International Investment Perspectives

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2006

International Investment Perspectives

2006 Edition

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Édition 2006

Foreword

International Investment Perspectives *is an annual publication. Each issue contains an update of trends and prospects in international investment and provides analyses of investment policy questions of topical interest. The publication aims to provide timely information to members of the investment policy community, academia and members of the public with an interest in international investment.*

Most of the contributions to International Investment Perspectives *are prepared by the OECD Secretariat, based on work undertaken for the OECD Investment Committee and reviewed by the Committee or its Working Party.*

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Preface

The global environment for international investment is evolving rapidly these years. A number of large developing or emerging economies that were until recently considered mainly as destinations for international investment have emerged as important outward investors. Strategies of off-shoring and outsourcing by which OECD-based enterprises move part of their value chains to overseas locations in search of special competences or lower costs have also attracted much public attention. A perceived potential shortage of minerals, especially hydrocarbons, have led companies to undertake outward investment with a view to acquiring or controlling "strategic" resources, in some cases giving rise to political controversy. And, the changing international security situation has led countries to rethink their international investment regulations.

There has been a tendency to perceive changes in the investment environment as representing a threat to OECD countries, to their industrial base and to their economic security. This is unfortunate, for cross-border investment benefits all participants as well as their domestic constituencies. It contributes to the fight against poverty in developing countries. For instance, the rapid growth and social enhancement in a number of Asian economies in recent decades has gone hand-in-hand with a growing willingness to embrace the opportunities created by a more global economy. International investment also offers great opportunities for OECD countries, especially when coupled with structural reform efforts to ensure sufficient domestic economic adaptability. Investment policy makers face the challenge of maintaining an open and transparent environment for international investment, while at the same time safeguarding national security and other essential public interests.

The present issue of International Investment Perspectives highlights several of the opportunities and proposes policy responses to ensure that home and host countries reap the full benefits of international investment. It includes two articles investigating the economics of globalisation, namely how multinational enterprises reposition themselves globally in response to technological innovation, and the impact of outward investment – the net benefits as it turns out – to the home economy.

One of the main tools for policy makers to influence the flows of international direct investment is bilateral investment treaties and investment provisions embodied in trade agreements. Such investment agreements have proliferated in recent years, and their novel features are a special focus of this publication. The special focus section also highlights issues arisen in recent investor-state arbitration and reviews ways proposed to deal with multiple proceedings to minimise inconsistent and conflicting awards, which could result in unnecessary expenses and legal uncertainty.

Manfred Schekulin
Chair, OECD Investment Committee

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PART I

ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART I

Chapter 1

Trends and Recent Developments in Foreign Direct Investment*

The global environment for FDI improved in 2005. Macroeconomic growth gained momentum in several OECD countries. At the same time, corporate profitability was generally strong, interest rates were low and equity valuation in most countries firm, all of which imply that ample liquidity was available to those companies wanting to invest abroad. Consequently, direct investment into OECD countries picked up in 2005 and reached an estimated USD 622 billion. This represents a 27 per cent increase over 2004. 2005 was the fourth-highest year on record in terms of inward FDI flows to OECD countries.

Outside the OECD area, economic developments have moved even faster. The Chinese economy is now firmly established as one of the world's foremost destinations for FDI and India, enjoying macroeconomic growth approaching Chinese rates, is quickly becoming a magnet for international direct investment. Countries that were weighed down by financial and macroeconomic crises in the late 1990s and around 2000 have also attracted renewed interest from international direct investors. At same time, some of the large emerging economies are also assuming an increasingly active role as outward investors.

* This article was prepared by Hans Christiansen, Senior Economist, and Ayse Bertrand, Manager, International Investment Statistics, in the Investment Division, OECD Directorate for Financial and Enterprise Affairs. Thanks are due to Céline Schwarz in the Investment Division for statistical inputs.

Introduction

The global environment for foreign direct investment (FDI) improved in 2005. Macroeconomic growth, traditionally one of the main drivers of direct investment, held up in North America and gained momentum in several other OECD countries. At the same time corporate profitability was generally strong, interest rates were low and equity valuation in most countries firm, all of which imply that ample liquidity was available to those companies wanting to invest abroad. In a separate development, real estate prices also reached peak levels in many countries, which seems to have spurred a wave of cross-border investment in property and in businesses involved in property administration.

Outside the OECD area, economic developments have moved even faster. The Chinese economy, now firmly established as one of the world's foremost destinations for FDI, continues to grow at official annual rates close to 10 per cent. After many years of chronically low growth, assisted by a process of regulatory reform and liberalisation the Indian economy now enjoys growth rates approaching Chinese rates, and is quickly becoming a magnet for international direct investment. Countries that were weighed down by financial and macroeconomic crises in the late 1990s and around 2000, including in South East Asia and South America, have also been in the process of recovering and attracting renewed interest from international direct investors.

The outlook for FDI in the coming years is positive overall, as the expectation is for macroeconomic conditions to firm in most OECD countries, and structural reform efforts to continue in emerging economies. However, some risks cloud the horizon. One is macroeconomic, relating to the fact that interest rates may rise, taking equity prices down and contributing to more cautious corporate investment strategies.

Another risk factor is political in nature. While many developing and emerging economies continue to take steps to open their economies to international participation, the international security situation and fears of negative consequences of globalisation have prompted the governments of several OECD countries to review their FDI regulations. Citing legitimate concerns about national security and other essential public interests, authorities have reviewed and in some cases sought to discourage foreign participation in sectors perceived as being of strategic interest. A few countries have tightened their legislation in this respect, and in several others there are discussions about doing likewise (Section 4 below).

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Without contesting sovereign nations' right to regulate, there is a risk that regulatory action may sometimes exceed what is needed to safeguard essential interests and be motivated by protectionist motives. The challenge for policy makers is to find ways of safeguarding essential interests while at the same time keeping their investment regimes transparent and non-discriminatory. Failure to do so may impose considerable economic costs on the host economy. In the broader international context it could compromise efforts to proceed towards a mutually beneficial open investment environment.

1. Foreign direct investment in OECD countries etched up in 2005

Direct investment into OECD countries picked up in 2005 and reached an estimated 622 billion US dollars (USD). This represents a 27 per cent increase over 2004 and is the highest level of inflows since the previous investment boom petered out in 2001. In consequence, 2005 became the fourth-highest year on record in terms of inward FDI flows to OECD countries. The country distribution of inflows (reviewed in more details below) is consistent with past trends, the United States and United Kingdom being the main destinations for FDI, followed by some of the largest continental European economies. The business sectors of some countries – notably the Benelux countries – have experienced large amounts of pass-through investment via holding companies, and the respective national data must therefore be interpreted with caution.

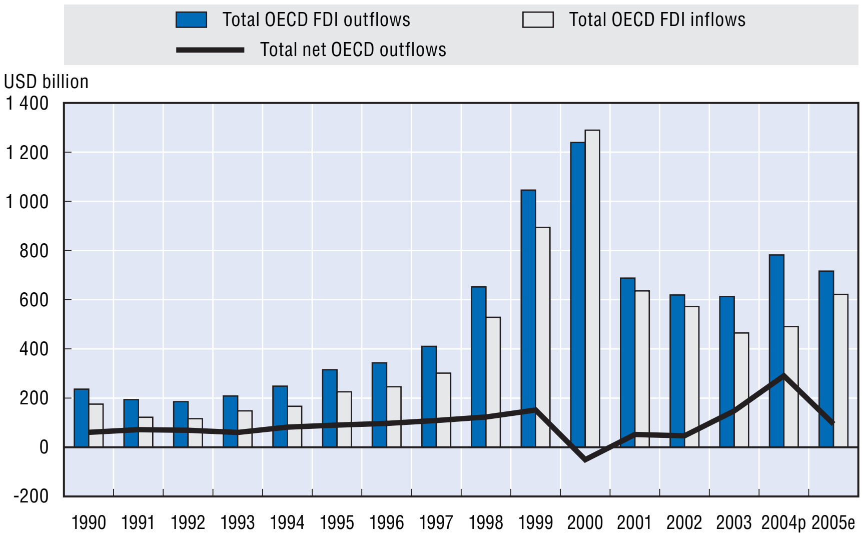
Total OECD outflows dropped slightly, by around 8 per cent, to reach an estimated USD 716 billion in 2005. However, as indicated below, the 2005 outflows are influenced in a one-off drop in US figures estimated at at least USD 100 billion, in the absence of which aggregated OECD figures would have shown continued growth.[1] Consequently, the United States temporarily lost its role as the world's foremost outward investor. This role was assumed by France (leaving aside the Netherlands, for reasons explained below), whose domestic enterprises undertook massive acquisitions abroad in 2005, followed by the United Kingdom, which was very active on the investment scene, both as an outward investor and as a recipient.

In consequence of large inflows and even larger outflows, the OECD area as a whole continued to act as a major net outward direct investor. The estimated net outflows in 2005 were USD 95 billion – less than in the immediately preceding years, but quite high by historic standards.

1.1. Developments in selected countries

In the *United Sates* the net FDI inflows were USD 110 billion in 2005. This represents an 18 per cent decrease from 2004 (USD 133 billion) and is way below the levels of investment that were recorded around 2000, but is still

Figure 1.1. **FDI flows to and from OECD**



p: Preliminary.
e: Estimate.
Source: OECD International Direct Investment database.

relatively high in a longer perspective (Table 1.1 and Figure 1.2). US inflows increasingly reflect inter-company loans and reinvested earnings, whereas equity capital inflows actually decreased in 2005.

US outward direct investment in 2005 fell from its habitually high levels to almost zero. However, this appears to be a temporary effect, triggered by changes in tax legislation. The American Jobs Creation Act of 2004 reduces the rate of taxation on US multinational enterprises' qualifying dividends from abroad for a period of one year. In consequence, the 2005 distributions of earnings from foreign affiliates to parents in the United States were elevated, and earnings reinvested in affiliates abroad were reduced by a like amount. For this reason the reinvested earnings component of US direct investment abroad became sharply negative, particularly in the last quarters of 2005.[2]

Total FDI outflows from *Japan* in 2005 were USD 46 billion, up from USD 31 billion in 2004. This is a spectacular increase. Even as the Japanese economy is traditionally one of the world's most important outward investors, the 2005 figure is the highest on record since 1990. However, most of the rise does not derive from "new projects" (equity capital investment, in statistical parlance), but from reinvested earnings in existing projects.[3] Japanese outward investors benefited from a high profitability of their overseas assets in 2005 and kept much of the money in the host economies. Conversely, inward direct investment in 2005, at

Table 1.1. **Direct investment flows to and from OECD countries: 2002-05**

USD billion

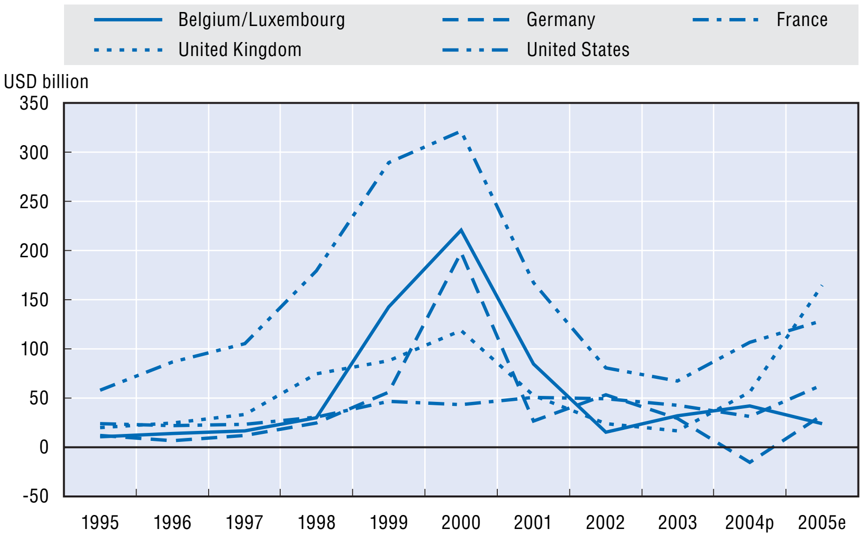
	Outflows				Inflows			
	2002	2003	2004p	2005e	2002	2003	2004p	2005e
Australia	8.0	15.5	17.5	–39.8	17.7	9.7	42.0	–36.8
Austria	5.8	7.1	7.4	9.4	0.4	7.2	3.7	8.9
Belgium	12.7	36.9	33.5	22.9	15.6	32.1	42.1	23.7
Luxembourg	125.8	99.9	81.7	52.4	115.2	90.3	77.3	43.7
Canada	26.8	21.5	43.2	34.1	22.1	7.6	1.5	33.8
Czech Republic	0.2	0.2	1.0	0.9	8.5	2.1	5.0	11.0
Denmark	5.7	1.1	–10.4	8.1	6.6	2.6	–10.7	5.0
Finland	7.6	–2.3	–1.1	2.7	7.9	3.3	3.5	4.6
France	50.5	53.2	57.0	115.6	49.1	42.5	31.4	63.5
Germany	19.0	6.2	1.9	45.6	53.6	29.2	–15.1	32.6
Greece	0.7	0.4	1.0	1.5	0.1	1.3	2.1	0.6
Hungary	0.3	1.6	1.1	1.3	3.0	2.1	4.7	6.7
Iceland	0.3	0.4	2.6	6.7	0.1	0.3	0.7	2.3
Ireland	11.0	5.6	15.8	12.9	29.4	22.8	11.2	–22.8
Italy	17.1	9.1	19.3	41.5	14.6	16.4	16.8	19.5
Japan	32.3	28.8	31.0	45.8	9.2	6.3	7.8	2.8
Korea	2.6	3.4	4.7	4.3	2.4	3.5	9.2	4.3
Mexico	0.9	1.3	4.4	6.2	18.3	14.2	18.7	18.1
Netherlands	32.0	44.2	17.3	119.4	25.1	21.8	0.4	43.6
New Zealand	–1.1	0.2	1.1	–0.3	–0.3	2.0	4.4	2.8
Norway	4.2	2.1	3.5	3.4	0.7	3.8	2.5	14.5
Poland	0.2	0.3	0.8	1.5	4.1	4.9	12.4	7.7
Portugal	–0.1	8.0	8.0	1.1	1.8	8.6	2.4	3.1
Slovak Republic	0.0	0.0	0.2	0.1	4.1	0.6	1.1	1.9
Spain	32.7	27.6	60.6	38.7	39.2	26.0	24.8	23.0
Sweden	10.6	21.3	11.9	26.0	11.7	1.3	–1.9	13.7
Switzerland	8.2	15.4	26.9	42.8	6.3	16.5	0.8	5.8
Turkey	0.2	0.5	0.9	1.0	1.1	1.8	2.8	9.7
United Kingdom	50.3	62.4	94.9	101.1	24.1	16.8	56.3	164.5
United States	154.5	140.6	244.1	9.1	80.8	67.1	133.2	109.8
Total OECD	**619.1**	**612.6**	**781.8**	**716.1**	**572.5**	**464.8**	**490.9**	**621.7**

Notes: Data are converted to US dollars using average exchange rates.
p: Preliminary.
e: Estimate.
Source: OECD International Direct Investment database.

USD 3 billion, was low by past standards and in comparison with other large economies.

German FDI inflows and outflows recovered briskly in 2005 from levels in previous years that were unusually low due to the one-off effects of a corporate tax reform. Outflows totalled USD 46 billion, mostly in the form of equity capital.

Figure 1.2. **Inward FDI in selected countries**



p: Preliminary.
e: Estimate.
Source: OECD International Direct Investment database.

According to a recent analysis the outflows were somewhat concentrated on the "old" EU countries (members prior to the latest enlargement) together with Switzerland, whereas Central and Eastern Europe received relatively little and there was disinvestment of German-owned assets in the United States.[4] Inward direct investment in 2005, at USD 33 billion, was high compared with the recent past, but less impressive in a longer historical perspective. The figures were influenced by a few very large transactions, especially in the financial and pharmaceutical sectors.

With inflows of USD 165 billion, the *United Kingdom* was the world's largest recipient of inward FDI in 2005. This is the largest inward direct investment flow ever recorded in the United Kingdom, and it represents a tripling of the already internationally high inflows in 2004. The high figure reflects, in part, the fact that many of the world's largest cross-border takeovers in 2005 targeted UK-based companies. It is also influenced by large flows in connection with the restructuring of a large hydrocarbons producer. Outward FDI likewise grew, from USD 95 billion in 2004 to USD 101 billion in 2005. In consequence, the United Kingdom, traditionally a net exporter of direct investment, in 2005 recorded large net inflows for the first time since 1990.

France continued to attract large direct investment inflows. FDI into France more than doubled from USD 31 billion in 2004 to USD 64 billion in 2005. As in previous years, one of the factors underpinning foreign direct investment in France was the acquisition by foreign companies of corporate and residential real estate. Moreover, France was the world's largest outward direct investor in 2005 (apart from the Netherlands, which was influenced by certain statistical peculiarities – see below). Total outflows for the year as a whole were estimated at close to USD 116 billion. This is mostly attributed to a few very large foreign corporate takeovers by companies domiciled in France. The largest four such transactions (described in more detail in the following section) were valued at a total USD 48 billion.

FDI inflows to Canada *bounced* back in 2005 from historically low levels in the previous years. Total inward FDI, at USD 34 billion, reached its second-highest level ever, which has so far only been exceeded in the boom year 2000. One of the main factors at play seems to have been that the investment by large US-based enterprises in Canada has regained momentum. Several large corporate takeovers took place across the US-Canadian border in the course of 2005.

Among the relatively new OECD member countries, the *Czech Republic* was very successful in attracting FDI in 2005. Total inflows reached USD 11 billion, which is the highest level ever recorded in this country and well above what small and medium-sized economies normally attract. Close to half of this amount is accounted for by a cross-border takeover in the telecom sector, but it also reflects a process of continued build-up of productive capacity with the support of foreign capital.

FDI inflows into *Mexico* remained strong in 2005, remaining close to the level of around USD 18 billion around which they have fluctuated in recent years (at just above USD 18 billion in 2005). The manufacturing sector received the majority of the inflows, much of which via the "maquila" free economic zones. The implication of this is that the high inflows may reflect the continued strength of the business cycle of the United States where most of the investors into this segment of the Mexican economy are located. According to a recent study, the fastest growing sub-sector is the automobile industry where established foreign companies have extended their operations and new investors, including from Japan, are in the process of entering the market.[5] At the same time, Mexico's role as an outward investor has also gathered pace, with outward FDI reaching an all-time-high of USD 6 billion in 2005.

The figures from two other countries should be interpreted with considerable caution because of statistical peculiarities. (See also Box 1.1 for a definition of foreign direct investment.) For instance, inflows as well as outflows in *Australia* turned sharply negative in 2005 because of corporate restructuring that triggered disinvestment in both directions. The *Netherlands'* 2005 outflows were huge, mostly because of a corporate restructuring that gave rise to outward direct investment and inward portfolio flows. The inflows

Box 1.1. **Foreign direct investment statistics: main concepts**

Direct investment is a category of cross-border investment made by a resident entity in one economy (the "direct investor") with the objective of establishing a "lasting interest" in an enterprise resident in an economy other than that of the investor (the "direct investment enterprise").

The *lasting interest* is evidenced when the direct investor owns 10 per cent of the voting power of the direct investment enterprise.

A *foreign direct investor* is an entity that has a direct investment enterprise operating in a country other than the economy of residence of the foreign direct investor. A direct investor could be: an individual (or a group of related individuals; an incorporated or unincorporated enterprise; public or private enterprise (or a group of related enterprises); a government; estates, or trusts or other organisations that own enterprises.

A *direct investment enterprise* is as an incorporated or unincorporated enterprise (including a branch) in which a non-resident investor owns 10 per cent or more of the voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise.

Direct investment is composed of: equity capital, reinvested earning and other capital.

Equity capital comprises: *i)* equity in branches; *ii)* all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and included under direct investment, other capital); and *iii)* other capital contributions.

Reinvested earnings of a direct investment enterprise reflect earnings on equity accruing to direct investors less distributed earnings; they are income to the direct investor. However, reinvested earnings are not actually distributed to the direct investor but rather increase direct investor's investment in its affiliate.

Other capital (or inter-company debt transactions) borrowing and lending of funds between direct investors and subsidiaries, associates and branches.

and outflows of *Luxembourg* were, like in previous years, very big reflecting large amounts of pass-through investment via holding companies domiciled in the country.

1.2. Taking the longer perspective

Over the last decade the role of OECD countries as the world's foremost provider of direct investment funds has been firmly established. Net outflows from OECD countries reached USD 1062 billion over the last decade (1996 to 2005 – see Table 1.2). France, the United Kingdom, Japan, the Netherlands, Switzerland and Spain have been the OECD's main next exporters of FDI over

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Table 1.2. **Cumulative FDI flows in OECD countries 1996-2005**

USD billion

Inflows		Outflows		Net outflows	
United States	1 539.7	United States	1 414.1	France	379.1
Belgium/Luxembourg	948.8	United Kingdom	1 021.1	United Kingdom	368.0
United Kingdom	653.1	Belgium/Luxembourg	962.0	Japan	244.0
Germany	424.5	France	782.1	Netherlands	177.3
France	402.9	Netherlands	489.9	Switzerland	154.4
Netherlands	312.6	Germany	459.0	Spain	107.8
Canada	228.3	Spain	332.4	Canada	65.8
Spain	224.6	Japan	304.1	Italy	47.1
Mexico	164.2	Canada	294.1	Germany	34.5
Sweden	157.2	Switzerland	242.2	Sweden	23.7
Italy	115.2	Sweden	180.9	Finland	21.6
Ireland	108.4	Italy	162.3	Belgium/Luxembourg	13.2
Switzerland	87.8	Finland	73.5	Iceland	6.8
Australia	77.8	Denmark	68.6	Portugal	4.8
Denmark	72.3	Ireland	65.8	Austria	–0.9
Poland	67.2	Austria	48.6	Greece	–3.1
Japan	60.1	Portugal	41.4	Denmark	–3.7
Korea	52.2	Korea	40.5	Norway	–9.8
Finland	51.9	Norway	39.2	Korea	–11.7
Czech Republic	50.0	Australia	32.8	Slovak Republic	–13.1
Austria	49.5	Mexico	17.2	Turkey	–17.7
Norway	48.9	Iceland	11.0	New Zealand	–24.0
Hungary	37.3	Greece	6.6	Hungary	–30.9
Portugal	36.6	Hungary	6.4	Ireland	–42.6
New Zealand	23.5	Turkey	5.3	Australia	–45.0
Turkey	23.0	Poland	3.1	Czech Republic	–47.1
Slovak Republic	13.5	Czech Republic	2.9	Poland	–64.0
Greece	9.7	Slovak Republic	0.3	United States	–125.7
Iceland	4.2	New Zealand	–0.5	Mexico	–147.1
Total OECD	**6 045.2**	**Total OECD**	**7 106.9**	**Total OECD**	**1 061.7**

Source: OECD International Direct Investment database.

this period. Some of the wealthiest non-OECD economies (*e.g.* in the Middle East) have also been active net outward investors.

