Decision on Jurisdiction).

The tribunal adopted a commercial view of the use of indirect shareholdings, recognising that the use of subsidiaries was an accepted commercial practice which helped to allocate risk and should not lead to a deprivation of rights. In line with *CMS Gas*, the tribunal here also held that shareholders, through the use of subsidiaries, had rights of action under the BIT.

The ad hoc committee in *Azurix (Decision on Annulment)*, elaborated on the tribunal's original position. In this case, the BIT contained a wide definition of investment which included the words "every kind of investment". This was sufficient to give the claimant standing to bring its claim. The committee stated that it could see no reason why an investment treaty could not protect a financial or commercial interest held by any of the following:

- A direct subsidiary.
- An indirect subsidiary.
- An unrelated third party.

Allowing claims from these parties did not alter their legal rights, but instead ensured that regardless of the nature of their interest, the investor was provided with certain protections.

Minority shareholdings

The size of a shareholding does not determine whether or not the latter constitutes an investment, as is evidenced by numerous decisions in which tribunals have held minority shareholdings to be an investment.

In *CMS Gas (Decision on Jurisdiction)*, the tribunal was unable to find any bar to allowing claims by shareholders independently from those of the corporation, regardless of the size of the relevant shareholding. The tribunal also emphasised that the protection of minority shareholders was now an accepted practice within investment treaty arbitration.

Further, in *Asian Agricultural Products*, the claim was based on a 50% holding of the ordinary shares of the local enterprise. The respondent claimed that this holding should be diluted on the basis that preference shares had been issued. The tribunal did not take into consideration whether the size of the claimant's shareholding is of any consequence to its standing to bring the claim, and only considered the issue when determining the quantum of its loss.

For other, more recent decisions in which minority shareholders have been granted protection under BITs, see:

- *Compania de Aguas del Aconquija & CGE v Argentina (ICSID Case No ARB/97/3 (Decision on Annulment)).*
- *Champion Trading v Egypt (ICSID Case No ARB/02/9 (Decision on Jurisdiction)).*
- *GAMI v Mexico (NAFTA Final Award, 15 November 2004).*
- *LG&E Energy v Argentina (ICSID Case No ARB/02/1 (Decision on Jurisdiction)).*
- *El Paso Energy v Argentina (ICSID Case No ARB/03/15 (Decision on Jurisdiction)).*
- *Enron Corporation and Ponderosa Assets, LP v Argentine Republic (ICSID Case No ARB/01/3)*).

Investment in accordance with host state law

It is common for investment treaties to contain a requirement that an investment be in accordance with the law of the host state. For example, Article 1(1) of the Italy-Morocco BIT provides that:

"the term 'investment' designates all categories of assets invested, after the coming into force of the present agreement, by a natural or legal person, including the Government of a Contracting Party, on the territory of the other Contracting Party, in accordance with the laws and regulations of the aforementioned party."

In *Salini (Decision on Jurisdiction)*, the tribunal said that the requirement "in accordance with the laws" referred to the validity of an investment and not its definition. Such a clause

prevents the BIT from protecting investments that should not be protected because they were illegal. This approach has subsequently been adopted by numerous tribunals, for example:

- *Tokios Tokelės v Ukraine (Decision on Jurisdiction).*
- *PSEG et al v Turkey (ISCID Case No ARB/02/5 (Decision on Jurisdiction)).*
- *LESI v Algeria (ICSID Case No ARB/05/03 (Decision on Jurisdiction)).*
- *Gas Natural SDG PA v Argentina (ICSID Case No ARB/03/10 (Decision on Jurisdiction)).*
- *Bayindir v Pakistan (Decision on Jurisdiction).*
- *Saluka Investments BV v Czech Republic (Partial Award, 17 March 2006).*
- *Inceysa v El Salvador (ICSID Case No ARB/03/26).*
- *Metal-Tech Ltd v Republic of Uzbekistan (ICSID Case No ARB/10/3)*, discussed in *Legal update, ICSID tribunal denies jurisdiction over investment tainted by corruption*.