By contrast, the United States was among the largest net recipients of direct investment over the last decade. This may appear paradoxical since it puts the US economy in the same league as countries like the Czech Republic, Poland and Mexico,[6] all of which have relied on direct investment to fund a build-up of domestic productive capacity. Rapidly growing economies outside the OECD area (*e.g.* China, India and emerging economies) have for similar reasons been net importers of direct investment as well.

Several factors seem to be influencing countries' relative roles as net importers or exporters of direct investment. Direct investors are basically motivated by risk-adjusted expected returns on their investments, meaning that particularly large or fast-growing markets exert a pull on investment, as do low production costs and an improving valuation of corporate assets (*e.g.* a booming stock market). The same applies to countries perceived to be relatively risk-free investment locations, whereas counties whose investment climates are dogged by political insecurity and poor public and corporate governance are unlikely to attract much investment.

It is in this light that the United States' role as a net recipient of direct investment should be seen. The country's role as the world's richest economy and home to the largest number of multinational enterprises on Earth would normally militate towards outward direct investment, but the pull that the US economy has exerted on foreign corporate investors has been even greater. All of the above factors may at some point have been at play. The US economy has outgrown most other OECD economies in recent years, and equity prices have been mostly firm, which has contributed to attract investment from other, less fast-growing, industrialised economies. At the same time, the widespread perception of the United States as being perhaps the world's lowest-risk investment location has helped attract investment from outside the OECD area.

The outward investors have in some cases been countries with large current account surpluses. Japan, Switzerland and some of the oil producing countries outside OECD have all been induced to place large sums of money in internationally denominated assets. While this need not be done by private sector investors – let alone in the form of foreign direct investment – it is a factor that generally contributes to lower domestic returns on capital encouraging private investors to look abroad for more profitable opportunities.

Among other of the largest net outward investors other factors have been at play. The fact that the Netherlands and the United Kingdom are home to many of Europe's largest multinational enterprises naturally has an impact on their FDI flows. Many of the large French enterprises appear to have, at least in the last 6-8 years, pursued strategies of cross-border acquisitions, not least in other European economies.

2. Robust activity in non-OECD economies

International investors' interest in non-OECD countries held up strongly in 2005. Without over-interpreting the figures which, as in most small or medium-sized economies, are affected by year-to-year fluctuations reflecting large individual transactions, a few general trends nevertheless suggest themselves.

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Among the ***non-member adherents*** to OECD's investment instruments, Brazil confirmed its position as the world's foremost destination for direct investment to developing and emerging economies outside Asia (Table 1.3). Inflows of USD 15 billion to this country in 2005 were not vast by historical standards, but easily the largest in South America. Investment was down a bit from the year before, but this reflects the one-off effect of a large investment in the brewery sector in 2004. In 2005, investment seems to have focused more strongly on new activities and extensions of capital, including in the manufacturing sector.

Table 1.3. **Foreign direct investment flows in selected non-member economies: 2001-05**

USD billion

	Inward FDI					Outward FDI				
	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Adherent countries[1]										
Argentina	2.2	2.2	1.7	4.3	4.7	0.2	–0.6	0.8	0.4	1.2
Brazil	22.5	16.6	10.1	18.1	15.1	–2.3	2.5	0.2	9.8	2.5
Chile	4.2	2.5	4.3	7.2	7.2	1.6	0.3	1.6	1.5	2.4
Estonia	0.5	0.3	0.9	1.0	2.9	0.2	0.1	0.2	0.3	0.6
Latvia	0.1	0.3	0.3	0.7	0.6	0.0	0.0	0.0	0.1	0.1
Lithuania	0.4	0.7	0.2	0.8	1.0	0.0	0.0	0.0	0.3	0.3
Israel	3.6	1.8	3.9	1.7	6.1	0.7	1.0	2.1	3.4	2.3
Romania	1.2	1.1	2.2	6.5	6.4	0.0	0.0	0.0	0.1	0.0
Slovenia	0.5	1.6	0.3	0.8	0.5	0.1	0.2	0.5	0.6	0.6
Others										
China	46.9	52.7	53.5	60.6	72.4	6.9	2.5	–0.2	1.8	. .[2]
Hong Kong, China	23.8	9.7	13.6	34.0	35.9	11.3	17.5	5.5	45.7	32.6
India	5.5	5.6	4.6	5.3	6.6	1.4	1.7	1.3	2.3	1.4
Russia	2.7	3.5	8.0	15.4	14.6	2.5	3.5	9.7	13.8	13.1
Singapore	15.0	5.7	9.3	24.0	33.4	17.1	3.7	3.7	14.3	9.2
South Africa	6.8	0.8	0.7	0.8	6.4	–3.2	–0.4	0.6	1.4	0.1

1. Non-member adherents to the OECD Declaration on International Investment and Multinational Enterprises.
2. According to the Chinese Ministry of Commerce, 2005 outflows were USD 6.9 billion. However, the figures released by the Ministry have generally not been consistent with the data reported elsewhere in the table.

Source: IMF Balance of Payments Statistics and national sources consistent with this database.

Inward FDI in Argentina was close to USD 5 billion. This figure is low compared with the inflows of around USD 10 billion per year that were recorded prior to the Argentine financial crisis (and USD 23 billion in the peak year), but it is nevertheless a rebound from the depressed levels of 2001 to 2003. It is apparently linked with the macroeconomic recovery – especially as it includes capacity expansions in the manufacturing sector – and a gradual return of business confidence. However, a large number of unresolved investor/state arbitration cases continue to dog investor sentiment, as does the announcement of several international service companies that they will withdraw from the Argentine economy.

Direct investment into Chile, at USD 7 billion, was almost unchanged in 2005. With an already large foreign corporate presence in the country, much of the inflows represent reinvested earnings. In addition to mining, some of the main foreign-invested sectors in Chile are related to infrastructure, especially transport, communication and electricity. According to recent estimates by the Chilean authorities, utilities concessions have also brought in around USD 1 billion of foreign investment annually in recent years.[7]

Direct investment in Israel jumped in 2005 to reach USD 6 billion, or more than three times the levels recorded in 2004. In the main this reflects foreign participation in a number of large-scale privatisations, including some in the financial sector. Israel is also one of the most active outward investors among the smaller non-member economies, including in technology-intensive sectors. For the last three years, total annual outflows have exceeded USD 2 billion and the indications are that levels in 2006 will be even higher.

Inward investment in Romania in 2005 remained high at around USD 6½ billion for the second year in a row. Inflows continue to be influenced by an ongoing process of privatisation. However, the high 2005 figure also includes considerable greenfield investment and extensions of previous investment projects, particularly in the automotive industry and the service sectors.

Among the largest ***other non-member economies***, as a destination for FDI China remains in a class of its own. Total inflows in 2005 are estimated at USD 72 billion. Even when taking into account that some of this money is commonly considered to be "round-tripping" of intra-China investment via Hong Kong (China), China is among the world's foremost recipients of direct investment. According to Chinese official pronouncements the sectoral balance of inward FDI, which was previously tilted toward manufacturing investment, is beginning to swing toward the service sectors. In 2005, the banking, insurance and securities sectors alone are estimated to have received investments of USD 12 billion.

China's increasingly active role as an outward investor – in the 1980s and 1990s mainly in natural resources, but now increasingly also in high-tech sectors – is not yet fully reflected in internationally comparable FDI statistics. There is evidence of widespread evasion of the burdensome approval and registration procedures by Chinese enterprises, particularly in the non-state-owned sector, using funds parked abroad in subsidiaries and special purpose entities in low-tax jurisdictions as well as retained foreign

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earnings. China's Ministry of Commerce has announced that total outward FDI in 2005 approached USD 7 billion. This figure is almost certainly an underestimate, Very large projected outflows of capital to the developing world, particularly Africa, are raising concern in some countries over competition for scarce energy resources and over possible undermining of internationally-recognised standards of corporate conduct, including in weak governance zones.

FDI into India apparently continues to grow. National sources estimate inward direct investment in 2005 at an all-time high USD 6½ billion. This is likely to be an underestimate, as recent sectoral liberalisation measures have ensured that an increasing proportion of inward FDI now arrives unscreened via the "automatic route", requiring only notification to the central bank – an obligation that is not enforced and therefore widely ignored. Although manufacturing is generally open to foreign investment and there has recently been substantial liberalisation of the FDI regime in some sectors, such as telecommunications, others, notably the retail industry, remain closed to foreign investors.

Direct investment in India is in public debate often linked with offshore outsourcing, especially in the information technology sector (though it should be noted that this is also an area of major domestic as well as foreign investment), but the real picture is more mixed. For instance, two of the sectors that received large amounts of inward FDI in 2005 were automobile manufacturing and mining. It should however be noted that a large number of international information technology and communication companies have in the last year announced plans to increase their corporate presence in India. If borne out by the facts this could push up inward FDI further in the coming years and lead to an even stronger concentration in the service sectors.

Also, while international direct investment in India is only recorded at about one-tenth of that in China, it should be noted that India receives far more equity investment than China in its more developed capital markets. India's outward FDI is starting to become significant, though this may not yet be apparent from official statistics, possibly because of some under-recording. Much Indian outward FDI in 2005 was in the form of cross-border mergers and acquisitions, mainly in telecommunications, energy and pharmaceuticals, though these remained small by international standards. Larger M&A transactions on the part of Indian multinationals are likely to follow in future years. Some large Indian services companies specialising in offshore outsourcing have in recent years also been active in investing in a large number of developed countries.

Russian inward investment, estimated at USD 14½ billion in 2005, remains at a high level following a sharp pick-up in 2004. However, the high figures appear to include non-trivial amounts of concurrent in- and outflows in the context of corporate restructuring. The main sectors of investment were manufacturing (including large amounts flowing into the production of automobiles) and the energy sector, which accounted for 45% and 32% respectively of total inflows.[8] According to recent announcements by the Russian government, increasing foreign participation in large-scale projects will be invited in the coming years, notably in the infrastructure sectors.

A final observation from Table 1.3 regards South Africa, which is active in direct investment by African standards but usually not comparable with the larger OECD economies. South Africa experienced massive FDI inflows in 2005 of close to USD 6½ billion. However, much of this amount is ascribed to one major takeover in the financial sector.

3. Mergers and acquisitions: trends and individual transactions

While mergers and acquisitions (M&A) are only one element in total FDI flows, in many OECD countries they account for more than half of total direct investment. This is especially the case in times of strong investment activity, as they tend to be the component of FDI that responds most strongly, or most immediately, to changes in the business climate, financial conditions and macroeconomic performance.

Overall data for cross-border M&As in 2005 and early 2006 may hence provide additional guidance on where FDI is heading. Some caution is, however, called for: privately collected M&A data tend to be more inclusive than official FDI statistics. FDI data include only the value of corporate assets actually transferred, whereas published M&A data tend to take as their starting point the market value of the enterprises acquired. Moreover, in overall FDI figures, disinvestment is subtracted from the totals, whereas the M&A data used in this article concerns gross cross-border flows. The data used in the reminder of this section was kindly provided by Dealogic.

True to their volatile nature, cross-border M&As have recovered much more briskly than FDI flows over the last few years. Since the trough in 2003, the value of both inward and outward M&As in OECD countries has doubled. Cross-border M&As with the acquirer located in the OECD area were valued at USD 671 billion in 2005 (Table 1.4). M&As targeting companies in OECD countries were a bit lower at USD 627 billion. This confirms a trend that the M&A component shares with the overall FDI figures: OECD countries as a whole are usually net outward investors.

In the first five months of 2006 (data end on 19 May 2006) total outward M&As worth USD 217 billion were recorded and the inflows amounted to USD 213 billion. If these numbers are taken to be indicative for 2006 as a whole then, by an admittedly rough estimate, total 2006 outward flows could amount

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Table 1.4. **Cross-border M&As to and from OECD countries, total**
USD billion

	Outward	Inward
1995	134.1	146.5
2000	1 166.4	1 135.8
2003	321.3	337.8
2004	418.8	441.3
2005	670.8	626.9
January-May 2006	217.3	212.5
Estimate 2006	566.9	554.3

Source: Dealogic and OECD Secretariat.

to around USD 565 billion and inflows to some USD 555 billion. If borne out by the facts, this will represent a slight decline in M&A activity since 2005, but still be high compared with the previous years.

Based on historic patterns of co-variation between cross-border M&As and FDI this can be translated into a projection of FDI flows. On current trends, both inward and outward FDI in the OECD area could stay unchanged or decline slightly in 2006.[9]

3.1. Recent sectoral trends and individual transactions

The largest mergers and acquisitions in the last 1½ years (2005 through 19 May 2006) display some interesting national and sectoral patterns. There has been a significant change since the last time cross-border M&A activity was at comparable levels (a the beginning of the decade) – at which time the largest transactions were mostly related with the high-tech euphoria of those days, as well as a wave of utilities privatisation in many countries. Recent large international M&As have been much more evenly distributed across sectors, albeit with notable differences across countries (Table 1.5 – which defines "large" cross-border M&As as transactions valued at no less than USD 1.5 billion).

Consistent with aggregate FDI figures, the two largest target countries for M&A were the United States and United Kingdom, both of which experienced 21 cross-border takeovers of large enterprises, or equity stakes, in the period under review. Other important targets for foreign takeovers were the small economies of Northern Europe and the Asian economy. The large continental European economies, South Europe and the rest of the world saw relatively less activity in 2005 and early 2006.

Table 1.5 makes special reference to certain sectors that have been identified and recently publicly debated in OECD and other countries in the context of protecting national security and other essential interests: energy and natural resources; chemicals, pharmaceuticals and medical equipment; defence and

Table 1.5. **Inward cross-border M&As valued at more than USD 1.5 billion from January 2005 to May 2006**

Number of transactions

	Energy and resources	Chemicals and medical	Heavy industry and defence[1]	Other manufacturing	Information and communication	Finance	Other services	Total
United States	3	4	2	3	2	2	5	21
Other America	6		2	3	2	1	1	15
United Kingdom	4		1	5	3	2	6	21
Germany	1	1		1	1	1	4	9
France		1		2			1	4
Other North Europe[2]	2	1		5	4	3	4	19
South Europe[3]			1		3	4		8
Other Europe		1	1		3	1	2	8
Asia	1			2	1	8	2	14
Rest of world	2				2	1	1	6
Total	**19**	**8**	**8**	**21**	**21**	**23**	**25**	**125**

1. Metals, cement and defence equipment other than information and communication.
2. BeNeLux, Scandinavia, Poland and the Baltic Countries.
3. Italy, Greece, Portugal, Spain, Turkey and the Balkans.

Source: Dealogic.

heavy industries; information and communication; and the financial sector. The following subsections summarise some of the main trends, but do not extend to discussing each of the individual 125 transactions.[10]

3.1.1. United States

Three of the large takeovers of US-based enterprises affected companies in the *energy and natural resource sectors*. The largest (which was also the sixth-largest cross-border M&A in the period under review) was the takeover of Innovene, BP's North American olefins, derivatives and refining subsidiary, by fellow UK company INEOS for USD 9.0 billion. Another large transaction was the USD 2.4 billion acquisition of the oil producer Spinnaker Exploration by Norsk Hydro of Norway. The third acquisition on record was the Norwegian Statoil's purchase of EnCana Corp's deepwater US oil portfolio in the Gulf of Mexico for USD 2.0 billion.

Early 2006 saw several large foreign acquisitions in the US *pharmaceutical and medical* industry. The generic drugs maker IVAX Corp was acquired by Teva Pharmaceutical Industries of Israel in a friendly takeover valued at USD 8.7 billion. Novartis of Switzerland paid USD 5.9 billion for a 56 per cent stake in Chiron Corporation. Likewise in 2006, the provider of dialysis services

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and products Renal Care Group was taken over by Fresenius Medical Care of Germany for USD 4.0 billion. In 2005, one comparatively smaller transaction took place, namely the purchase of 65.4 per cent of the equity on the drugs maker Eon Labs by Novartis of Switzerland.

In the US *defence industry*, one foreign takeover attracted considerable public attention in 2005, namely the acquisition United Defense Industries, a maker of heavy combat equipment, for USD 4.0 billion by BAE Industries of the United Kingdom. A notable acquisition in the *heavy industries* was the takeover of the steelmaker International Steel Group by Mittal Steel of the Netherlands for an estimated USD 4.8 billion.

3.1.2. Other America

Recent large-scale foreign takeovers in American countries "other than the United States" have frequently targeted Canada. However, there have been a few notable exceptions, including Mexico and a couple of large economies in South America – as well as Bermuda, where some of the information and communication companies that have been targeted recently were domiciled.

In the *energy and natural resource sectors* on the American continent the acquirers have mostly been domiciled in the United States. The largest acquisition of a Canadian company in this sector was the USD 5.7 billion takeover of the gas distributor Terasen by the US-based company Kinder Morgan. The Canadian oilfield services company Precision Drilling's energy services and international contract drilling division was acquired by Weatherford International of the United States for USD 2.7 billion, and the oil producer Northrock Resources was sold by Unocal of the United States to Pogo Producing Company, likewise of the United States, for USD 1.8 billion. A couple of non-US investors were also involved in this sector of the Canadian economy. The Canadian arm of Nelson Resources was taken over by Lukoil OAO of Russia for USD 2.0 billion, and Xstrata of Switzerland paid USD 1.7 billion for 19.9 per cent of the nickel maker Falconbridge. In Mexico, Southern Peru Copper Corporation of the United States acquired the mining company Minera Mexico for an estimated USD 4.1 billion.

A few high-profile takeovers took place elsewhere in the economies of the Americas. For instance, the Luxembourg-based steel maker Arcelor, itself the target of a recent cross-border bid, acquired the Canadian steelmaker Dofasco for an estimated USD 5.1 billion in 2006. Finally, and illustrating that not all large M&As are in particularly "strategic" sectors, three of the biggest cross-border takeovers in the western hemisphere in 2005-06 targeted beer producers.

3.1.3. United Kingdom

The United Kingdom was the target country for two of the largest three cross-border M&As in 2005 and early 2006. The largest of these, in one of the sectors that are considered as "sensitive" in many countries, was the takeover of the telephone operator O2 by Telefonica of Spain for USD 31.7 billion in the beginning of 2006. (The other top-three transaction was the USD 17.8 billion acquisition of the distiller Allied Domecq by Pernod Ricard of France.) Another very sizable acquisition of a UK company was the takeover of the Peninsular and Oriental Steam Navigation Company by Dubai Ports World of the United Arab Emirates for USD 8.2 billion. The latter transaction gave rise to security concerns in the United States owing to P&O's North American port operation services (further details in the following section).

The United Kingdom experienced several cross-border takeovers in the *energy and natural resource sector*. The largest such transaction was the restructuring of electricity provider British Energy plc with the participation of an international group of creditors for USD 2.9 billion. National Grid Transco sold its gas distribution networks in Northern England to corporate investors in Hong Kong (China) for USD 2.5 billion, and its gas distribution networks in Wales and Western England to a group of Australian investors for USD 2.2 billion. A strategic stake in the uranium mining company Paladin Resource was acquired for USD 2.4 billion by Talisman Energy of Canada.

In addition to the O2-Telefonica linkup, a couple of other notable mergers and acquisitions took place in the *information and communications sector*. NTL sold its broadcasting and television transmission business for USD 2.4 billion to an Australian group of investors. And, Marconi Corporation sold its interests in telecommunications equipment and international service business to Ericsson of Sweden for USD 2.1 billion.

3.1.4. France and Germany

Relatively few cross-border mergers and acquisitions targeted France and Germany in 2005 and early 2006 (13 in total), but one of them was the second-largest during the period under review. The purchase of Bayrische Hypo- und Vereinsbank (HVB Group) for USD 22.3 billion by UniCredito Italiano of Italy was a very large transaction – even by the past standards of international investment in the financial sector. In fact, the banks involved were so large as to trigger competition concerns in an OECD country other than the two directly involved (further details in the following section). Confirming a trend from previous years, several of the other large transactions in both France and Germany were cross-border acquisitions of property administration companies or real estate portfolios.

Within the *medical sector* there was one transaction in each country, namely the USD 5.7 billion acquisition of the German drugs maker Hexal by Novartis of Switzerland, and the takeover of the French Laboratoires Fournier by Solvay of Belgium for an estimated USD 1.9 billion. In the *energy sector* one large takeover was recorded, namely the purchase of the German gas provider Ruhrgas Industries by CVC Capital Partners of the United Kingdom for USD 1.8 billion.

3.1.5. North Europe

North Europe – for the present purpose defined broadly to include the Benelux, the Nordic countries, Poland and the Baltic countries – was the target of 19 large cross-border acquisitions in 2005 and early 2006. The number of transactions is relatively big given the size of the area's economy. Many of the M&As, however, took place outside the sectors that usually generate a lot of public interest. Among the largest individual transactions were Old Mutual of the United Kingdom's takeover of the Swedish insurer Skandia Försäkrings AB for USD 7.0 billion, and the acquisition of the Dutch plastic maker Basell by Access Industries of the United States for USD 5.7 billion.

The largest individual acquisition was in the *energy sector* where French utilities company Suez paid USD 13.9 billion for control over the Belgian power generator Electrabel. At the same time the Dutch power generator InterGen divested of substantially all assets to a group of US-based investors in return for USD 4.5 billion.

The *information and communications* sectors accounted for four of the inward investment projects. The Dutch mobile telephony activities of ClearWave were sold to Vodafone Group of the United Kingdom for USD 4.5 billion, and France Telecom acquired 13.6 per cent of the Polish telecom company Telekomunikacja Polska for USD 3.4 billion. On the internet side, the Luxembourg-based company Skype Technologies was acquired by eBay of the United States for USD 4.1 billion and European Directories of Australia bought the Dutch directory provider Yellow Brick Road for USD 2.3 billion.

3.1.6. Asia

Out of a total 14 large-scale international investment projects in Asia during the period under review, more than half were in the *financial sector*. Two somewhat related factors have influenced this, namely the fact that a number of international investors have taken minority shares in Chinese commercial banks, and a bout of outward investment by the Singapore-based investment fund Temasek in 2005 and 2006. For instance, a UK-based investor group has acquired 10 per cent of the Bank of China for USD 3.1 billion, and Temasek bought another 5 per cent for USD 1.6 billion. Likewise, Bank of America paid USD 3.0 billion for 9 per cent of the equity in China Construction Bank, and

Temasek bought another 5 per cent for USD 2.5 billion. In a separate transaction, Goldman Sachs of the United States took a 7 per cent stake in Industrial and Commercial Bank of China for USD 2.6 billion.

Transactions outside China included the USD 4.0 billion takeover of Shin Corporation of Thailand by Temasek and Siam Commercial Bank. The Korea First Bank was sold by a consortium of Newbridge Capital and the Korean authorities to Standard Chartered of the United Kingdom for USD 3.2 billion. And, Deutsche Bank (Germany) and Capital Group Companies (United States) took large minority stakes in Softbank Corporation of Japan for a combined price of USD 4.7 billion.

4. Rising concerns about national security and "strategic" interests

Issues of security and other strategic concerns have moved to the forefront of domestic and international investment policy making. A number of OECD and other countries have taken recent steps to review, and in some cases tighten, national practices toward cross-border mergers and acquisitions with potential national security ramifications (examples of recent or prospective changes are provided in Annex 1.A2). There are several reasons for this. Perhaps most importantly, security priorities in many countries have been realigned since 11 September 2001. An actual and potential scarcity of raw materials has also led countries to reconsider their perceptions of sectors of strategic importance.

Additional factors have also been at play. For instance, the growing role of non-OECD countries as outward investors appears to have heightened concerns that all countries and their companies may not play by common rules or promote high standards of business conduct. The public and press in many OECD countries have also demanded that policy makers take action to block individual attempted takeovers by foreign enterprises, mostly based on fears over long-term job losses. This is not a novel phenomenon, but it has arguably intensified in recent years, not least in countries plagued by a prolonged period of sluggish growth and high unemployment.

The European Union has been the scene of particular controversy. A cross-border consolidation in industries where economies of scale prevail could be a logical consequence of the European single market, but in some cases governmental spokespersons, legislators, regulators and others have expressed hostility to takeovers even by companies domiciled in other EU countries. Where a proposed merger or acquisition was previously cleared with the EU competition authorities, national resistance to let it proceed has led to disciplinary action by the EU Commission. National authorities have sometimes justified their stance on grounds of national security and related strategic concerns, sometimes by a need to protect "national champions" in areas where the nationality of ownership is perceived as being of great societal interest. In North America, issues debated ranged from essential infrastructure, to control with natural resources, to cross-border takeovers by government-controlled or subsidised enterprises.

4.1. A *few illustrative examples*

The most widely publicised recent case of a cross-border takeover being questioned on grounds of ***national security*** was, as mentioned earlier, the acquisition of the UK company Peninsular and Oriental Steam Navigation Co. by Dubai Ports World. The takeover, which would have brought six US ports under the control of the Emirates-based acquirer, gave rise to great concerns in the United States regarding port security in the post-9/11 world. It was opposed by Congress on the formal grounds that the transaction had been approved without the Committee on Foreign Investment in the United States (CFIUS) exercising its right to undertake an extended "investigation". The dispute was resolved when Dubai Ports World agreed to divest the merged company of its US port interests.

A couple of examples relate to Indian reservations about the investment of Chinese companies. In 2005, Indian authorities reportedly put on hold the plans of Huawei Technologies to extend the capital in its software development operation in Bangalore. According to newspaper reports this was partly triggered by concerns over Huawei's links with the Chinese military. In a case reminiscent of the ports debate in the United States a bid by Hutchinson Port Holdings of Hong Kong, China to construct and operate container terminals in Mumbai and Chennai was deferred by the Cabinet Committee on Security over the issue of security clearance of the bidder.

On the issue of ***access to resources***, another recent high-profile case occurred in the United States. A takeover bid by the state-owned Chinese oil company CNOOC for the American oil company Unocal met with strong political resistance. The formal objections to the deal were based partly on concerns about the long-term energy security of the United States, despite the concentration of Unocal's activities on supplying oil within Asia, and partly on the fact that the bidder is state owned and apparently enjoys financial support from Chinese state banks. Faced with the uncertainties of whether a deal would be allowed to proceed, CNOOC withdrew its bid.

Natural resources also figure prominently in the investment policy of Russia. Inward investment in the hydrocarbons sector, while not discouraged, nevertheless seems held back by a political reorientation that has been described as "resource nationalism". One example is the government's decision to re-tender the oil concession Sakhalin-3, which ExxonMobil had previously won in 1993, following which the Ministry for National Resources capped the foreign capital participation in bidders for oil and mineral concessions at 49%. Another example was the 2004 attempt by Total to acquire a 25% blocking minority in the independent gas producer Novatek. The transaction was temporarily halted by antitrust investigations; in the meantime Novatek effectively prevented the investment and announced a co-operation with the state-owned company Gazprom. An arguably even stronger preoccupation with national control over hydrocarbons has been seen in several South American countries, some of which have reneged on earlier agreements, imposed additional conditions on foreign oil companies and, in one case, nationalised foreign-owned assets.

Russian hydrocarbons producers are at the same time active outward investors. Gazprom's attempts to gain a better downstream representation, including in the distribution of gas, in Western Europe has led to security-related concerns in some of the affected countries. In the United Kingdom, government officials have recently cited "political" issues concerning the potential takeover of the British energy group Centrica by Gazprom of Russia. However, following early reports of plans to revise UK legislation on mergers and acquisitions to counter Gazprom's bid, the UK government has lately ruled out any attempt to block the takeover.

The control over ***public utilities*** is increasingly also seen as a strategic issue. Over the last 1½ years several European governments have, if not directly blocked cross-border takeovers, then at least played an active role in searching for alternative solutions. One example is the German company E.ON's bid for the Spanish electricity group Endesa in early 2006. Spanish government officials, quoted as saying that a domestic alternative to the merger was in the "strategic national interest", boosted the powers of the energy regulator CNE a few days after E.ON's bid. An alternative linkup between Endesa and the Spanish group Gas Natural was mooted, but opposed by Endesa and blocked by a court order in April 2006.

Likewise, an intervention by the French government was widely suspected when the energy companies Suez and state-controlled Gaz de France announced a merger in February 2006 (the implementation of which has been since postponed). The merger followed announcements by the Italian electricity group ENEL that it was preparing a bid for Suez. The perception that the deal was forged to foil an Italian entry into the French electricity market drew high-level political comments in both countries. (At almost the same time, Suez itself orchestrated one of the world's largest cross-border takeovers in 2005 when it took control of the Belgian electricity provider Electrabel.)

A case in Chinese manufacturing was also somewhat related with the utilities sector. Siemens of Germany considered acquiring one of the largest Chinese state-owned electrical equipment manufacturers to facilitate supply

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to a large hydro-electric engineering project. The deal was ultimately prevented by a decision of the State Council (China's cabinet) on the grounds that the targeted enterprise was a strategic asset of China.

Other "strategic" concerns have also been cited as reasons for opposing cross-border takeovers in recent years, including in the banking sectors of European countries. The issue came to the forefront in 2005 when the Dutch bank ABM Amro launched a bid for the Italian lender Antonveneta. The Italian bank regulator was accused of trying to foil the bid and actively promote a linkup between Antonveneta and a domestic competitor. More recently controversy has arisen in Poland, including in the context of the successful takeover of the German bank HVB Group by UniCredito of Italy. The Polish government voiced strong concerns regarding the control over HVB's Polish operations, triggering, among other things, a challenge by the EU Commission.

In recent months a case attracting considerable public interest was the bid for the Luxembourg-based steel maker Arcelor by its competitor Mittal Steel. While ultimately successful, the bid was at first trumped by a "white knight", the Russian steel maker Severstal. The case could be a straightforward corporate takeover battle, except for the fact that concerns were repeatedly voiced over the Indian nationality of the main owners of Mittal. At any rate, given that Mittal is domiciled in the Netherlands and listed in New York, resistance to its bid for Arcelor did not seem rooted in concerns about the quality of regulation and supervision.

Notes

1. Additional one-off occurrences in the data for the Australia and the Netherlands largely offset each other.
2. For more information, see the Bureau of Economic Analysis news archive at *www.bea.gov*.
3. Japanese Ministry of Finance, *www.mof.go.jp/bpoffice/ebpfdi.htm*.
4. Deutsche Bundesbank, *Monatsbericht*, March 2006.
5. United National Economic Commission for Latin American and the Caribbean (2006), *Foreign Investment in Latin America and the Caribbean, 2005*.
6. The Mexican figures are incomplete in the sense that FDI outflows are available only since 2001. However, it is assumed that gross outflows in the 1990s were of a limited size.
7. United National Economic Commission for Latin American and the Caribbean, *op. cit.* and Chile Investment Review, February 2006.
8. Further details are provided in OECD (2006), *OECD Investment Policy Review of the Russian Federation: Enhancing Policy Transparency*.

9. The prediction of unchanged FDI despite the receding M&A is due to the fact that, based on the historic pattern of co-variation, FDI was unusually low in 2005. If that abnormality corrects itself in 2006 the estimated decline in M&A will be commensurable with a broadly constant FDI.
10. In actual fact, close to 130 individual acquisitions have been recorded. However, transactions such as augmentations of an equity stake through sequential acquisitions have been discarded in Table 1.5.

ANNEX 1.A1

International Direct Investment Statistics

Table 1.A1.1. **OECD direct investment abroad: outflows**

USD million

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004p	2005e
Australia	5 266.9	1 947.0	2 816.5	3 281.8	7 087.6	6 427.9	3 344.8	–420.7	3 158.5	11 962.0	8 034.5	15 525.8	17 488.4	–39 787.5
Austria	1 697.5	1 190.5	1 257.2	1 130.6	1 935.0	1 988.2	2 745.2	3 300.7	5 740.9	3 137.9	5 812.0	7 143.0	7 392.2	9 382.3
Belgium/Luxembourg	10 955.9	3 850.5	1 205.4	11 728.4	7 811.3	7 884.5	29 107.8	132 325.8	218 364.4	100 624.7	. .	. .	. .	. .
Belgium	. .	. .	. .	. .	. .	. .	. .	. .	. .	. .	12 705.4	36 932.9	33 544.5	22 945.6
Luxembourg	. .	. .	. .	. .	. .	. .	. .	. .	. .	. .	125 823.9	99 851.7	81 711.3	52 368.0
Canada	3 589.2	5 699.9	9 293.5	11 462.3	13 094.3	23 059.2	34 349.2	17 250.1	44 678.5	36 037.2	26 761.1	21 526.0	43 247.8	34 084.3
Czech Republic	. .	90.2	119.6	36.6	152.9	25.2	127.1	89.8	42.8	165.4	206.5	206.7	1 014.4	855.8
Denmark	2 236.0	1 260.5	3 955.1	3 063.5	2 519.1	4 206.6	4 476.6	16 433.9	23 093.2	13 376.1	5 694.9	1 123.9	–10 370.7	8 071.9
Finland	–751.7	1 407.1	4 297.8	1 497.3	3 596.5	5 291.7	18 641.5	6 615.5	24 034.7	8 372.0	7 629.1	–2 281.6	–1 075.9	2 703.5
France	30 407.1	19 736.1	24 372.3	15 758.1	30 419.5	35 580.9	48 612.7	126 859.2	177 481.6	86 783.3	50 486.1	53 197.0	57 044.4	115 606.5
Germany	18 595.1	17 196.1	18 857.8	39 051.6	50 806.3	41 794.1	88 837.2	108 691.6	56 567.5	39 691.1	18 963.5	6 179.5	1 884.0	45 606.1
Greece	. .	. .	. .	. .	. .	. .	–275.6	552.1	2 136.5	616.1	655.3	412.6	1 029.7	1 450.0
Hungary	. .	10.6	48.3	59.1	–3.6	461.9	278.3	250.1	620.2	368.1	278.1	1 644.0	1 122.3	1 346.3
Iceland	6.3	14.3	23.7	24.8	63.4	56.0	74.1	123.1	392.6	341.8	320.0	373.2	2 553.1	6 692.9
Ireland	214.4	217.8	436.3	819.8	727.9	1 013.7	3 902.1	6 109.1	4 629.6	4 066.1	11 035.2	5 554.7	15 813.1	12 930.6
Italy	5 948.5	7 230.6	5 108.8	5 731.4	6 464.9	12 244.7	16 077.6	6 721.7	12 318.5	21 475.9	17 138.3	9 079.3	19 273.2	41 536.2
Japan	17 301.6	13 915.3	18 117.0	22 627.8	23 417.6	25 991.7	24 153.9	22 748.3	31 537.6	38 348.7	32 280.1	28 797.7	30 961.6	45 830.2
Korea	1 161.5	1 340.0	2 461.1	3 552.0	4 670.1	4 449.4	4 739.5	4 197.8	4 998.9	2 420.1	2 616.5	3 425.5	4 657.9	4 312.3
Mexico	. .	. .	. .	. .	. .	. .	. .	. .	. .	4 404.0	890.8	1 253.5	4 431.9	6 170.7
Netherlands	12 697.1	10 063.3	17 553.8	20 175.5	32 098.1	24 522.1	36 475.1	57 611.3	75 648.7	50 602.3	32 046.0	44 222.8	17 291.6	119 382.3
New Zealand	391.4	–1 388.7	2 008.2	1 783.5	–1 239.7	–1 565.5	401.4	1 072.5	608.7	407.7	–1 133.5	195.0	1 074.2	–318.1
Norway	394.2	933.0	2 172.5	2 856.2	5 892.5	5 015.3	3 200.7	5 503.6	7 613.8	–1 322.7	4 200.7	2 139.9	3 526.0	3 413.5
Poland	13.0	18.0	29.0	42.0	53.0	45.0	316.0	31.0	16.0	–90.0	230.0	300.0	778.0	1 455.0
Portugal	684.2	107.3	282.5	684.6	728.8	2 092.0	4 028.5	3 191.4	8 133.6	6 262.7	–149.2	8 035.2	7 962.6	1 145.8
Slovak Republic	. .	12.8	17.7	43.0	62.9	95.1	146.6	–377.2	28.7	64.5	11.2	13.3	152.1	146.4
Spain	2 171.0	3 173.6	4 110.8	4 157.8	5 590.1	12 546.8	18 937.7	44 383.5	58 224.0	33 112.6	32 744.0	27 555.4	60 566.5	38 748.4
Sweden	408.7	1 357.7	6 701.1	11 214.3	5 024.8	12 647.5	24 379.4	21 928.6	40 667.3	6 374.9	10 630.0	21 259.8	11 947.2	26 028.8
Switzerland	6 049.2	8 764.5	10 797.2	12 214.0	16 150.4	17 747.7	18 768.8	33 264.3	44 698.0	18 326.1	8 212.4	15 443.4	26 850.5	42 753.9
Turkey	65.0	14.0	49.0	113.0	110.0	251.0	367.0	645.0	870.0	497.0	175.0	499.0	859.0	1 048.0
United Kingdom	17 740.9	26 063.1	32 205.7	43 560.0	34 055.9	61 620.0	122 861.2	201 436.7	233 487.7	58 885.2	50 346.5	62 439.3	94 928.5	101 079.8
United States	48 266.0	83 950.0	80 167.0	98 750.0	91 885.0	104 803.0	142 644.0	224 934.0	159 212.0	142 349.0	154 460.0	140 579.0	244 128.0	9 072.0
Total OECD FDI	**185 509.2**	**208 175.1**	**248 465.0**	**315 419.0**	**343 174.4**	**410 295.8**	**651 718.4**	**1 045 472.7**	**1 239 004.3**	**687 659.9**	**619 104.3**	**612 627.3**	**781 787.3**	**716 061.5**

Notes: Data are converted to US dollars using average exchange rates.
p: Preliminary.
e: Estimate.
Source: OECD International Direct Investment database.

Table 1.A1.2. **OECD direct investment from abroad: inflows**

USD million

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004p	2005e
Australia	5 719.8	4 281.7	5 024.6	11 963.2	6 111.0	7 633.4	6 002.6	3 268.4	13 949.9	8 297.1	17 674.5	9 675.0	42 036.3	–36 809.9
Austria	1 432.7	1 136.5	2 102.9	1 904.2	4 428.6	2 655.6	4 534.1	2 974.6	8 841.7	5 920.5	357.0	7 150.9	3 687.4	8 905.0
Belgium/Luxembourg	10 957.3	10 467.8	8 313.2	10 894.2	13 924.4	16 510.1	30 146.9	142 512.3	220 987.8	84 717.6	. .	. .	. .	. .
Belgium	. .	. .	. .	. .	. .	. .	. .	. .	. .	. .	15 640.5	32 127.2	42 063.6	23 709.9
Luxembourg	. .	. .	. .	. .	. .	. .	. .	. .	. .	. .	115 175.4	90 317.6	77 259.8	43 729.0
Canada	4 721.6	4 730.3	8 204.1	9 255.4	9 632.6	11 522.0	22 802.8	24 747.2	66 795.5	27 669.9	22 145.9	7 618.5	1 533.2	33 823.6
Czech Republic	. .	653.4	868.3	2 561.9	1 428.2	1 301.1	3 716.4	6 326.2	4 980.2	5 644.6	8 483.5	2 108.7	4 975.0	10 987.5
Denmark	1 014.7	1 669.0	4 897.6	4 179.8	768.0	2 798.6	7 725.7	14 657.1	31 305.8	11 525.3	6 633.4	2 597.1	–10 721.4	5 019.9
Finland	406.2	864.4	1 577.7	1 062.9	1 109.0	2 115.8	12 140.7	4 610.2	8 835.6	3 732.2	7 926.7	3 322.1	3 538.8	4 557.8
France	17 849.2	16 442.7	15 574.0	23 679.1	21 959.5	23 171.5	30 984.5	46 545.9	43 258.4	50 485.1	49 078.7	42 538.4	31 387.8	63 539.6
Germany	–2 088.9	368.3	7 133.9	12 025.4	6 572.8	12 243.4	24 596.7	56 077.3	198 313.0	26 419.0	53 570.8	29 228.2	–15 122.9	32 642.9
Greece	1 588.6	1 243.6	1 166.1	1 197.7	1 196.4	1 088.6	72.1	561.5	1 108.1	1 589.4	50.3	1 276.4	2 102.6	606.1
Hungary	1 477.2	2 446.2	1 143.5	5 101.9	3 300.4	4 170.9	3 337.1	3 313.1	2 763.0	3 936.0	2 993.6	2 137.5	4 657.0	6 700.4
Iceland	–12.7	0.4	–1.5	9.2	83.1	147.9	147.8	66.6	170.5	172.6	90.9	327.9	653.8	2 329.3
Ireland	1 458.1	1 068.5	856.2	1 441.5	2 615.7	2 709.6	8 856.3	18 211.2	25 784.2	9 652.7	29 350.0	22 802.8	11 165.4	–22 759.1
Italy	3 210.8	3 751.4	2 235.6	4 816.2	3 534.9	4 962.5	4 279.8	6 911.4	13 377.3	14 873.4	14 558.2	16 430.2	16 824.5	19 497.9
Japan	2 755.2	210.5	888.2	41.5	227.9	3 224.8	3 192.8	12 743.9	8 317.7	6 245.5	9 240.0	6 324.0	7 818.8	2 778.4
Korea	728.3	588.1	809.0	1 775.8	2 325.4	2 844.2	5 412.3	9 333.4	9 283.4	3 527.7	2 392.3	3 525.5	9 246.2	4 338.6
Mexico	4 393.0	4 389.0	15 069.1	9 678.8	10 086.7	14 164.8	12 408.6	13 631.2	17 587.8	27 150.9	18 274.7	14 183.8	18 674.3	18 054.8
Netherlands	6 169.4	6 443.1	7 158.4	12 306.8	16 660.1	11 136.5	36 924.9	41 206.1	63 865.6	51 936.8	25 060.3	21 760.1	442.3	43 604.3
New Zealand	1 089.2	2 211.6	2 615.7	2 849.7	3 922.0	1 917.2	1 825.5	940.4	1 344.4	4 591.3	–275.0	2 049.3	4 370.8	2 834.3
Norway	810.4	1 460.7	2 777.6	2 408.0	3 168.5	3 946.4	4 353.7	7 061.7	6 907.7	2 009.3	679.0	3 802.8	2 546.6	14 463.6
Poland	678.0	1 715.0	1 875.0	3 659.0	4 498.0	4 908.2	6 365.0	7 270.0	9 343.0	5 714.0	4 131.0	4 870.0	12 355.0	7 724.0
Portugal	1 903.8	1 516.2	1 254.6	660.1	1 343.8	2 361.7	3 004.7	1 156.8	6 636.5	6 231.8	1 800.8	8 600.9	2 368.1	3 111.6
Slovak Republic	. .	179.1	272.9	241.4	395.7	230.6	706.8	428.5	2 383.1	1 584.1	4 126.5	593.8	1 107.5	1 907.2
Spain	13 350.7	9 571.6	9 275.8	6 285.1	6 820.6	6 387.8	11 798.4	18 743.9	39 582.4	28 347.0	39 248.7	25 950.4	24 774.5	22 972.9
Sweden	41.0	3 845.1	6 349.7	14 446.9	5 436.6	10 967.4	19 842.7	60 929.1	23 245.5	11 900.1	11 734.1	1 285.3	–1 852.2	13 691.5
Switzerland	411.4	–83.1	3 367.7	2 224.0	3 078.4	6 641.9	8 942.1	11 714.4	19 266.0	8 859.0	6 283.8	16 505.3	750.0	5 781.3
Turkey	844.0	636.0	608.0	885.0	722.0	805.0	940.0	783.0	982.0	3 352.0	1 137.0	1 752.0	2 837.0	9 686.0
United Kingdom	15 474.8	14 821.3	9 254.6	19 968.4	24 441.3	33 244.9	74 348.9	87 972.8	118 823.8	52 650.2	24 051.9	16 845.9	56 253.2	164 499.2
United States	19 823.0	51 362.0	46 121.0	57 776.0	86 502.0	105 603.0	179 045.0	289 444.0	321 274.0	167 021.0	80 841.0	67 091.0	133 162.0	109 754.0
Total OECD FDI	**116 206.7**	**147 990.4**	**166 793.3**	**225 299.3**	**246 293.7**	**301 415.3**	**528 454.9**	**894 142.1**	**1 289 314.0**	**635 756.1**	**572 455.5**	**464 798.6**	**490 895.1**	**621 681.7**

Notes: Data are converted to US dollars using average exchange rates.
p: Preliminary.
e: Estimate.
Source: OECD International Direct Investment database.