By contrast, in *Phoenix Action*, the tribunal held that the requirement that an investment be established in accordance with the laws of the host State is implicit even when not expressly stated in the relevant BIT. The tribunal in *Plama v Bulgaria (ICSID Case No ARB/03/24 (Decision on Jurisdiction)*) reached a similar conclusion, even though the ECT contains no specific requirement requiring conformity of the investment with the laws of the host state.

In accordance with arbitral practice, it is widely accepted that the relevant time for assessing legality is the time at which an investment is made. Subsequent illegality on the part of an investor will not deprive a tribunal of jurisdiction, although it may be relevant in determining whether or not there has been a breach of the relevant investment protection standards. Furthermore, minor illegality will not deprive an investment of protection. It will generally be necessary to show that the relevant investment activity is illegal or that the investment was obtained illegally.

The requirement for specific approval

In addition to the general provision that the investment must be lawful under the law of the host state, certain BITs also require the investment to have been specifically approved in accordance with the law of the host state. For example, Article 3 of the UK-Thailand BIT provides as follows:

"(1) The benefits of this Agreement shall apply only in cases where the investment of capital by the nationals and companies of one Contracting Party in the territory of the other Contracting Party has been specifically approved in writing by the competent authority of the latter Contracting Party.

(2) Nationals and companies of either Contracting Party shall be free to apply for such approval in respect of any investment of capital whether made before or after the entry into force of this Agreement."

Similar provisions were considered in *Yaung Chi Oo Trading*. The case concerned the alleged expropriation of the claimant's investment, which it had made before the accession of Myanmar to the ASEAN Treaty. At the time of making the investment, the claimant had satisfied the requirements of the Foreign Investment Law and Procedure of Myanmar. The respondent challenged the jurisdiction of the tribunal on the basis that the investment was not protected by the ASEAN Treaty because approval under the Foreign Investment Law and Procedure did not satisfy the requirements of approval as required by the ASEAN Treaty. The respondent also contended that the investment did not qualify for protection as the claimant had not obtained approval in writing after the ASEAN Treaty entered into force as required by the Treaty.

The tribunal rejected the respondent's argument that approval under the Foreign Investment Law of Myanmar did not constitute approval under the ASEAN Treaty, confirming that prior registration pursuant to a domestic foreign investment law would constitute approval under the ASEAN Treaty. However, the requirement under the ASEAN Treaty for the investment to have subsequently been approved in writing had not been satisfied. Therefore, the investment did not qualify for protection under the ASEAN Treaty.

The specific approval provision was also addressed in *Middle East Cement Shipping and Handling Co SA v Arab Republic of Egypt (ICSID Case No ARB/99/6)*. The claimant issued a claim pursuant to the Greece-Egypt BIT. Article 2(1) of that BIT provided that investments are admitted by the host state "in accordance with its legislation". The Egyptian foreign investment law required foreign investments to be registered in order to qualify as an

investment. The tribunal declined to hold that the claimant's investment was subject to the registration requirement in the Egyptian investment law, as the Greece-Egypt BIT did not require registration.

Subsequent to the above case was the decision in *Desert Line Projects LLC v Republic of Yemen (ICSID Case No ARB/05/17)*, in which the respondent argued that the claimant's alleged investment was not accepted by it and no investment certificate was issued, both of which were requirements of the Oman-Yemen BIT.

The tribunal rejected those arguments. It concluded that the respondent had not established either that the claimant's investment was inconsistent with Yemeni laws or regulation, or that it was not accepted by the respondent.

The tribunal also held that the requirement for an investment certificate must be interpreted broadly, in the light of the objectives of the BIT. The requirement for the certificate was not necessary to bring the investment within the ambit of the BIT. However, even if the certificate was a requirement of the definition of investment, the tribunal agreed with the tribunal in *Fraport* in advocating a more liberal approach to interpreting jurisdiction *ratione materiae*. Such an approach is likely to be more generous to the investor in the light of the fact that laws and regulations of the host state in question may be unclear and mistakes may be made in good faith. The tribunal observed that it would be extraordinary if a project of this scale, which involved the mobilisation of vast resources from the very country which had co-signed the BIT, should be deprived of protection because of a failure to obtain some unspecified stamped or signed form.