Table 1.A1.3. **OECD direct investment abroad: outward position**

USD million

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004p	2005e
Australia	34 559.6	40 503.6	47 786.3	53 009.0	66 857.9	71 968.4	78 647.9	89 583.6	85 385.3	109 688.2	108 848.6	150 732.8	197 631.5	159 990.5
Austria	6 584.5	7 974.2	9 514.1	11 832.0	13 059.8	14 011.4	17 468.4	19 127.3	24 819.9	28 510.6	42 483.2	55 961.0	67 832.6	67 007.0
Belgium	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Canada	87 867.3	92 469.1	104 308.0	118 106.1	132 321.9	152 959.3	171 784.7	201 446.8	237 646.9	250 691.0	275 711.3	318 718.2	375 054.7	399 362.8
Czech Republic	..	181.4	300.4	345.5	498.0	548.2	804.1	697.9	737.9	1 135.6	1 473.1	2 283.5	3 758.9	4 239.3
Denmark	16 305.7	15 799.2	19 613.7	24 702.5	27 601.6	28 127.7	38 836.8	51 376.0	73 074.2	78 236.2	86 696.8	102 586.9	118 702.1	..
Finland	8 564.6	9 178.2	12 534.0	14 993.2	17 666.0	20 297.5	29 405.9	33 850.3	52 108.7	52 224.4	63 920.9	76 049.7	82 556.3	74 415.8
France	156 326.6	158 750.3	182 331.8	204 430.3	231 112.8	237 248.9	288 035.9	334 102.9	445 087.0	508 842.0	586 306.6	724 445.4	829 309.7	851 743.5
Germany	154 741.3	162 365.0	194 523.4	233 107.4	248 634.1	296 274.9	365 195.7	412 881.3	486 749.8	551 083.1	602 690.9	727 201.3	754 618.9	..
Greece	..	..	..	..	..	..	2 792.2	3 935.0	6 094.0	7 020.4	9 000.6	12 337.0	13 791.3	13 344.8
Hungary	223.6	224.6	291.2	278.1	265.3	646.6	785.1	924.2	1 279.1	1 554.5	2 165.8	3 509.4	6 030.9	6 604.3
Iceland	98.1	113.5	148.5	177.2	240.1	275.0	360.5	451.8	662.9	840.2	1 255.0	1 733.4	4 024.6	9 429.9
Ireland	..	..	..	..	..	..	20 314.4	25 232.1	27 925.0	40 818.7	54 024.7	64 457.2	..	..
Italy	70 382.3	81 086.6	89 688.3	106 318.6	117 278.0	139 437.2	176 985.2	181 855.5	180 273.6	182 373.3	194 488.3	238 887.6	280 481.1	293 475.2
Japan	248 060.0	259 800.0	275 570.0	238 452.0	258 612.4	271 905.7	270 034.0	248 776.0	278 441.5	300 115.7	304 237.5	335 499.5	370 543.6	386 581.3
Korea	..	..	..	..	..	..	..	..	..	19 967.0	20 734.5	24 986.4	..	..
Luxembourg	..	..	..	4 703.3	4 695.4	5 022.3	7 982.8	8 467.8	7 927.0	8 810.2	16 006.7	17 386.3	..	..
Mexico	..	..	..	..	..	..	..	..	..	12 077.5	12 868.7	16 587.0	22 218.8	28 040.1
Netherlands	121 052.5	120 116.2	142 944.0	172 675.1	194 015.6	198 539.0	228 983.2	263 761.3	305 459.2	332 151.2	396 514.3	531 150.9	595 360.7	641 257.9
New Zealand	5 899.0	4 430.7	5 896.2	7 675.6	9 293.1	5 646.0	5 490.8	7 006.2	6 065.1	8 807.8	9 162.2	11 458.3	12 509.5	12 935.7
Norway	11 794.4	12 717.7	17 648.0	22 520.7	25 439.1	27 494.5	31 609.4	42 452.9	46 301.5	55 403.2	72 487.3	82 787.7	..	..
Poland	101.0	198.0	461.0	539.0	735.0	678.0	1 165.0	1 024.1	1 018.0	1 156.0	1 457.0	2 147.0	3 221.0	..
Portugal	..	..	..	4 406.3	3 834.3	5 395.4	9 894.5	11 184.4	19 551.5	22 086.0	21 147.2	35 883.1	48 335.5	44 457.0
Slovak Republic	..	..	166.4	138.5	185.0	236.4	408.2	346.0	379.1	506.6	485.6	633.2	692.1	..
Spain	22 046.8	24 014.3	30 044.8	36 547.3	41 999.6	53 035.2	74 109.4	118 042.9	167 717.9	191 648.9	233 937.3	292 464.3	371 154.4	381 161.1
Sweden	48 844.6	45 522.5	60 309.0	73 142.5	72 187.8	78 201.2	93 533.7	106 273.8	123 234.0	123 268.1	146 509.8	183 768.9	204 084.7	202 797.9
Switzerland	74 411.8	91 570.3	112 588.0	142 481.4	141 586.8	165 354.1	184 237.3	194 598.3	229 756.4	249 265.0	288 949.4	338 408.5	396 442.1	394 753.9
Turkey	..	..	..	..	..	..	..	..	3 668.0	4 581.0	5 847.0	6 138.0	7 060.0	..
United Kingdom	221 678.9	245 628.9	276 743.8	304 864.9	330 432.5	360 796.3	488 372.0	686 420.4	897 844.8	869 700.5	994 135.7	1 187 045.0	1 268 532.3	1 237 997.5
United States	663 830.0	723 526.0	786 565.0	885 506.0	989 810.0	1 068 063.0	1 196 021.0	1 414 355.0	1 531 607.0	1 693 131.0	1 860 418.0	2 062 551.0	2 399 224.0	2 453 933.0
Total OECD FDI outward positions	**1 953 372.6**	**2 096 170.2**	**2 369 976.0**	**2 660 952.5**	**2 928 362.1**	**3 202 162.3**	**3 783 258.2**	**4 458 173.8**	**5 240 815.2**	**5 705 693.6**	**6 413 963.8**	**7 607 798.4**	**8 433 171.3**	**..**

Notes: Data are converted to US dollars using average exchange rates.

p: Preliminary.

e: Estimate.

Source: OECD International Direct Investment database.

Table 1.A1.4. **OECD direct investment from abroad: inward position**

USD million

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003p	2004e	2005
Australia	75 821.7	82 877.7	95 543.8	104 074.3	116 797.2	101 089.0	105 961.7	120 625.7	111 138.5	111 826.7	141 549.2	199 880.3	267 419.8	210 651.2
Austria	12 040.8	12 105.5	14 636.0	19 721.0	19 629.2	19 522.2	23 564.8	23 471.6	30 430.8	34 328.0	43 506.7	53 844.2	61 703.2	61 344.4
Belgium	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Canada	108 500.1	106 869.7	110 210.1	123 182.3	132 970.2	135 935.6	143 348.8	175 000.9	212 722.7	213 755.4	225 902.1	282 211.1	316 494.1	356 857.9
Czech Republic	..	3 422.8	4 546.6	7 349.8	8 573.1	9 233.2	14 377.1	17 549.5	21 647.0	27 092.8	38 672.3	45 286.3	57 246.1	59 459.0
Denmark	14 387.3	14 617.9	17 846.3	23 800.9	22 337.0	22 267.8	35 704.8	47 725.6	73 573.0	75 382.6	82 743.2	100 236.3	108 093.9	..
Finland	3 688.9	4 216.7	6 714.1	8 464.5	8 797.5	9 529.8	16 454.8	18 320.4	24 272.3	24 069.8	34 005.9	50 256.5	55 661.6	52 823.1
France	127 881.4	135 077.8	163 451.4	191 433.0	200 095.8	195 913.0	246 215.9	244 672.5	259 773.0	295 308.0	385 186.7	527 624.6	619 578.8	599 995.5
Germany	74 730.1	71 095.4	87 338.1	104 367.2	104 658.1	190 732.9	252 392.5	290 457.1	462 529.1	416 826.5	529 322.6	655 586.7	675 629.3	..
Greece	..	..	..	..	..	..	13 084.0	15 890.0	14 113.0	13 941.0	15 560.0	22 453.6	28 481.5	29 312.0
Hungary	3 424.1	5 575.6	7 083.5	11 303.5	13 274.9	17 953.6	20 752.9	23 259.7	22 856.2	27 377.5	36 213.4	48 344.9	62 725.8	61 220.6
Iceland	123.8	116.5	127.5	148.7	197.4	331.9	468.7	478.4	491.4	676.5	797.4	1 189.7	1 998.0	3 842.6
Ireland	..	..	..	..	..	..	62 453.1	72 817.0	127 087.6	134 051.3	178 566.5	217 164.0	..	..
Italy	49 972.7	53 961.9	60 416.0	65 347.2	74 599.9	85 401.8	108 835.3	108 640.7	121 168.7	113 433.5	130 813.8	180 890.6	220 720.3	219 866.6
Japan	15 510.0	16 890.0	19 170.0	33 507.7	29 939.7	27 079.8	26 064.0	46 115.3	50 321.9	50 319.0	78 140.3	89 729.2	96 984.2	100 898.5
Korea	..	..	..	..	..	..	..	..	..	53 207.5	62 658.3	66 069.7	..	..
Luxembourg	..	..	..	18 503.4	18 232.7	17 279.7	20 766.1	20 362.0	23 491.7	26 346.5	34 970.2	41 750.0	..	..
Mexico	35 680.0	40 600.4	33 197.7	41 129.6	46 912.0	55 810.0	63 610.4	78 060.0	97 170.2	140 376.0	158 650.7	172 834.5	191 508.8	209 563.6
Netherlands	74 434.3	74 474.2	93 402.9	116 051.2	126 536.4	122 183.1	164 461.1	192 591.9	243 730.3	282 879.2	349 954.9	457 984.0	501 072.0	463 415.7
New Zealand	11 779.5	15 539.1	22 062.2	25 727.6	34 743.7	31 365.3	33 169.9	32 860.8	28 069.8	23 640.7	30 519.6	39 389.8	51 950.4	52 619.6
Norway	13 644.9	13 642.5	17 018.0	19 835.9	20 623.8	20 704.4	26 081.4	29 433.0	30 261.4	32 589.6	42 649.2	48 966.9	..	..
Poland	1 370.0	2 307.0	3 789.0	7 843.0	11 463.4	14 587.2	22 461.0	26 075.3	34 227.0	41 247.0	48 320.0	57 851.0	85 509.0	..
Portugal	..	..	..	18 973.4	21 103.2	22 413.7	30 089.6	26 910.8	32 043.4	36 022.7	44 635.1	62 200.2	70 566.4	64 516.6
Slovak Republic	..	..	897.0	1 297.1	1 899.8	2 103.4	2 919.6	3 227.6	4 679.4	5 729.8	8 530.6	11 283.9	14 503.7	15 795.5
Spain	85 989.4	80 295.6	96 302.3	110 290.5	111 532.2	105 265.6	126 018.5	125 363.6	156 346.8	177 252.0	257 095.4	339 652.0	395 189.1	367 656.2
Sweden	14 057.0	13 126.9	22 649.4	31 089.3	34 784.1	41 512.7	50 984.6	73 312.5	93 972.5	91 584.0	119 315.4	157 028.7	197 983.2	171 496.0
Switzerland	32 989.3	38 713.3	48 668.4	57 063.7	53 916.7	59 515.2	71 997.1	76 000.2	86 809.9	88 766.3	124 811.9	161 988.7	195 928.5	172 488.7
Turkey	..	..	..	..	..	..	..	..	19 209.0	19 677.0	18 791.0	33 533.0	32 489.0	..
United Kingdom	172 986.4	179 232.6	189 587.5	199 771.8	228 642.5	252 958.6	337 386.1	385 146.1	438 630.7	506 685.6	523 319.2	606 157.3	707 924.0	816 715.9
United States	540 270.0	593 313.0	617 982.0	680 066.0	745 619.0	824 136.0	920 044.0	1 101 709.0	1 421 017.0	1 518 473.0	1 517 403.0	1 585 898.0	1 727 062.0	1 874 263.0
Total OECD FDI	**1 469 281.9**	**1 558 071.8**	**1 732 639.6**	**2 020 342.9**	**2 187 879.2**	**2 384 825.4**	**2 939 667.4**	**3 376 077.2**	**4 241 784.1**	**4 582 865.5**	**5 262 604.5**	**6 317 285.7**	**6 744 422.6**	**..**

Notes: Data are converted to US dollars using average exchange rates.
p: Preliminary.
e: Estimate.
Source: OECD International Direct Investment database.

ANNEX 1.A2

National Security and Strategic Sectors: Regulatory Change

Recent developments

In ***Germany***, the rules for foreign ownership of defence-related enterprises were tightened in 2004 and again in 2005. Following controversy over a foreign acquisition of the submarine builder Howaldtswerk-Deutsche Werft, parliament amended the Foreign Trade Act and Foreign Trade and Payments Regulation. The Act and the Regulation, previously concerned mainly with export and import of sensitive products and payments in relation therewith, were amended to stipulate that the acquisition of more than 25 per cent of the voting rights in a German company producing armaments, ammunition or cryptographic programmes has to be reported to the Federal Ministry of Economics and Labour. The Ministry has the right, within one month after receiving all relevant information, to prevent the investment if this is needed to safeguard "important security interests". In 2005, following renewed controversy over a prospective takeover, the list of activities covered by the provision was extended to include companies producing and developing engines and gear systems for tanks and similar armoured military vehicles. (Foreign Trade and Payments Regulation, paragraph 52.)

In comparison with many other countries, the measures the German government has put in place to limit foreign participation in its defence industry do not appear particularly problematic. However, controversy has arisen over the country's protection over one of its carmakers, which is shielded from hostile takeovers through specific legislation passed in 1960. The so-called "Volkswagen Law" forbids individual shareholders from holding more than 20 per cent of the carmaker's voting rights, and establishes that important decisions on Volkswagen's future require the approval of at least 80 per cent of shareholders. The EU Commission has referred the matter to the European Court of Justice, claiming that the Law impedes the free movement of capital.

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The government of ***France*** has been rethinking its foreign investment regulations in recent years, the starting point apparently being the March 2000 ruling by the European Court of Justice in the "Church of Scientology" case. The Court set aside the French argument that its foreign investment rules were justified to safeguard public order, holding that while restrictions on the free movement of capital may be imposed for reasons of public order or public safety, they must be narrowly tailored to the public interest at issue.

In December 2004 the French parliament enacted a law reforming its foreign investment rules (the "Reform Law"*). The Reform Law requires the government to issue a Ministerial Decree setting out the types of conditions that may be imposed on foreign investment. The law also modifies the scope of French foreign investment regulations. Under the new rules, prior authorisation is needed for investment not only in arms manufacturing but all companies operating in "the interest of national defence".

The detailed list of sectors concerned was set out by the French government on 31 December 2005 in Decree No. 2005-1739. According to the Decree, investment in the following activities can be subject to authorisation: 1) money gambling; 2) private security services; 3) research and development or manufacture of means of fighting the illegal use of pathogens or toxic substances; 4) wire tapping and mail interception equipment; 5) auditing and certifying services relative to the security of information technology systems and products; 6) the security of information systems of companies managing critical infrastructure; 7) businesses relating to certain dual-use items and technology; 8) cryptology services; 9) business involving companies privy to classified information; 10) weapons, munitions and explosive substances for military purposes; and 11) activities involving design or equipment supply contracts with the French Defence Ministry.

Prospective change

In ***Canada***, investment legislation is currently under consideration. Prior to the recent parliamentary elections that had as a result the replacement of the previous government, a draft piece of legislation dubbed Bill C-59 "An Act to amend the Investment Canada Act" was presented to parliament. It is not yet clear whether the new government will want to re-table the Bill in its old form, draft a new Bill or let the issue rest.

The main purpose of the Bill is to provide authorities with new powers to review foreign investments that might compromise Canada's national security, independent of existing reviews and not subject to sectoral or asset value thresholds. On completion of the review, the Governor in Council could order further action, including modifying or disallowing the investment.

* Article 30 of Law No. 2004-1343, dated 9 December 2004.

As existing screening mechanisms provide the authorities with relatively broad powers to block undesired investment, the main outcome of the Bill would be ensuring that investment beneath the current review thresholds (in most cases C$ 250 million) could be made subject to a national security review. As the Bill proposes no notification requirements or mandatory reviews, it is commonly perceived as tool for use in exceptional circumstances.

The government of ***Russia*** is in the process of drafting new legislation regarding the protection of "strategic sectors" from foreign ownership. In the view of the Russian authorities, the proposed law should be seen as an attempt to make the current situation – where limitations of foreign ownership is often stipulated for individual companies – more transparent and predictable, and to put the Russian procedures in line with similar legislation adopted in other countries. The new law is expected to be submitted to the Duma by the end of 2006.

According to the Russian authorities, the proposed law on strategic sectors as currently discussed within the government would cover a few closed sectors and contain a list of approximately 39 sectors, including in particular arms and defence-related sectors as well as nuclear energy and aerospace industries, in which foreign investors would need the governmental authorisation to acquire more than 50 per cent ownership. As for gas and oil sectors, prior authorisation for majority foreign ownership would concern only a limited number of large extraction sites and would be determined by a proposed subsoil law. A special commission composed by representatives of the main ministries and federal agencies, will be in charge to deliver relevant authorisations and notify them to the applicants within a specified time period (30-60 days in the government's current draft).

Legislators in the ***United States*** have introduced a number of bills to amend the Exon-Florio statute, which provides for a process to review of the national security implications of certain foreign investments. Exon-Florio (an amendment to the Defense Production Act) gives the President authority to suspend or prohibit any acquisition by foreign entities of an enterprise engaged in interstate commerce in the United States so that such control will not threaten to impair the national security. The law also authorises the President to seek relief, including divestment, in order to enforce his authority in this matter. The government body charged with carrying out the Exon-Florio provisions is the Committee on Foreign Investment in the United States.

The law provides for a two-stage review and investigation procedure before action may be taken by the President. The "review" phase is to be completed within 30 days from the receipt of written notification of a proposed acquisition. During this phase, a decision will be taken on whether the proposed investment raises any national security concerns or whether any

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national security implications should be explored further by investigation. In the event that the acquisition is made by an entity controlled by a foreign government, an investigation is obligatory if CFIUS determines that the acquisition could affect national security. At the conclusion of the "investigation" phase, which must not exceed 45 days, a final administrative determination will be made. If the conclusion is that the President should take action against the foreign investment in question, such action must be initiated within 15 days. The president must, in each case, submit to Congress a written report concerning his intentions, the findings of the investigation and the factors that he took into account.

The two principal bills aimed at amending Exon-Florio are the proposed "Foreign Investment and National Security Act of 2006", put forward by Chairman of the Banking, Housing and Urban Affairs Committee Senator Richard Shelby, and H.R. 5337 "Reform of National Security Reviews of Foreign Direct Investment Act", introduced by House Majority Whip Rep. Roy Blunt. Among the main proposed changes are: mandatory investigations of transactions involving entities owned or controlled by a foreign government; reporting or notification requirements on CFIUS *vis-à-vis* the US Congress; and changes in the management of CFIUS to assign a greater role to the government departments charged with national security.

ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART I

Chapter 2

Globalisation, New Technology and International Investment*

The last few decades represent a period of major technical innovation in fields that bear on international investment decisions in fundamental ways. More powerful and cheaper information and communication systems and technical advances in transportation and logistics management, for instance, narrow the divide of distance and enable the greater unbundling of the production process, including across borders and at a global level. This is altering the patterns of national and corporate comparative advantage, leading to the opening of new markets and sectors, notably among services that have not traditionally been a source of, or attracted international investment, and is changing the shape of industrial organisation.

This article takes stock of how new technologies are a force advancing the closer integration of economies, reconfiguring both the external and internal organisational structures of international businesses. The impacts of this process of globalisation, driven by technological advances, on the patterns of international investment, how they may continue to evolve and on how international business is conducted are then examined, based on a synthesis of the existing literature and various statistical sources. The analysis provides the grounds for the final, forward-looking section of the article, which identifies the potential issues facing the investment policy community now and in the coming years.

* This article was prepared by Jonathan Coppel, Senior Economist in the Investment Division, OECD Directorate for Financial and Enterprise Affairs.

Introduction

The last few decades represent a period of major technical innovation in fields that bear on international investment decisions in fundamental ways. More powerful and cheaper information and communication systems and technical advances in transportation and logistics management, for instance, narrow the divide of distance and enable the greater unbundling of the production process, including across borders and at a global level. This is altering the patterns of national and corporate comparative advantage, leading to the opening of new markets and sectors, notably among services that have not traditionally been a source of, or attracted international investment, and is changing the shape of industrial organisation. The quick pace of innovation in technologies that facilitate international investment shows no sign of slowing and represent one of the key drivers of the globalisation process.

The purpose of this article is to take stock of how new technologies are a force advancing the closer integration of economies, reconfiguring both the external and internal organisational structures of international businesses. The impacts of this process of globalisation, driven by technological advances, on the patterns of international investment, how they may continue to evolve and on how international business is conducted are then examined, based on a synthesis of the existing literature and various statistical sources. The analysis provides the grounds for the final, forward-looking section of the article, which identifies the potential issues facing the investment policy community now and in the coming years.

1. New technologies are driving globalisation through international investment

Globalisation has both a width and depth dimension. The width dimension refers to the cross-border interdependence and integration of new players into the global economy and the depth dimension to the intensity of commercial linkages (*e.g.* in the supply chain) among economies. Policy reforms, such as liberalising trade and investment regimes and placing more emphasis on markets as a resource allocation device, have played a part in advancing the globalisation of production, through international investment (the un-shaded area in Figure 2.1). Another driving force of the globalisation process, and the subject of this article, is technological advancements directly leading to more and different forms of international investment opportunities and the formation of global business structures that are made possible due to the

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Figure 2.1. **The drivers and dimensions of globalisation bear on international investment**

Drivers	Dimensions: Width	Dimensions: Depth
Policy factors	*E.g.* lower barriers to FDI: – New players – Increased competition – Market seeking FDI	*E.g.* increased market based resource allocation: – Efficiency seeking FDI – Specialisation by foreign affiliates
Technology factors	*E.g.* transport innovations: – Asset seeking FDI – New players – New FDI location opportunities	*E.g.* ICT innovations: – Cross-border technology alliances – International off-shoring – Facilitates FDI by SMEs

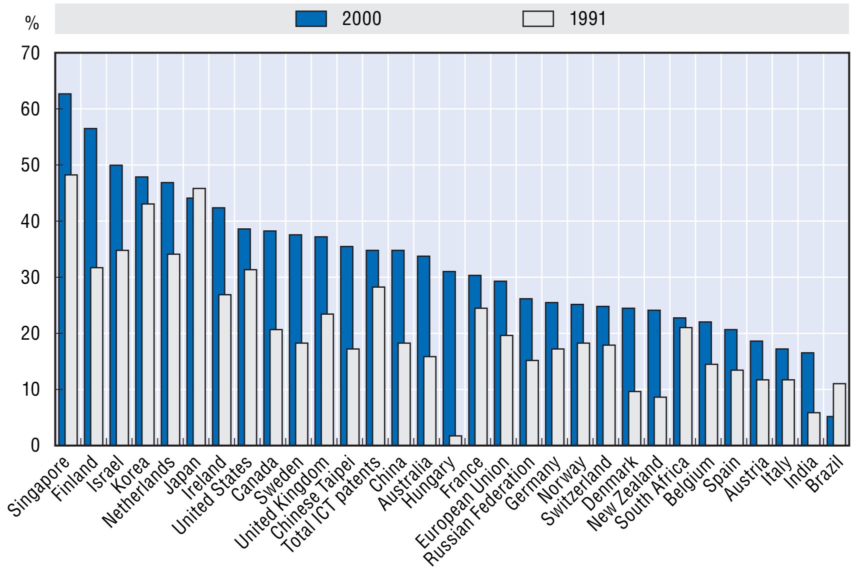
Source: OECD Investment Division.

adoption of these technologies (the shaded area in Figure 2.1).[1] According to recent OECD analysis, policy and non-policy factors (*e.g.* transaction costs and market size) explain about equally the differences in FDI positions across member countries (OECD, 2003).

Clearly, not all technological innovations broaden and deepen the interdependence between the actions of economic actors located in one country and those located in other countries. The areas where technical innovations have the most potential to shift international comparative advantage and the specialisation of firms and countries relate to materials science, biotechnology, transport and especially information and communication technologies (ICT). Their potential to impact on international investment has been heightened by innovations enabling synergies in these fields, such as between laser, fibre and optic satellites and information technologies, leading to breakthroughs in areas such as logistic management techniques. In addition, the last couple of decades have been characterised by an increased preponderance of innovations in these fields (OECD, 2005a). The share of ICT patents issued, for instance, has increased sharply in virtually all OECD countries between the early 1990s and the end of the decade, to represent on average about one third of all patents granted (Figure 2.2). Collectively, these innovations and others have contributed to a rise in the relative importance of intellectual assets in production, which is reinforcing international investment as businesses seek access to knowledge-based assets.

At the most fundamental level, the channel through which new technologies impact on international investment and the internal organisation of businesses is through a shift in the relative transactions costs of doing business. These costs concern the expense in finding and retaining partners and in making monitoring contracts. When these costs are high they favour business transactions channelled within organisations (*i.e.* intra-firm co-ordination) and when they are low, they favour business transactions

Figure 2.2. **The share of ICT patents has increased in virtually all OECD countries**[1]



1. Patents presented according to the residence of the inventor for countries with more than 100 European Patent Office applications in year 2000.

Source: OECD, Patent database, September 2004.

channelled through markets (*i.e.* inter-firm co-ordination). Technical advances are shifting the boundary between inter-firm and intra-firm co-ordination, but it is not clear-cut in which direction. Indeed, the line between what is inside and what is outside the firm has blurred.

On the one hand, intra-firm co-ordination is becoming cheaper, as the emergence of new technologies, such as the Internet, deepen the penetration of ICT in business operations, improve accessibility to, and the management of information flows. Intra-firm information networks better enable and make it more practical for companies, including smaller ones, to organise production through foreign affiliates on a global scale. On the other, the same new technologies also lower transactions costs between firms to find suppliers and potential buyers (*e.g.* through the creation of industry-wide business-to-business electronic exchanges via the internet[2]), making it relatively less attractive to establish foreign affiliates and favouring the specialisation of production in a location, with intermediate and final outputs traded at arms-length (OECD, 2000b). If this were the case, one would expect to see growth in international investment decline, or slow and trade growth to accelerate. In practice and for a wider range of reasons, the complementary relationship between trade and investment has strengthened (see Box 2.1).

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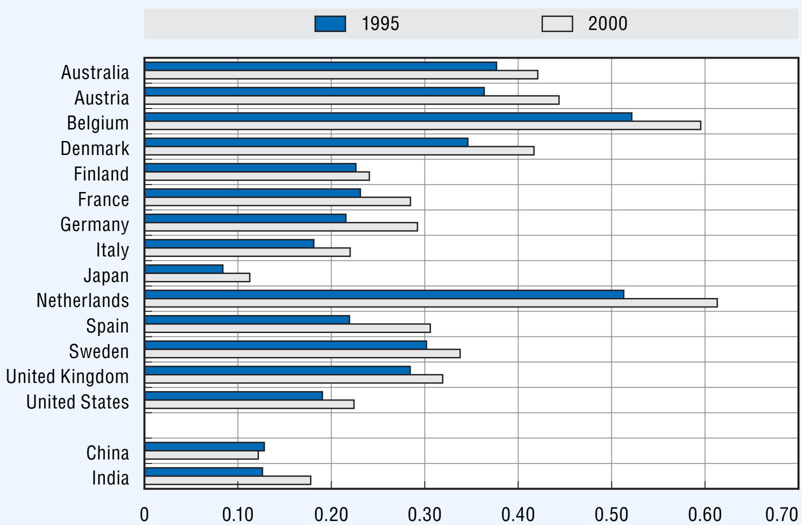
Box 2.1. **New technology is strengthening the relationship between trade and investment**

Traditionally international trade and investment were considered substitutes. That is, an upturn in international trade was believed to be associated with less international investment and *vice versa*. This view held sway because it was intuitively appealing that products are either exchanged once made, or if produced by a foreign affiliate there is no need to import the product.

Such a theoretical relationship, however, sat uncomfortably with the observed phenomenon of intra-industry trade – exports and imports within the same industry (Figure 2.3) and a considerable proportion of this trade was between multinational enterprises and their foreign affiliates (*i.e.* intra-firm trade).

Figure 2.3. **Manufacturing production is becoming more globally integrated**[1]



Note: Australia 1994-99, India 1994-99, US 1996-2000.

1. Ratio of imported to domestic sourcing of inputs, per cent.

Source: OECD [DSTI/IND(2006)2] based on Input-Output database, November 2005, preliminary estimates.

The phenomenon of intra-industry trade led to explanations based on the complementarity between international merchandise trade and investment. Likewise, a complementarity between international investment and trade in services is to be expected, since to trade services a physical presence in the partner country is usually necessary. In line with the growth in the share of services in total output, a complementary relationship between trade and investment has been firmly established.

Box 2.1. **New technology is strengthening the relationship between trade and investment** *(cont.)*

Technological developments, which make possible the specialisation of manufacturing and increasingly services production across borders and among new players, are likely further strengthening and broadening the complementary relationship between trade and investment. More than before, multinational trade, investment and alliances are interlinked. Being a nascent development, however, it is still too early for empirical studies to quantify the influence on the relationship between investment and trade. Two indicative measures of this process are the export and import intensity of manufacturing, which have increased in virtually all OECD countries over the past decade.

Source: OECD (1993) and OECD (2002).

2. The way globalisation, driven by new technology, is influencing international investment

Since, *a priori*, the net effect of new technology on the volume of international investment is ambiguous this section of the article synthesises the evidence. It also interprets the influence of technology on the emerging patterns of international investment in terms of the choice of countries and sectors, the decisions on how to structure investments as well as on the organisational configuration of businesses used to manage investments.

2.1. International investment and the deepening of globalisation

As noted above, advances in communication and information technology have made it easier and cheaper to manage international production networks. Likewise, innovations in transport, such as large-scale containerisation, inter-modal transport and their assimilation with information and communication technologies are shrinking the cost, while reducing the time and improving the consistency of delivering goods to market. These developments also tend to expand the range and span of corporate control, making optimal firm size larger than was previously possible. Together, they are facilitating the growth in multinational enterprises, helping even the smaller firms to foster deeper integration and to seek-out more intensely investments in established markets to exploit scale economies and consolidate their competitive advantage.

At the beginning of the 1970s there were some 7 000 multinational enterprises. Today, that number is closer to 70 000 enterprises each with, on average, ten foreign affiliates. Since multinationals are the primary source of international investment, their growth in number has been associated with a

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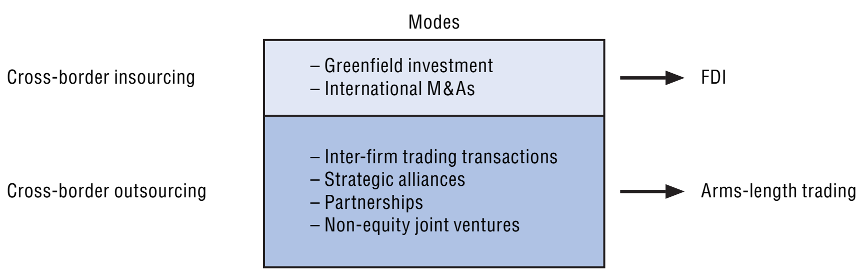
rising intensity of international investment in OECD economies. In line with the deepening process of globalisation, the stock of outward FDI relative to GDP among OECD countries for which the data are available has reached a level nearly quadruple what it was in the early 1970s. The intensity of international investment has risen in virtually all industrial sectors in the OECD area.

Technology innovations also influence a country's relative attractiveness as an investment location, in terms of its competitive position in many industries, reshaping the set of efficiency-seeking investment opportunities – one of the key motives for international investment. Two of the more contentious of these new relationships is cross-border in-sourcing and out-sourcing. Cross-border in-sourcing is when firms organise production by splitting links in their value chain into affiliate entities across borders to reap the efficiency gains from specialisation and from site-specific location advantages, yet remain tightly integrated and co-ordinated at the global level. Cross-border out-sourcing is when firms organise production by handing over to others links in the value chain that were once considered core functions to reap the efficiency gains from firm specialisation.

The result from the globalisation of value chains through cross-border in-sourcing is evident in higher levels of international investment and changes in its composition. However, the globalisation of value chains through cross-border out-sourcing does not directly influence international investment (Figure 2.4). Rather, it is evident by an increased level of inter-firm trade in intermediate goods, such as components, sub-assemblies and semi-finished goods organised through arms-length business relationships (*e.g.* alliances, joint ventures and partnerships, discussed further in Section 2.3). In practice though, much of the trade in intermediate goods is intra-firm trade among multinationals and their foreign affiliates. In the OECD countries for which such data are available the share of intra-firm exports in total exports of manufacturing affiliates under

Figure 2.4. **Organisational modes for cross-border production and investment**



Source: OECD Investment Division.

foreign control ranges between 15 and 65 per cent. This suggests, at least, in the manufacturing sector that the globalisation of the value chain has so far been mostly driven by a deepening of international investment, even if traditional FDI measurement systems do not capture the full complexity of the underlying relationships (see Box 2.2 on FDI statistical challenges).

2.2. International investment and the broadening of globalisation

As well as deepening business linkages among countries, new technologies and technical advances are expanding the geographic reach of commercial relationships, broadening the process of globalisation. For example, innovations that enable the exchange of data and information in real time have improved the ability and reduced the cost of organising activity in distant countries. In some industrial sectors new manufacturing technologies and product innovations are an additional force influencing investment decisions. In vehicle production, for instance, new manufacturing techniques have reduced the importance of scale economies in building the metal frames of cars, but as cars get more complex it is the electronics components that need more scale. These developments are supporting both new market and efficiency seeking motives for international investment and deepening the capacity for specialisation of economic activity (see Box 2.3 for a case study on the car sector).

Businesses in both OECD and non-OECD countries are responding to this new environment by going further a field in looking for new investment opportunities. Fifteen years ago OECD countries held the vast majority of their investments abroad in other OECD countries. Since then the proportion of OECD outward positions to non-OECD countries has increased in 8 countries and in some, especially the smaller ones, the proportion is now close to 30 per cent. The bulk of these investments are in low-end manufacturing and the potential for further expansion appears substantial. Likewise, non-OECD countries are increasingly becoming major investors in OECD countries. Although the level remains small, six major non-OECD countries in terms of international investment have increased their investments in most OECD countries relative to GDP (Figure 2.5). This is only part of the picture, however. Increasingly, non-OECD countries are investing in other non-OECD countries. For instance, South Africa and Brazil now feature among the largest investors in Africa and South America respectively.

The growing sophistication of technology and intangible assets embodied in output is itself a force broadening globalisation. In the United States, knowledge intensive services represent the equivalent of around 25 per cent of gross value added, up 4 percentage points since the early 1990s (OECD, 2005a). And according to the few available estimates surveyed in an OECD report, the stock of intangible assets, broadly defined to include intellectual property

Box 2.2. **FDI statistical challenges arising from new technology**

Foreign direct investment is defined as international investment by a resident entity in one economy – the direct investor – with the objective of obtaining a lasting interest in an enterprise resident in another economy – the direct investment enterprise. Ownership of 10 per cent or more of the equity is a basic criterion for determining the existence of a direct investment relationship for statistical purposes. The application of these concepts for the collection of reliable and comparable statistics and thus for meaningful analytical and policy work face a number of challenges as the process of globalisation through international investment made possible by technological innovations advances.

New technologies that facilitate firm specialisation are leading businesses to shed non-core activities. This is creating shifts in the sectoral composition of international investment which do not necessarily reflect underlying structural changes. For example, a marketing services provider may be interested in only purchasing the marketing unit operations of a chemicals business. Even though the acquisition is in the same sector, if the foreign investment is allocated according to the industry of the non-resident direct investment enterprise it will be recorded as if investment in the chemical sector had expanded.

To minimise this problem, the OECD recommends when feasible two sets of FDI statistics be compiled. One that allocates FDI according to the industry of the resident direct investment enterprise for inward investment and the non-resident direct investment enterprise for outward direct investment. The second allocating FDI according to the industry of the non-resident direct investor for inward direct investment and the industry of the resident direct investor for outward direct investment. In practice, however, this approach is not always applied for many countries. Moreover, because MNEs frequently use "pass-through" funds domiciled in other countries to finance acquisitions, analysis of the ultimate home or host country investing enterprise is blurred. As a result there is an increasing lack of international comparability as the trend towards fragmenting the value chain continues.

A second statistical challenge concerns the scope of international investment statistics. Again, as multinationals fragment their value chain in line with core competencies, they are increasingly relying for certain functions on forms of partnership that fall outside the scope of the definition of FDI. For instance, to access strategic knowledge and minimise the costs of research and development multinationals are turning to cross-border R&D joint ventures, R&D consortia and university industry linkages. While data sources for the number of alliances is available they are not comparable with existing FDI statistics, as it is difficult to measure the value of a strategic alliance. Since often a partnership may start as an alliance and evolve into a foreign acquisition, efforts to better link FDI and alliance data sources would help to better understand the evolving patterns of industrial globalisation.

Source: OECD Benchmark Definition of Foreign Direct Investment.

Box 2.3. **Technology is favouring Eastern Europe as a car production and assembly location**

Since the early 1990s the automobile industry has been strongly influenced by technology driven globalisation as well as policy factors, such as lower trade barriers. Initially, efforts were focussed on seizing economies of scale through a wave of mergers and acquisitions, or alliances with production based on a global, yet modular platform strategy (see *e.g.* Lung, 2001).

By the middle of the 1990s this strategy was loosing favour as expected efficiency gains did not materialise and as trends in manufacturing technology (*e.g.* space-frame construction technology) reduced the case for platform volumes above 300 000 units. Computer-Aided-Design software is also contributing to the fragmentation of the design segment of the car value chain. Consumer preferences favouring distinctive styling and electronic sophistication (*e.g.* car navigation systems) were an additional force changing manufacturing strategies and boosting co-operative relations with car part suppliers and with suppliers in other industrial sectors.

The Eastern European economies gained a competitive advantage from these technology driven shifts in the trade-of between scale economies and product differentiation and the trend towards vertical de-integration of downstream functions such as engineering services and the supply of electronic components via outsourcing. Eastern Europe has also benefited from technical advances in transport and logistic management methods, which effectively reduce the trade-off between global sourcing and proximity of consumers and suppliers, by reducing transport delays and by improving the reliability of vehicle delivery.

Coupled with low wage costs, a skilled workforce and good infrastructure, the response has been a surge in international investment into Eastern Europe's automobile sector, dominated by the Czech Republic, Slovakia, Hungary and Poland. Initially foreign investment took place through the acquisition of obsolete local manufacturing sites. Then a growing number of producers turned to a greenfield investment strategy, establishing new production and assembly capacity. Average annual growth in inward foreign investment in the motor vehicle industry has been above 30 per cent and the sector accounts for between 16 and 25 per cent of total manufacturing FDI (Table 2.1). These trends are expected to continue at least for several years, with Hyundai, Peugeot, Volkswagen, Fiat and Suzuki all recently announcing investment plans to expand assembly plant capacity.

Box 2.3. **Technology is favouring Eastern Europe as a car production and assembly location** *(cont.)*

Table 2.1. **Motor vehicle FDI in Eastern Europe has expanded rapidly**

	As a per cent of manufacturing FDI		Change in share	Average annual growth[1]
	1990s	2003		
Czech Republic	15.71	22.69	6.98	32
Hungary	10.03	24.74	14.71	31
Poland	6.64	16.73	10.09	48

1. Since 1997 for Czech Republic, 1992 for Hungary and 1994 for Poland.
Source: OECD FDI statistics.

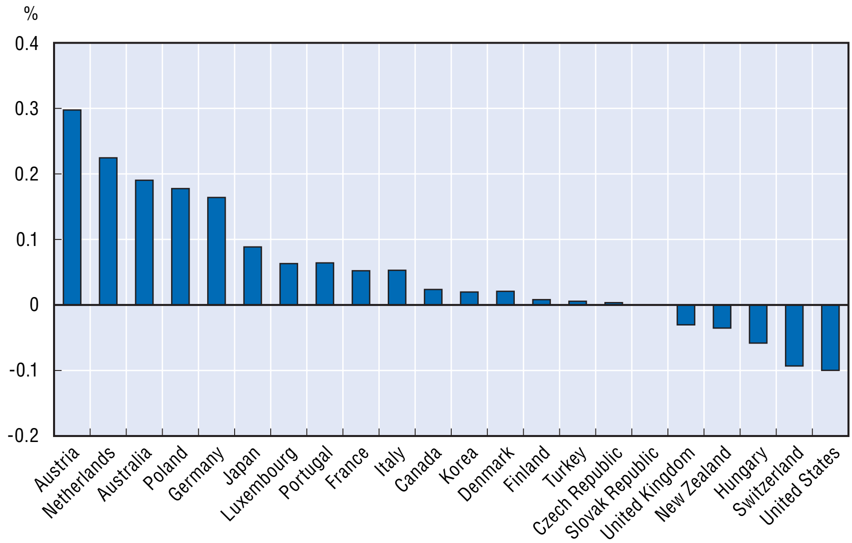
Accompanying this wave of assembly plants is an influx of automotive suppliers, which in turn has stimulated a network of local sub-suppliers. This clustering of activity is itself acting as an additional draw for investment in the automobile sector. Information networks are helping suppliers and assembly plants to maintain close links with each other.

Source: Balcet and Enrietti (2002), Baldwin and Clark (2000), Gage and Lesher (2005), Lung (2001).

rights, human capital, brands, organisational know how, software, etc., is approximately equal in size to the stock of physical capital in advanced economies (OECD, 2006a). The rising relative importance of intangible assets is strengthening the asset-seeking motive for international investment as multinational enterprises compete for access to technology and others strive to remain on the technological frontier and cost efficient producers. Businesses from emerging market economies, have likewise found it useful to own affiliates in advanced economies as a way of assimilating know how throughout the enterprise.

As well as expanding the potential number of players in international investment, new technologies (and policy reforms) are also enlarging the scope for FDI. Up to recently, this has been evident in the manufacturing sector and among OECD countries. But advances in communication and computing technologies are expanding the capacity for the international division of labour through FDI in the services sector, especially in information intensive services. Financial service providers, airlines, and other sectors are increasingly able to geographically detach links in their value added chain, such as back office operations. In some other areas, however, technology is favouring a shift away from out-sourcing towards in-sourcing. Financial institutions, for example, are bringing the processing of payments in-house as

Figure 2.5. **Large non-member economies have increased investment in most OECD countries**[1]



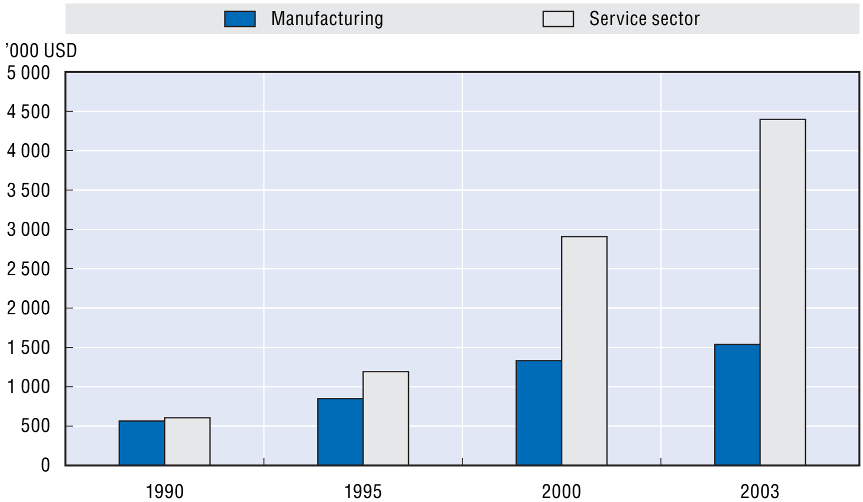
1. Average change in six major non-OECD economies' [Brazil, China, Hong Kong (China), India, Russia and South Africa] investment position share in OECD economies between the early 1990s and 2000s as a per cent of GDP.

Source: OECD Economic Globalisation Indicators (2005b).

new IT technology enables financial businesses to exploit market information in ways that add additional value, including the creation of new products.

So far most service production separation has been within the same country, but the scope to offshore is considerable. A recent OECD study estimated that around one fifth of total employment in OECD countries is in functions that could potentially be affected by off-shoring (Van Welsum and Reif, 2005). New technologies have also been associated with the emergence of entirely new service sectors and markets *e.g.* software development and mobile telephony. While it is not possible to discern the contribution of the various factors, there has been a marked trend over the past decade towards increased flows of international investment in services. At the beginning of the 1990s services and manufacturing represented about equal shares of outward FDI positions and flows in the OECD area. Since then, the OECD outward FDI position in services has grown at an annual average rate of 16.6 per cent, more than double the annual rate of growth in the FDI outward position in the manufacturing sector, with services now accounting for ⅔ of the OECD outward FDI position (Figure 2.6). The growth in services partly reflects the blurring boundary between manufacturing and services, as businesses shed non-core, often service activities, such as research and development, information technology and legal departments to specialised service producers.

Figure 2.6. **The composition of OECD FDI has shifted massively towards services**



Source: OECD International Investment Statistics database.

To date, only a very small part of the international investment in service sectors is associated with off-shoring to non-OECD countries. Relative to their size, however, trends in service sector off-shoring are receiving disproportionate media and political attention. This reflects the rapid growth and the widening geographical reach of off-shoring from countries at similar stages of development to include developing countries and uncertainty over how far the process is likely to proceed. Most experts think that the sourcing of services at the global level is yet to see its full potential. This potential may well be given added impetus due to the considerable scope to lower barriers to international investment in services and since services still generally need to be produced when and where they are consumed.

2.3. New organisational forms of international business

The use and production of certain new technologies at a global level are leading to changes in the traditional methods for expanding and managing international operations, particularly in the skill-intensive sectors of economic activity (*e.g.* biotechnology). (Box 2.4 examines how the supply side of technological innovation is going global.) While cross-border mergers and acquisitions account for the bulk of international investment and this is likely to remain the case, there has been a rapid expansion in the number, scale and complexity of cross-border strategic alliances, joint ventures and co-operation agreements. These agreements are not reflected in FDI statistics, yet represent one form for investing in the globalisation of business activity.

Box 2.4. **The supply side of technological innovation is going global**

Multinational enterprises in the past have usually located their research and development centres – the core source of business funded technological innovations – in the home country (Office of Technology Assessment, 1994). This pattern, however, is changing. Firms from developed economies are establishing research capacity in developing countries and multinationals from emerging market economies are doing likewise in advanced economies according to their comparative advantage. As a result, it is less and less the case that research and development activity is in a handful of economies.

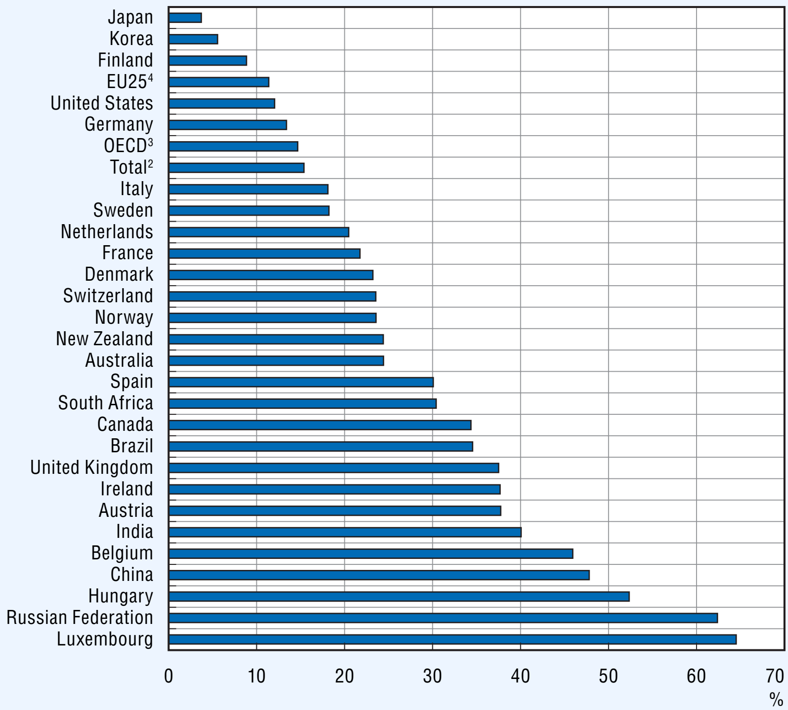
This development is being driven by a number of factors. They include scale and scope economies in research and development, a desire to share risks and the costs of innovation through cross-border partnerships and strategic alliances with firms owning complementary technological resources and competitive pressures to shorten the innovation cycle. As well, earlier technological progress has itself contributed to the globalisation of the supply side of technology.

One measure of how strongly countries depend on foreign research and development activity for innovation is the nationality of patent ownership on domestic inventions. On average in the OECD area, some 15 per cent of all inventions filed at the European Patent Office were owned or co-owned by a non-OECD resident over the period 1999-2001 (Figure 2.7). In some countries, notably the large non-OECD economies the incidence is much higher and mostly the result of the research and development activity of the foreign affiliates of multinationals. The foreign ownership of domestic inventions is concentrated in the chemical, pharmaceutical, petroleum refining and food and beverage sectors.

A number of factors explain the growing importance of alliances. The rising cost of research and technological convergence between sectors (*e.g.* computers and automobiles) are spurring the demand for technological alliances. On the supply side, improvements in information and communication network technologies have reduced the cost of co-ordinating, monitoring and enforcing alliances. More accessible information allows many small services firms, which previously could not profitably engage in international business to reach across borders to form joint ventures and alliances (Figure 2.8).

Box 2.4. **The supply side of technological innovation is going global** *(cont.)*

Figure 2.7. **Foreign ownership of domestic inventions varies widely across countries**[1]

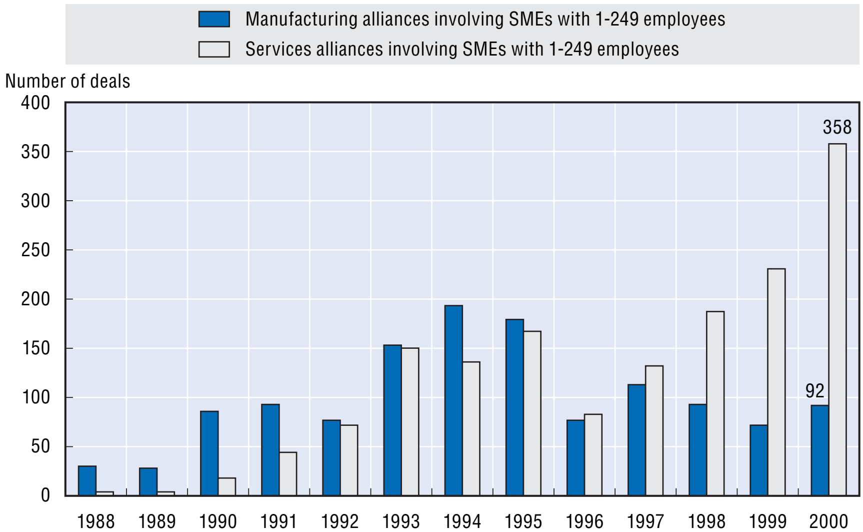


1. Patent applications filed at the European Patent Office, 1999-2001
2. All EPO patents that involve international co-operation.
3. Patents of OECD residents that involve international co-operation.
4. The EU is treated as one country; intra-EU co-operation has been netted out.

Source: OECD (2005a and 2005b) and UNCTAD (2005).

Alliances are more flexible than cross-border mergers and acquisitions and offer a quicker way to build competencies than greenfield investment. But they involve a loss of control and more risks, especially for firms owning complex technology entering countries with poor intellectual property protection and when the enforceability of contractual agreements is weak. In these circumstances it is more efficient to internalise the costs of technology transfer through wholly owned subsidiaries. In practice, alliances are not an alternative to FDI, but complement it. Indeed, often what begins as an alliance ultimately leads to international investment (Narula and Hagedoorn, 1999).

Figure 2.8. **SMEs are increasingly involved in cross-border alliances**



Source: Sakai (2002) based on Thompson Financial.

The evolving patterns of international investment fostering a globalised system of production and sales is also influencing how firms organise their internal structure to manage foreign investments and cross-border alliances. In the traditional organisational structure, units tended to be either within the organisation and well connected, or they were outside the organisation and not connected at all. As firms have become more specialised and outsourced certain functions, the need to manage external relationships and networks has expanded. In this regard, communication and information technologies, such as internet and email are enabling firms to better connect units within the firm and between partners external to the firm. This allows firms to improve knowledge management by sharing expertise and experience with a vast number of partners. As a result of reduced monitoring costs, businesses are adopting different organisational forms, such as delegating more responsibility to foreign affiliates, introducing human resource policies that treat their employees more like partners and trying to foster internal in-house marketplaces.

3. What are the investment policy challenges that lie ahead?

The nexus between technological innovations and the globalisation of investment is fostering new debates about the benefits and costs of various forms of international linkages. Some stakeholders are concerned that certain technology is rendering existing barriers to international investment inconsequential. Others stress the wider economic benefits of international

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investment, in terms of efficiency gains and wealth creation. Inevitably, adjustment to the design and implementation of investment policy will be needed. This section of the article identifies the potential investment policy implications of new sectors, new players and new methods of international investment.

1. **Managing the globalisation process: what role for international investment policy?** As technological developments advance globalisation through international investment, both host and home countries stand to benefit through an expansion of an economy's productive capacity, job creation and the diffusion of technological and enterprise expertise, boosting productivity and national incomes.[3] But the shifting patterns of international investment in response to changes in national and corporate comparative advantage also entail sizeable transitional adjustment costs and have raised fears of permanently lower labour and environmental standards. The challenge facing policymakers is how to adopt and adjust policies so that all countries and their societies benefit fully from the globalisation process while limiting the adjustment costs. This is likely to require efforts to:
   - *Seize the full benefits of FDI.* As illustrated in Section 2, technological innovations have strengthened the efficiency-seeking motive for international investment. But realising the full potential offered by technical advances also depends on the degree of market openness. While many countries have lowered obstacles to inward investment, barriers remain sizeable, including opaque barriers to cross-border mergers and acquisitions especially in the service and utility sectors (OECD, 2006b). A recent OECD study estimated that aligning remaining FDI restrictions on those of the least restrictive OECD country might increase OECD-wide inward FDI positions by almost 20 per cent and boost per capita incomes. Moreover, such estimates ignore the efficiency gains in the supply chain from the broadening of globalisation among the large non-OECD players, such as China, India and Russia where the degree of restrictiveness on inward FDI is more than double the average OECD level. As more economies emerge as global players, governments wishing to address the barriers to FDI will need to continue to widen and strengthen their international policy co-operation efforts to include these new players.
   - *Maintain support for international investment.* Although the broadening and deepening of the globalisation process through international investment brings both host and home countries net economic benefits, there are winners and losers and transitional costs. For example, the nascent trend toward off-shoring production to non-OECD countries through foreign affiliates reduces demand for OECD workers and exerts downward pressure on wages in the affected sectors and has more generally heightened fears of

a "race-to-the-bottom" in terms of labour and environmental standards. A protracted period of adjustment and a concentration of the costs within specific groups (*e.g.* unskilled workers) could compromise support for open international investment policies and lead to resistance to reforms that would otherwise benefit society as a whole. Governments will need to develop labour market, education and training policies that limit these dislocation costs and at the same time facilitate adjustment to globalising investment. There is also an increased need for adhering governments to promote wider adherence to the OECD Declaration on International Investment and its Guidelines for Multinational Enterprises to foster good practice in managing change and in raising standards of responsible business conduct among the emerging new players.

2. **Adapting investment attraction strategies.** As economic activity becomes more globally integrated, competition for FDI intensifies and new technologies alter the relative attractiveness of a country as an investment location. The rebalancing of the key drivers of investment has consequences for international investment attraction strategies. Some of the issues and challenges that governments and agencies are likely to confront include:
   - How to expand the reach of investment attraction strategies to new types of international investors, in particular small- and medium-sized enterprises? Improved communication technologies have already facilitated the broader dissemination of information on policies, programmes and procedures, but a more pro-active approach may be needed to identify first-time investors. To this end, and against the background of shifting motives for international investment, how should existing investment attraction strategies be adapted? Addressing this challenge will require a better understanding of what determines national attractiveness and efforts to identify and fix weaknesses in the investment environment. It will also require governments to focus on the appropriate balance and coherence of policies designed to, on the one hand improve the investment environment and on the other targeted facilitation measures, such as establishing special economic zones, incentives for the creation of industrial clusters, technology parks, etc. The latter measures, if designed to lock business interests into specific niches risk losing relevance as investment mobility increases.
3. **Ensuring the effectiveness of international investment instruments.** Technologies that reduce the "tyranny of distance" and enable deeper economic integration with new players are creating unprecedented opportunities for both OECD-based investors and others. But not all new players operate by high investment policy standards, regarding transparency, predictability, openness and corporate responsibility. These developments raise several new challenges for the effectiveness of

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international investment instruments that are likely to take on growing significance in the years ahead, including:

- *Extending investment policy standards.* The emergence of new players in the field of international investment is driving up the demand by businesses for governments to negotiate investment and double taxation treaties with countries where bilateral investment rules presently do not exist. This will help to create a more level playing field and foster a climate of greater certainty. One side-effect is likely to be a more complex Web of treaties, raising the transactions costs of doing international business. As a result, pressure to limit these transactions costs may rise. As important, will be an ongoing need to extend and encourage the enforcement of established international investment standards among new players, such as the OECD Guidelines on Multinational Enterprises, since the increasing ability to separate links in the supply chain across countries has raised fears of a failure to respect core labour standards among suppliers downstream in the supply chain.
- *Adapting international investment agreements.* Outsourcing and new modes of creating international business linkages, such as offshore centres, joint ventures and strategic alliances tend to make less functional nationality and residency criteria of ownership and management control on which international investment agreements and standards are based and further complicate their application. Moreover, an increasing share of the market value of firms derives from their intellectual assets, and the external accessing of knowledge is a rising source of value creation in OECD countries. In this context, both the coverage of agreements protecting intangible forms of property and how well existing agreements cover new types of intellectual assets are likely to merit closer examination. Do, for instance, intellectual property rules need to be adjusted and if so in what way? Uncertainty in these areas could hinder international investment and distort the deployment of advanced technology by the affiliates of foreign-owned firms, weakening the size of technology diffusion spill-over benefits. At the same time, the rising importance of intellectual assets in economic output, especially leading-edge technology raises issues of protecting strategic assets that are in the national interest. What, for example, are the principles that determine the scope of strategic assets and if foreign access is to be limited, what sort of policy instrument should be used?
- *Building policy capacity for investment among less developed players.* A level playing field and good investment policy standards are not sufficient to ensure the full benefits from international investment, policy making capabilities and improved implementation and enforcement capacity are needed too. While globalisation through new technologies in principle

influences advanced, emerging and developing countries, in practice the distribution of international investment is uneven across countries, with some missing-out almost entirely. This is due in part to the nature of the changes in corporate and economy-wide comparative advantage, but it also reflects a lack of capacity in some countries to refocus policy in ways that take advantage of the new global market. International investment policy makers are being called on to help poorer countries to improve their policy environments for investment. The OECD has responded by launching the Investment for Development Initiative in 2003 and expanding its relations with non-members. And the demand for tools, such as the Policy Framework for Investment (OECD, 2006c), to assist governments engaged in domestic reform and dialogue is likely to continue to expand in the years ahead.

4. **Better statistics.** New forms and the changing structure of international investment in a wider range of countries is undermining the relevance of traditional FDI statistics:
   - Technological advances are blurring concepts on which international investment statistics are based. Against this background, work by the OECD and the IMF statisticians to improve international standards and survey implementation needs to continue. In addition, as the globalisation process advances the need to better understand the impacts will escalate and this is likely to lead to calls for more comprehensive and comparable data on the modes of investment and on the activities of foreign affiliates, including at the firm level.

Notes

1. In fact, the two factors are interrelated, since technological advances are a source of pressure for market-opening policy reforms, and market-oriented policy reforms are a spur for technological innovation in order to maintain and gain a competitive advantage.
2. Examples include Global Health Care for hospital equipment and healthcare products, Avolo for aircraft parts and maintenance services, e-steel for steel products and Covisint for automobile parts. See also OECD (2000a) for an assessment of the potential outcomes and economic impacts of e-commerce, the forces underlying its expansion and the implications for structural and macroeconomic policy management.
3. See OECD (2002) for an evaluation of the benefits of inward FDI to the host country. ***Chapter X*** offers a survey of the literature on the home country benefits from outward FDI.

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ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART I

Chapter 3

International Investor Participation in Infrastructure: Challenges for Policy Makers*

The main success and failure stories of international investor participation in infrastructure over the past decade are enumerated in a rich body of literature. A number of challenges for policy makers and businesses can be identified from this body of evidence, including pieces of supplementary analysis made available by the Investment Committee's Secretariat, which were discussed with infrastructure specialists at an Expert Meeting on 3 March 2006. Some of the tentative lessons are summarised in this article.

The success of infrastructure projects depends on the general political, regulatory and economic reality in which they are set. International investor participation in infrastructure should be seen as a long-term commitment to provide end-consumers in the host country with services. Government, in its capacity of a contracting party, acts as proxy for these consumers' interests, and it partners with the private sector in delivering the services. Responsible business conduct is a key challenge for international investors participating in infrastructure. This is particularly in developing countries, where enabling environments tend to be less developed, and governments' relative bargaining positions vis-à-vis international enterprises weaker.

* This article was prepared by Hans Christiansen, Senior Economist in the Investment Division, OECD Directorate for Financial and Enterprise Affairs.

Introduction

International investor participation in infrastructure may cover a wide range of models of co-operation between the public and private sectors. In terms of increasing private investor involvement, options range from subcontracting; to publicly-controlled incorporated infrastructure providers; to delegated management contracts; to concessions and joint ventures; to full privatisation with the public partner ceding all but a regulatory role. All of these are covered touched upon in the present article, but in practice most of the focus is on the models that involve a degree of continued partnership between government and international investors.

"International investors" are considered in the broad sense of the word. The focus of the discussion is infrastructure providers operating on a wholly commercial basis and subject to international competition. International investor participation may be used interchangeably with the more common phrase private participation in infrastructure (PPI), with the proviso that truly local operations (including "private" involvement through publicly held special-purpose vehicles) are not included.

1. Getting the background right: enabling environment, attitudes and capacities

International investor participation in infrastructure raises some of the perhaps most complicated challenges for investment policy makers. PPI involve contracts that are more complex, and of a longer duration, than what is seen in manufacturing and other parts of the service sectors. Moreover, direct investment in the infrastructure sector attracts political and public interest, and frequently a commercial relationship between the private and public sector. And, in the words of a private sector participant at a recent OECD event, "working with the public sector is much more complicated than a contractual relationship with another company".[1]

1.1. Is private participation necessarily the best solution?

A textbook approach to PPIs would be that their main advantage over publicly run projects lies in the private operators' superior operational and administrative efficiency. Their main drawback would be the fact that the public sector has access to cheaper funding than private companies. In consequence, the involvement of private infrastructure providers is warranted when the efficiency gains are expected to exceed the extra financing costs.

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To some extent recent developments around the world have reflected this – not so much in terms of the projects embarked upon as in the extent of private sector involvement. For example, "high-tech" activities such as mobile telephony – in which the private sector advantages in knowledge and efficiency are assumed to be major – have been largely developed by the private sector. Infrastructure sectors commonly considered as "low tech" (the best example being water and sewerage) have, following initially sweeping privatisation in a number of countries, in many cases seen the ambitions for corporate involvement scaled back to the management of publicly-owned networks.[2]

A special case arises where host country authorities face binding fiscal constraints. Where the counterfactual scenario of government-funded infrastructure is not available, a decision on PPI will rely on a cost-benefit evaluation of this option alone. That said, for a country in this situation particular caution regarding fiscal sustainability is warranted. PPIs whose main purpose is to escape budgetary discipline are rarely successful. Few PPI projects involve transferring every risk to the private sector. And, if a project involves an element of government guarantees – explicit or implicit – the contingent liabilities that arise from these can potentially impede fiscal sustainability. The implication is not that PPI should be avoided or even circumscribed, but that prudent fiscal transparency practices must be applied.[3]

1.2. Market access

Infrastructure services are among the few economic activities where important barriers to cross-border participation exist, even among OECD countries. Many countries have liberalised access to their national markets over the last decade, and in only a few activities (*e.g.* air and water transport) are discriminatory practices still the norm. Supplementary material for non-member countries, based *inter alia* on GATS schedules, tell a similar story.

However, statutory discrimination is only part of the picture. Several countries are in principle open to direct investment in their infrastructure sectors, while at the same time maintaining legislation on grounds of public order and essential security that may potentially be used to stifle market entry. Examples range from clauses protecting sensitive technologies to more sweeping rights to screen any foreign investment on grounds of "national security". Recently, a number of countries appear to have tightened their approaches to cross-border mergers and acquisitions, based on stated national security and other "strategic" considerations.

Moreover, a number of non-discriminatory barriers to entry, which may be particularly onerous to foreign or non-resident companies, remain in place. In most OECD countries, monopolies, public ownership and sweeping concessions persist in parts of the infrastructure area, hampering market access and competition for international and domestic investors alike. Others apply complex regulatory practices that, whilst not directed specifically at foreigners, make market entry cumbersome.

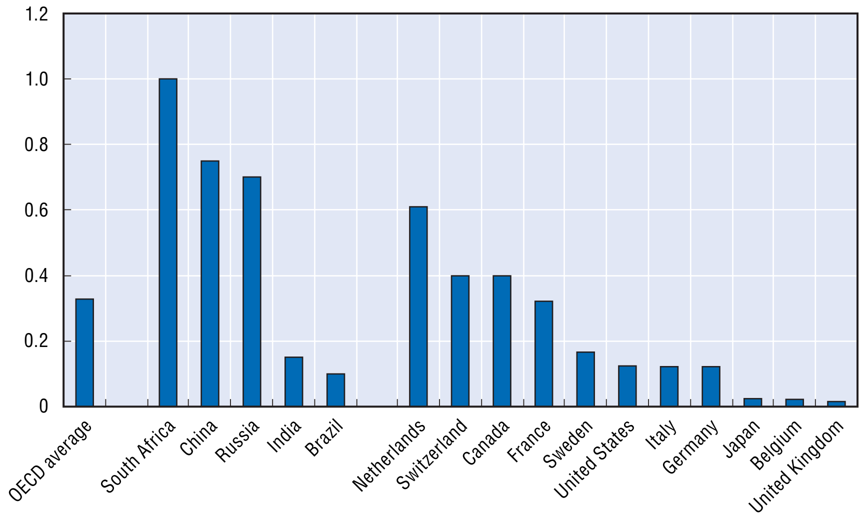
A methodology for quantifying restrictiveness to direct investment was developed and the results published under the auspices of the OECD Economic Policy Committee.[4] This methodology is based largely on the prevalence of discriminatory restrictions (whether on the basis of nationality or residency) in individual sectors. The main initial data sources were OECD countries' positions under the MAI negotiations and their GATS schedules. The first uses of the data for economic analysis attracted much interest in and outside the OECD.[5] Recent work has served to update the indicators for OECD countries, and extend them to 13 non-member countries. The information contained in OECD's investment instruments was used as a principal data source, but supplementary information from national and multinational sources was also included.

The methodology behind the restrictiveness indicators is as follows. Essentially each sectoral indicator is constructed by scoring the existence/ absence of restrictions which fall into three groups: 1) foreign equity limits; 2) screening and approval procedures; and 3) other restrictions (mainly board restrictions, expatriate staff and domestic content requirements). Many of the restrictions reported under (2) and (3) are often of a cross-sectoral rather than sector specific nature. Totally closed sectors are scored 1; totally open ones are scored 0.

By ways of illustration, the FDI restrictiveness index for the electricity sectors of the G10 countries and selected non-OECD members is shown in Figure 3.1. It appears from the figure that variations among countries are vast. The largest OECD countries do generally not have monopolies or near-monopolies in their electricity sector, but in several of them foreign establishment is nevertheless difficult. Among the large non-member economies, the electricity sector of South Africa is seen as effectively closed to foreigners, and China and Russia also come across as very restrictive. Conversely, several countries – including Brazil and India outside OECD – have either no restriction on investment in electricity or only generic requirements (*e.g.* notification of investment; limitations on expatriate staff) applying to electricity among other sectors.

Finally, infrastructure providers are particularly sensitive to government procurement practices. Adherents to the OECD Declaration are required to notify exceptions to National Treatment in government procurements. According to the notifications, few statutory discriminatory measures are in place – and notified exceptions relate largely to development aid programmes. However, these notifications refer only to statutory measures, not to administrative practices that could in some cases be strongly biased toward national preference.

Figure 3.1. **FDI Restrictiveness Index: Electricity**



Source: OECD's FDI Restrictiveness Indicators.

1.3. The enabling environment

Where authorities welcome international investor participation in infrastructure the main obstacle tends to become the business climate surrounding such investment. The outcome of PPI projects depends strongly on the quality of the political, economic and regulatory environment in which it takes place – in short, on many of the elements of the enabling environment for investment as defined in the emerging Policy Framework for Investment.

The quality of the legal environment is of paramount importance. Unless the rule of law is firmly established, and regulation consistently enforced, PPI is fraught with risk.[6] Even the strongest contracts and project finance amount to little in an environment where agreements cannot be adequately enforced. In addition, the concrete contractual underpinnings of PPI projects need to have the strongest possible legal grounding, consistent with internationally accepted good practices.[7] A lack of legal clarity has been behind many widely-publicised cases of governments (especially newly-elected ones) challenging existing contracts or dismantling regulatory setups.

There has been a tendency in the past among countries aiming to involve international investors in their infrastructure sectors to focus on the legislation deemed particularly important for such projects – that is, concession and privatisation law. However, such an approach has often proven too narrowly focused, as the success tends to depend on a whole body of other legislation bearing on business. Often PPI has been held back by tax and government procurement laws seen by the potential investors as unsuitable for private involvement in the infrastructure sectors.

A specific issue pertains to international treaty obligations, which may gain prominent importance where the domestic legal underpinnings of contracts and investor protections are seen as falling short of international standards. This attested by a relatively large number of investor-state disputes in the infrastructure sector that have arisen under international investment agreements. Not many disputes have so far reached final awards, but those that have (all of which in consequence of bilateral investment treaties) have mostly been decided in favour (or, at least partly) of the private claimants (for an overview, see Table 3.1). Several cases have ended with arbitration tribunals finding that disagreements of a largely contractual nature breached the fair and equitable treatment provisions of the relevant investment agreements.

1.4. Stakeholder involvement

The infrastructure sector is "burdened by its own past". International investors are often invited into national infrastructure sectors at a point where basic services are already at risk. This may imply a generally difficult investment environment, where newcomers are expected to address long-standing problems of inefficiency and mismanagement. This can be particularly difficult for foreign-based operators who are seen by some stakeholders as lacking in legitimacy.

Host country authorities may also sometimes have been too focused on international investment as a means of getting hold of infrastructure assets. There is a need to see private involvement more as a long-term process by which companies deliver a stream of infrastructure services to the general public. In other words, from the corporate perspective public authorities act as an intermediary for the end users and main stakeholder groups. The implication is that PPI is more likely to be successful when authorities have assured themselves that the envisaged undertakings meet the approval of consumers and other stakeholders – or are at least not wholly unacceptable to them.

Several challenges have been encountered in this respect. First, the decision to transfer utilities services from the public to the private domain is not infrequently linked with a decision to cede subsidies. This has been the case in the past where PPI was motivated predominantly by a need to break a long period of underinvestment. The previous subsidies were largely invisible – taking the form of utilities tariffs that were artificially low on grounds of not covering the cost of maintaining the capital equipment. The subsequent shift to "cost recovery pricing" to finance the new capital spending was seen by many existing consumers as a denial of well-earned rights, especially as it was not accompanied by any immediate or visible benefits to them.

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Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1]

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
Water sector									
Aguas del Tunari v. Bolivia, Decision on Jurisdiction, 21 October 2005	Water and sewage facilities.	ICSID.	Netherlands-Bolivia BIT.	Indirect claim.	Concession agreement, contract rescinded.	Policy changes.	The dispute arose as public resistance to the concession terms made the Bolivian authorities rescind the contract. Aguas del Tunari asserts the authorities acted in breach of the investor protection provisions of the relevant BIT.	n.a.	A Tribunal has assumed jurisdiction to hear the claims.
The Biwater Dispute, case registered 2 November 2005	Water and sewage facilities.	ICSID.	n.a.[2]		Privatisation agreement; contract terminated.		Both parties to this dispute have alleged breach of contract; Biwater has also stated it will contest the legitimacy of the termination of contract.	n.a.	Dispute has been submitted to international arbitration.
Vivendi v. Argentina, Award of 21 November 2000	Water distribution.	ICSID.	France-Argentina BIT.	Direct claim by investor.	Concession Contract; contract terminated.	Policy change (Provincial authorities).	Claimants alleged a series of contract breaches and, under the BIT, violations of the fair and equitable standard of treatment and expropriation.	Negotiations failed.	1st Award annulled; new decision pending.
Energy sector									
OPIC Decision, Ponderosa Assets S.A., Decision 2 August 2005	Gas transport.	OPIC Tribunal.	OPIC Contract (US investor; US overseas investment insurance scheme).	Indirect claim by share holder.	Privatisation of industry sector.	Policy changes.	The dispute in this case relates to the termination of US dollar based tariffs and termination of certain tariff adjustment mechanisms as part of the foreign exchange reforms taken in an attempt to remedy the Argentine financial crisis; the Claimant alleged breach of contract, breach of fair and equitable treatment and expropriation of investment.		The OPIC Tribunal concluded the acts of the Argentinean government amounted to expropriation as the value of the investor's investment was extinguished. As such, the Claimant was entitled to claim for damages under its political risk insurance.

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Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
CMS Gas Transmission v. Argentina, Award 12 May 2005	Gas transport.[3]	ICSID.	US-Argentina BIT.	Indirect claim by share holder.	Privatisation of industry sector.	Policy changes.	The dispute in this case relates to the termination of US dollar based tariffs and termination of certain tariff adjustment mechanisms as part of the foreign exchange reforms taken in an attempt to remedy the Argentine financial crisis; the Claimant alleged breach of contract, breach of fair and equitable treatment and expropriation of investment.		The Tribunal rejected claims of expropriation but held Argentina liable for breach of contract and breach of fair and equitable treatment; the Tribunal awarded pecuniary damages and ordered Argentina to re-purchase the Claimant's shareholding. Argentina has recently instituted annulment proceedings against this decision.
Gas Natural v. Argentina, Decision on Jurisdiction 17 June 2005	Gas supply and distribution.	ICSID.	Spain-Argentina BIT.	Indirect claim by share holder.	Privatisation of industry sector.	Policy changes.	The dispute in this case relates to the termination of US dollar based tariffs and termination of certain tariff adjustment mechanisms as part of the foreign exchange reforms taken in an attempt to remedy the Argentine financial crisis; the Claimant alleged expropriation, measures tantamount to expropriation and breach of fair and equitable treatment.		The Tribunal assumed jurisdiction to hear the claims however the proceedings have since been suspended pursuant to an agreement between the parties.

Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
Camuzzi/Sempra v. Argentina, Decisions on Jurisdiction 11 May 2005	Gas supply and distribution.	ICSID.	Belgium and Luxembourg-Argentina BIT.	Indirect claim by share holder.	Privatisation of industry sector.	Policy changes.	The dispute in this case relates to the termination of US dollar based tariffs and termination of certain tariff adjustment mechanisms as part of the foreign exchange reforms taken in an attempt to remedy the Argentine financial crisis; the Claimants have alleged breach of investment protections under the relevant investment treaties.		A Tribunal has assumed jurisdiction to hear the claims; a decision on the merits is pending.
Petrobart v. Kyrgyzstan, Award 29 March, 2005	Gas supply.	Stockholm Chamber of Commerce.	ECT (investor company incorporated under the laws of Gibraltar).	Direct claim by contractor.	n.a.; delivery ceased.		The dispute concerns non-payment under the supply contract and interference by the authorities to enforce such payment; the Claimant alleged breach of the ECT provisions providing for fair and equitable treatment and the obligation to provide effective means for enforce legal rights.		Tribunal awarded pecuniary damage to Claimant for non-payment under the contract and breach of fair and equitable treatment.
The Dabhol Power Project	Power generation.	n.a.	n.a.[4]		Power Purchase Agreement; Production and construction halted.	Policy change.	Dispute concerned failure of a state agency to pay invoices generated under the contract and failure of the government to honour guarantees granted in connection with the contract.	Settlement agreement reached with two investors; claims against the state agency resulted in pecuniary damages awarded by arbitral tribunals.	n.a.

Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
Plama v. Bulgaria, Decision on Jurisdiction 8 February 2005	Power generation.	ICSID.	ECT (Cypriot investor).	Indirect claim by majority share holder.	n.a.	Policy.	The Claimant alleges actions and omissions of the Government have led to material damage of the enterprise in which the Claimant holds a majority interest; the Claimant has sought compensation for damages and expropriation.	n.a.	A Tribunal has assumed jurisdiction and a decision on the merits is pending.
Enron v. Argentina, Decision on Jurisdiction (Ancillary Claim) 2 August 2004; Decision on Jurisdiction 14 January. 2004	Gas transport.	ICSID.	US-Argentina BIT.	Indirect claim by share holder.	Privatisation of industry sector.	Policy changes.	The first dispute relates to Enron's tax liabilities; the ancillary claim relates to Argentina's measures taken in response to the financial crisis. The Claimant has alleged these actions amount to expropriation and other violations of the relevant BIT.		The Tribunal has assumed jurisdiction to hear both claims.
PSEG v. Turkey, Decision on Jurisdiction 4 June 2004	Power generation.	ICSID.	United States-Turkey BIT.	Direct claim by investor.	Concession Contract; Dispute arose before performance under contract commenced.	Policy change alleged.	A dispute arose between the parties as to purchase price and capacity purchase obligations under the Contract; the Claimant alleged breach of contract, breach of treaty protections and expropriation.	Negotiations failed.	Tribunal has assumed jurisdiction to hear case.

Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
Nykomb Synergies v. Latvia, Award 16 December 2003	Power generation.	Stockholm Chamber of Commerce.	ECT (Swedish investor).	Indirect claim by sole share holder.	Liberalisation of energy sector; delivery of energy continued under interim settlement but further construction works halted.	Policy change.	The dispute concerned a disagreement between a domestic energy producer and a state agency as to the appropriate tariff rate; the Claimant alleged breach of contract, violation of the fair and equitable standard of treatment and expropriation.	Negotiations failed.	Tribunal found state liable for breach of ECT and contractual obligations.
AES Summit Generation v. Hungary, case discontinued 3 January 2002	Power generation.	n.a.	Unclear on the basis of available information (US investor).	Direct claim by investor.	Privatisation Agreement; Project continued.	Policy change.	Claimant's alleged breach of contract and breach of protections under the ECT in relation to the government's refusal to ratify the PPA and failure to agree to an appropriate power purchase price.	Settlement agreement reached by parties.	n.a.
Tanzania Electric Supply (TANESCO) v IPTL, Award 12 July 2001	Power generation and distribution.	ICSID.	Contract (Malaysian investor).	Claim raised by State agency.	Power Purchase Agreement; Dispute arose during construction phase of project.	Contract dispute.	The dispute in this case relates to a failure between the parties to agree on an appropriate tariff; both parties alleged breach of contractual stipulations by the other party.	Negotiations failed.	The Tribunal awarded non-pecuniary remedies in this award; more precisely, the Tribunal set the mechanism for determining the appropriate tariff, determined questions of breach of contract and ordered the parties to perform their obligations under the contract.

Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
Himpurna California v. Indonesia, Award 4 May 1999	Power generation and distribution.	UNCITRAL Rules, case administered by PCA.	Contract (US investor).	Direct claim by investor.	30 year Power Purchase Agreement; Operational site shut down; other construction works terminated.	Policy change resulting in breach of contract.	Claimant's contract suspended in response to the State's inability to meet its US dollar obligations in the wake of the Asian Financial Crisis 1997/98.	Negotiations failed.	Tribunal awarded Claimant USD 527 million in wasted costs and lost profits for breach of contract.
Telecommunication sector									
Motorola-Turkey Settlement	Mobile telephony.	ICSID.	United States-Turkey BIT.	Direct claim by creditor.	n.a.	n.a.	Dispute concerned the prioritisation of the State's claim against a third party over that of the Claimant.	Settlement agreement reached under which the State paid pecuniary damages to the Claimant and the Claimant suspended arbitral proceedings and agreed to enforce its claim against the third party in certain specified States.	n.a.

Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
France Telecom v. Lebanon, Award 22 February 2005	Mobile telephony.	UNCITRAL Rules.	n.a. (French investor).	Indirect claim by share holder.	Shareholdin g; Contract terminated; project awarded to a third party.		Claimant raised a claim on the basis of early termination of contract.	Unknown.	Claimant awarded USD 266 million for early termination of a contract entered into by the State with the enterprise in which the Claimant had a 66.66% share ownership.
Nagel v. Czech Republic	Mobile telephony.	Stockholm Chamber of Commerce.	United Kingdom-Czech Republic BIT.	Direct claim.	Co-operation Agreement; Project not commenced.		Claimant attempted to enforce a Co-operation Agreement under which establishment and operation of a telecommunications network was envisaged.	Settlement agreement entered into with state enterprise but without prejudice to treaty claim raised against State itself.	Claim dismissed as no "investment" under the BIT. (Award rendered in 2003.)
Transport sector									
Soufraki v. UAE, Decision on Jurisdiction 7 July 2004	Port management and operation.	ICSID.	Italy-UAE BIT.	Direct claim by investor.	Concession Agreement; Project status unknown.	n.a.	n.a.	n.a.	Tribunal declined jurisdiction on basis of non-fulfilment of nationality requirements by Claimant.

Table 3.1. **Arbitral decision and negotiated settlements in cases related to infrastructure operations**[1] *(cont.)*

Case name	Activity	Arbitral institution/ rules	Instrument containing consent to arbitration	Direct or indirect claim	Nature and status of underlying Agreement	Nature of dispute	Nature of claim	Negotiations/ settlement	Award
Aucoven v. Venezuela, Award 23 September 2003	Highway maintenance and operation.	ICSID.	Contract (Claimant treated as having Mexican nationality through operation of Article 25(2)(b) ICSID Convention.	Direct claim by investor.	Concession Agreement; Dispute arose during the life of the Concession Contract but prior to commence ment of main construction works under that contract.	Policy change.	Dispute related allegations of breach of contract, cancellation of contract and the consequences thereof.	Negotiations failed.	Tribunal found state liable for certain breaches of contract and awarded Claimant's pecuniary damage.

1. Because of confidentiality or other reasons, complete information is not available in all cases. N/A indicates that sufficient information is not available to adequately complete the field in question.
2. ICSID has registered a dispute in connection with this case under the name Biwater Gauff (Tanzania) Ltd. v. Tanzania (ICSID Case No. ARB/05/22), however, from the information available the place of incorporation of this corporate vehicle is unclear, nor is it apparent how nationality requirement will be satisfied under the ICSID Convention.
3. The ICSID Centre Web site lists this case as arising in the "gas transmission" sector, however, the Tribunal states the enterprise to be involved in "gas transportation". This latter language has been used so as to provide consistent use of language where possible. In all other ICSID cases arising from the Argentine financial crisis, the industry sector listed is as stated by the ICSID Centre Web site.
4. While the three investors involved in this project were reported to be enterprises incorporated under the law of the United States, it is unclear from the information available whether the investment took place through these companies directly or through subsidiary companies incorporated in other jurisdictions.

Second, where a part of the motivation is to raise productivity or lower costs in the provision of infrastructure. In both cases, private participation in infrastructure is almost invariably faced with resistance from domestic constituencies such as employee representatives and incumbent operators. Where employer-employee relationships and competition frameworks are codified and transparent, controversy can mostly be avoided. However, where arrangements are informal at best, authorities may need to make a concerted effort to gain support around PPI.

A policy of transparency and inclusive dialogue with all stakeholder groups invariably produce the best long-term results. Conversely, attempts to push PPI projects forward without consultations, or whilst providing faulty or no information to the public, have been at the heart of many policy upsets.

1.5. Authorities' consistency of approach and capacity to deliver

Another cross-cutting issue for public authorities is the coordination of infrastructure policy. Divergent PPI strategies are sometimes pursued at the national and sub-national levels. The need for coordination arises from the fact that infrastructure projects often have important repercussions outside the implementing jurisdiction. Such "externalities" may sometimes turn negative, as exemplified by certain failed PPI projects in the recent past that, while conducted at the local level, had an adverse effect on the reputation of the entire host country. A separate issue relates to the subsidisation that is in many cases needed to render PPI projects financially viable. Many governments have found it necessary to pass separate legislation regarding subsidies to avoid sub-optimal outcomes at the local and regional levels.

Even within the central government successful infrastructure programmes involve a host different functions – responsible for areas such as planning and financing, technical implementation and overall fiscal sustainability. If any of these is unable, or unwilling, to play their part, the overall outcome is imperilled. This is of particular relevance in the context of privatisation, where parts of the public sector may have a stake in the status quo. In consequence, national authorities will normally want to anchor their strategies for private participation in infrastructure in an overall policy programme, which is communicated and implemented throughout all levels of public administration.

Administrative capacity and competence are a separate issue. International investor participation in infrastructure involves sophisticated technological, corporate and financial solutions that government entities may not be fully equipped to handle. Even in OECD economies that count as among the most experienced in PPI one of the most consistent complaints from private infrastructure providers has been a lack of implementation capacity among their public-sector partners.[8] Hands-on corporate experience is in short supply among government employees in most countries, and authorities need to consider how to build the necessary competences to act as an equal partner to their private partners.

1.6. The role of domestic capital markets

The role of domestic capital markets is an important, yet often overlooked, aspect of international investor participation in infrastructure. First, many of the PPIs in recent years have taken place in countries without fully convertible exchange rates or an easy access to repatriation of profits and investments. Attempts to compensate investors for the exchange rate risk through tariffs linked to foreign currency have not been generally successful – and have been at the heart of some of the more problematic breakdowns of PPI contracts in recent years (as also exemplified in Table 3.1). This gives investors a powerful incentive to fund themselves locally, or charge a premium on their services where this is not possible. The implication is that countries with well functioning domestic capital markets find the involvement of international investors in their infrastructure sectors easier and cheaper.

Conversely, private participation in infrastructure can also help develop financial markets. Loans to infrastructure projects can be securitised with the double benefits of lowering the funding cost and adding depth and liquidity to domestic capital markets. Funds for investment in such instruments are available in the insurance and pension sectors of most countries. However, in the past the Treasuries of countries with illiquid capital markets have been unwilling to contemplate the issuance of corporate bonds to finance infrastructure for fears of the effects on the cost of governments' own borrowing.

2. Working together: toward a balanced partnership between public and private actors

Liberalisation and reform of infrastructure in OECD and other countries have revolved around one fundamental precept: the separation of commercial from public interest objectives and their assignment to different institutions. However, this does not imply that the institutions representing the two sets of objects do not need to co-operate and exchange information.

The most "radical" tool for separation, and the one that involves the smallest degree of co-operation between the public and private spheres, is a full privatisation of infrastructure providers with the public sector subsequently limited to a regulatory role. OECD experience indicates that a first-best privatisation strategy might include a thorough commercial reconstruction of enterprises, as well as an introduction of competition in the relevant markets, prior to privatisation.[9] Where competition is not feasible (*e.g.* in the case of

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natural monopolies), independent and well-resourced regulators must be put in place early in the process. Some of the least encouraging experiences have been made where governments privatised unreconstructed entities and offered a period of guaranteed monopoly to boost the privatisation bids.

2.1. Partnership

Where continued public ownership of the infrastructure assets is deemed preferable, involving private investors in public-private partnerships (PPP) is a preferred option. PPP range from delegated management contracts, where private operators make their managerial and operational expertise available to public asset owners, to concessions where the private investor gain control over the assets and undertake agreed investment for a specified period of time.

A vital observation – strengthened by the experiences of recent years – is that successful private involvement in infrastructure is feasible only when both the public and the private participants are willing to enter into a *bona fide* partnership for a considerable period of time. This gives rise to a number of separate issues, some of which are:

- Host country authorities need to make their general policy objectives, as well as the expectations to individual projects, clear. International investors may decide to participate in infrastructure amid a weak enabling environment, but the concept of partnership makes no sense in the absence of a modicum of openness about what is to be achieved.
- The expectations to infrastructure projects should be specified in terms of the services to be provided to the public. Output-based specifications are easier to verify, more relevant to stakeholders and encourage greater efficiency and flexibility than traditional "bricks and mortar" contracts. Also, when the general public rather than the government sector is considered as the client, the private infrastructure providers gain additional leverage through their direct contact with the end-consumers.
- A successful partnership must be based on a full disclosure of all project-relevant information between the partners. Unless sufficient technical, economic and environmental data is made available to would-be private sector infrastructure operators, a project is at risk from the outset. The same applies to information about the checks that the public sector is going to apply to a project and the penalties for underperformance that will be put in place.[10]
- The terms of PPI can be endangered by political change. A degree of political uncertainty is the norm since infrastructure is inevitably a political subject. Private infrastructure providers must live with this and be prepared to work with politicians and within the political realities of host countries. However, this engagement must not rise to the level of an improper involvement in the political process.

- Strong and enforceable contracts are vital to successful projects, but they cannot cover all aspects of PPI. Over-detailed contracts attempting to cover every eventuality of a long-term partnership are incompatible with operational flexibility. They also give the contractual parties incentives to "look for loopholes" rather than make the partnership work. By a similar logic, renegotiation of contracts is a normal consequence of long-term partnerships. However, they should be kept to a minimum.
- The best way of balancing the sanctity of the contract with the necessary flexibility may be to include contractual stipulations specifying under what circumstances revisions to the original agreement shall be considered. Permanent dispute and review panels could also be put in place as part of the contractual relationship.

2.2. Apportioning risk

The apportioning of risk has been crucial to the success, or failure, of many PPI projects. This cuts across many of the issues raised in the previous sections. First, the chosen strategy for involving the private sector in infrastructure already implies a risk allocation. Options range from delegated management contracts (almost all risks carried by the public partner); to concession contracts (risks split according to contractual stipulations); to outright privatisation (almost all risks carried by the private partner). Second, public governance the quality of the enabling environment has important ramifications for what has been termed political risk. Third, the contractual relationship between the PPI partners itself contains stipulations bearing on risk allocation.

A commonly agreed principle applies, namely that the party that has more control over a given risk factor should bear the risk.[11] This implies that the private partners should bear all the risks usually arising from a commercial venture, including design defects, cost overruns, failure to meet performance criteria and changes in demand – except where these occur in direct consequence of action taken by authorities. This does, however, raise the issue of the financial capabilities of infrastructure providers: weakly capitalised operating companies have in the past sometimes been unable to carry risks that were "appropriately allocated" to them.

The public sector is expected to carry risk classified as political and regulatory. Again, this does not imply that political and regulatory change should not take place, but it should take place in an open and transparent fashion including stakeholder involvement. Private operators are normally not expected to bear the burden of political upheaval, regulatory upsets and public discontent, except if triggered by their own actions.

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There is, however, a grey zone between the risks appropriately allocated to either the public or the private sector. In the context of partnerships between investors and governments the allocation and shifting of risk are recurrent subjects of negotiation. For instance, it has been argued that the asymmetry of power between the partners creates an additional regulatory and contractual risk. Delays in regulatory approvals and denial of previously agreed tariff increases may be seen by the public partner as integral to its "right to regulate", but from a commercial viewpoint they constitute an endogenous risk.

From the viewpoint of international investors exchange rate arrangements constitute an additional source of risk. Ordinary exchange rate fluctuations and devaluations of pegged exchange rates constitute a commercial risk that the private partners are expected to bear. However, where foreign exchange is not convertible or contractual relationships are the subject of specific exchange arrangements major shifts in this area may take the nature of political risk. The same observation applies to financial crises in which the private sector's recourse to many of its habitual financial instruments is impaired.

Measures are available to mitigate risk. Major risks and risks outside anybody's control (*e.g.* acts of God, political upheaval) are commonly covered by insurance and most exchange rate risks can be hedged against. In developing countries, aid agencies have sometimes offered specific risk mitigation instruments to induce the private sector to invest.[12]

Somewhat more controversial have been efforts to mitigate or eliminate risk involving the host country authorities. Recent attention has been given to the issue of "standstill" or "stabilisation" clauses written into infrastructure contracts, effectively guaranteeing the private party against political and regulatory change. There are examples where such guarantees are offered by the authorities in the form of insurance in return for a fee or other contractual benefits.[13] In the absence of an insurance element, certain stabilisation clauses which effectively impede the country's right to regulate have been considered excessive.

2.3. The specifics of concessions

Most PPI and almost all public-private partnership involve an element of concession contracts. As concessions imply a degree of monopoly they are rarely the first choice of policy makers who prefer to rely on competition between infrastructure providers to maximise the public outcome. Where competition is feasible in part of a given infrastructure activity, the best policy option is normally to separate these parts from the rest and open them to competition. An example of this is the separation of track ownership from operating companies in the railway sectors of many OECD countries. Also, in some activities (mobile telephony being the most widely quoted example) authorities may keep monopoly rents in check through "monopolistic competition" by granting multiple licences to companies engaged in similar operations.

Where such approaches are not applicable, authorities rely on a triple strategy of: 1) awarding concession (whether through public tendering or negotiations); 2) circumscribing the commercial discretion of the infrastructure providers through detailed service contracts; and 3) empowering regulatory bodies to monitor compliance with the contractual terms and applicable law. Each of these elements raises a number of challenges for authorities, including:

- *Award procedures.* Competitive tendering is commonly considered as the best way to allocate concession contracts – though in certain cases (for instance where large amounts of proprietary information are exchanged in the pre-contract phases) preferred bidders may be desirable. The above discussion indicates that the concrete services to be provided to the end-users should be the object of the contract for which would-be concessionaires are invited to be. A consensus also seems to be developing that the likelihood of a successful tendering process is enhanced when relatively simple award criteria are applied. Multiple criteria make it virtually impossible to discern what bid is "best", and lay the tendering process open to manipulation and illicit practices. An example of problematic award procedures is provided in Box 3.1.
- *Contracts.* One recurrent issue in contract renegotiations and investor/state disputes in the infrastructure sector is claims by investors that host country authorities have reneged on agreed tariff adjustment clauses. Another one is the contestation, by the public authorities, that investors have failed to honour their service obligations (or, in some cases investment obligations, which are even harder to monitor). The need alluded to above, to combine unambiguous contracts with formal mechanisms through which they can be renegotiated, applies particularly to the award of concessions. In extreme cases, opportunistic renegotiation may totally undo the benefits of a competitive awards procedure.
- *Future tariffs.* Most infrastructure concessions world wide (though not necessarily in the OECD area) have applied a capped-price regime with automatic adjustments for inflation, etc., including regulation clauses allowing a review of the tariff structure after a period or time or in the case of extraordinary events. The revision procedure pits the private investors against host countries' regulatory authorities. By a purely economic logic, decisions should be as forward-looking as possible, taking into account expected future investment needs, coverage, operational efficiency, etc. However, this assumes a very high degree of regulatory autonomy that investors may perceive as a source of uncertainty and risk. In practice, tariff revisions are often based on contractual stipulations taking into account

Box 3.1. **Water services in Buenos Aires**

In May 1999 the province of Buenos Aires (Argentina) used competitive bidding to award a concession for the private provision of water services. Of the seven firms that pre-qualified for the operation, four submitted bids. The award criterion was the highest (lump-sum) transfer fee to the government of the province. The concession contract also required the concessionaire to invest USD 500 million in improvements and service extensions in the first five years of the concession. The winning bidder was the foreign owned water company, which offered USD 227 million for the right to provide water services in three zones of the province. The other firms bid USD 15 million, USD 10 million and USD 8 million to provide the same service.

The provincial government awarded the concession to the highest bidder, even though concerns about the viability of the bid were aired at the time. Problems began shortly afterward, when the concessionaire sought to renegotiate the contract. Among other conflicts, the company and the government accused each other of non-compliance with agreed-upon terms. The government did not concede to a renegotiation and, as a result, in 2002 the company abandoned the concession and the government reassumed responsibility for providing water services. The case was left in the hands of the courts, with the company seeking to secure compensation for its cost and investments.

Source: Guasch, J.L. (2004), "Granting and Renegotiating Infrastructure Concessions: Doing It Right", World Bank Institute Development Studies.

the operating figures and capital spending of previous years. The alternative to capped prices – rate-of-return regulation – has the advantage from firms' perspective of allowing a freer setting of tariffs and being perceived as less "risky". However, it involves recurrent assessments of the costs of capital that may give rise to additional regulatory complications.

- *Regulation.* Immediately after the transfer of infrastructure services from the public to the private domain a strong case can be made for relying on formal agreements leaving little scope for both regulatory discretion and investor-induced contract renegotiations. However, as concessions are set in a changing external context, a greater degree of flexibility is called for in the longer run. The challenge for authorities is to safeguard the independence and objectivity of regulatory bodies, generating the necessary confidence by all stakeholders (together with the emergence of a body of case-law) to allow regulators to fill this enhanced role.

3. Infrastructure investment in developing countries

International investor participation in the developing world may raise a number of additional concerns for governments and businesses. The challenges of getting the private sector involved do not differ fundamentally from the points made above, but the economic and political realities add to the difficulty of addressing them. Enabling environments tend to be weaker, technical and administrative competences less developed, and mechanisms for stakeholder involvement sometimes non-existent. End-consumers are generally poorer, which means that the financial viability of PPI in many cases hinges on a subsidisation that host country authorities may not be able to provide. Moreover, the relative bargaining position of host governments *vis-à-vis* multinational enterprises tends to be weaker in developing countries, which might lead to different dynamics of the partnership between private and public operators.

The poorest developing countries also differ qualitatively from others in the sense that meeting their populations' infrastructure needs may be intrinsically linked with issues of subsistence and human rights. There is an emerging consensus that many of the developmental challenges, including infrastructure, are interlocked and need to be addressed concomitantly. Efforts to address the quality of governance, the fight against corruption, legal and contractual frameworks, infrastructure, poverty reduction and sustainable development need to be conducted in unison and with the involvement of host and home country governments as well as private investors.

Bilateral and multilateral development aid agencies have taken steps to encourage private investment in infrastructure, including in the poorest countries. Their disbursement of aid in support of this objective has essentially followed a three-pronged approach:

- *Outright subsidisation of individual projects*. The basic idea is the fill a funding-gap to render a socially desirable infrastructure project financially viable from the private perspective. Where subsidisation can be limited to the preparatory and start-up phases, or is otherwise limited in time, this is uncontroversial. However, most development agencies find it difficult to commit themselves to an "open ended" subsidisation for the duration of an infrastructure project.
- *Technical assistance and capacity building.* Official development assistance is used to fund a host of technical capacity building programmes. Some of these aim at the general enabling environment for investment and will only indirectly affect infrastructure. Others involve educational programmes and direct assistance in the planning, design and project finance phases of infrastructure projects.[14]

- *Risk mitigation*. As mentioned most foreign investors have access to market-based insurance against political and other risks. However, as recent experience show risks go well beyond what is thus covered and a case can be made for development agencies providing extra coverage. More evidence and policy analysis would be needed to establish the boundaries between purely actuarial risk insurance and subsidised schemes with the purpose of boosting cross-border investment.

3.1. Responsible business conduct: the challenges

For the purpose of the present paper responsible business conduct (RBC) is defined as efforts by corporate players to ensure that their actions are consistent with societal expectations in the host country. This includes compliance with laws and regulations as well as observance of host countries' standards communicated by other means than laws and regulation. One complication is that host countries encompass a number of stakeholder groups that rarely have the same expectations. A second complication arises in economies or geographic areas where public governance is so weak that legal and regulatory frameworks themselves fall short of communicating "societal expectations".

The RBC challenge is further complicated by the fact that, as observed earlier, most PPI projects are delivered in a form of partnership involving public and private participation. The end-users of infrastructure services and other stakeholders tend to state their expectations in terms of the outcome of infrastructure projects rather than the behaviour of individual investors. The implication is that RBC may in practice often be engulfed in the greater issue of the project partners' joint responsibility. In more extreme cases RBC could be even construed as a "residual political risk" that is shifted onto the private investors.

That said, prior to the awards of infrastructure contracts a more "traditional" case for RBC can be made. One of the main challenges for responsible business conduct in the early phases is corruption. In weak governance zones and other national contexts where corrupt practices are commonplace, the procedures for awarding infrastructure contracts as well as subsequent regulatory practices have frequently been called into question (a frequently-quoted example is provided in Box 3.2).

While corruption arises for a variety of reasons, infrastructure has a number of peculiarities that make it a frequent target. The monopoly structure of supply can provide significant opportunity for rent-seeking. The political protection and intervention given to infrastructure often blurs financial accountability, and provides cover for a range of corrupt activities, including in allocating scarce services, overstaffing and excessively high

Box 3.2. **The Lesotho Highlands Water Project (LHWP)**

LHWP was embarked upon in 1986 by the governments of Lesotho and South Africa. Five major dams, 200 kilometres of tunnels and a hydroelectricity station are to be completed by 2020. The USD 8 billion project is to control and exploit the flow of the Senqu River, provide water for Gauteng province and generate electricity for Lesotho.

In 1993, an audit of revealed substantial administrative irregularities in Lesotho Highlands Development Authority (LHDA), one of the project's two oversight bodies. This gave rise to an inquiry into the conduct of its chief executive officer, M.E. Sole. By 1996 Mr. Sole had been dismissed from the LHDA.

In 1999 bank records were delivered to the Lesotho government, indicating that Mr. Sole had received large sums of money through middlemen or intermediaries from companies and consortia that had been awarded contracts in the LHWP. The government proceeded to prosecute not only Mr. Sole, but also many of the corporations and intermediaries. In 2001, Mr. Sole was found guilty of 16 counts of bribery and sentenced to 18 years in prison (reduced to 15 years on appeal).

A Canadian engineering company had been involved in two contracts within the LHWP, and was the first company to be tried in connection with the payments to Mr. Sole. Acres agreed that it had made payments to a middleman. However, the company argued that such payments were made pursuant to a "representation agreement" it had made for services rendered by him to the company in his capacity as its representative. In the absence of evidence of any services performed by the middleman, the court found the company guilty of bribery and sentenced it to a fine of USD 2.5 million.

Following this trial, a German engineering company faced similar charges. The facts of the case were different, but the German and Canadian companies had used the same middleman, and in this case too the court found the representation agreement between company and middleman insubstantial.

A South African intermediary charged with bribery has since pleaded guilty. Legal proceedings against other international infrastructure providers are still ongoing.

Source: Transparency International, 2005 Global Corruption Report.

wages. With difficulties in establishing the relationship between level of capital investment and service outputs, infrastructure providers can inflate levels of capital spending or hide underinvestment. The large scale of infrastructure often creates opportunities for large kickbacks associated with procurement.[15]

A second challenge that tends to present itself early in a project is communication. Communication and consultation with affected communities are commonly considered as key elements of responsible business conduct.[16] Corporate approaches to communication and consultation generally work better when applied in concert with – rather than in lieu of – public communication strategies. This applies in particular to infrastructure projects, the construction and operation of which often have significant societal and environmental consequences.

Some of the generally-accepted lessons from past experiences include a need to involve affected communities early in the planning process in order to give them a genuine chance to be heard. Also, providing as much information as possible is essential, including about technological and location options the investor faces. When projects are limited in size and/or confined to specific local areas, one option for policy makers (often termed "community empowerment") is to invite local communities to assume a direct responsibility for the execution of the projects. The involvement of representative civil society organisations has also been attempted.

On the broader issue of whether private-invested infrastructure projects deliver the hoped-for benefits (and, if not, who is to blame), one of the central issues is the access to and affordability of vital services. Widely publicised debates of this issue have arisen from the water and sanitation sector, where cost-recovery prices have been at risk of rendering basic services unaffordable to many households. The subsidisation of basic utility services is ultimately a public responsibility, and companies have in the past treated issues such as the imposition of penalties, denial of service, etc., in case of non-payment as purely contractual issues.

However, an evolving international consensus among civil society organisations – which applies similarly to their views of the public sector in developing countries – focuses on the so-called rights based development. According to this thinking, certain basic tenets of human development are not optional or "to be addressed" but absolute rights of the individual. The access to clean water is commonly perceived as such a right. Unless partners to infrastructure projects take account of this fact they are likely to face further controversy.

International investors in infrastructure often find themselves more strongly criticised in their home countries than in the developing world. To some extent this may reflect different societal expectations in countries at different levels of economic development, but there have also been cases in which civil society organisations in developing countries have actively canvassed the support of foreign partners. Arguably, this development could be a reflection of investors' increasing recourse to international arbitration: civil society organisations, equally distrustful of the legal recourse in their home countries, also increasingly seek international redress for their grievances.

3.2. Societal benefits from international investor's presence

Some of the controversy over the record of private infrastructure investment in developing countries may derive from unclear success and failure criteria. In particular, should success be measured by the quantity, the quality or the affordability of the infrastructure services provided? A plethora of studies have documented that PPI has been successful in delivering infrastructure services to a growing number of households in developing countries.[17] Much of the contestation of societal benefits seem to derive from the fact that most PPIs have been associated with increasing tariffs and improved revenue collection. In other words, insofar as the tariff increases have not been disproportionate or priced households out of their access to vital services, some such criticism may be discarded as the discontent of existing users who saw their "well earned rights" eroded.

Secondly, a point often raised by corporate representatives is the fact that, even if the conduct of private infrastructure providers in developing countries can sometimes be criticised, the relevant point of comparison is the quality of infrastructure that predated private involvement. Since the participation of international investors is often sought only as a last option, PPI has often had as its immediate impact improved services, enhanced governance and less corruption relative to the operations previously run by national or local authorities.

Finally, as infrastructure projects are mostly large and depend strongly on project finance, the attitude of financial institutions have important ramification for responsible investment. One main source of guidance for financial practices has been the Equator Principles, a set of social and environmental guidelines designed to ensure that project funding is used in a sustainable way. The Principles were formulated in June 2003 by leading financial institutions, based on the social and environmental safeguard mechanisms of the International Finance Corporation (IFC). They have since been adopted by more than 40 banks. The IFC has since developed a revised set of Performance Standards encompassing subject areas including labour and working conditions; pollution; health and safety; land acquisition and resettlement; biodiversity and natural resource management; indigenous peoples; and cultural heritage.

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Notes

1. A discussant at the OECD Global Forum on International Investment in Brazil, November 2005.
2. An overview of recent evidence was provided by S. Thomsen, "Encouraging Public Private Partnerships in the Utilities Sector: The Role of Development Assistance", *OECD International Investment Perspectives 2005*.
3. The appropriate fiscal practices have been discussed in recent studies by the International Monetary Fund, including IMF (2005), "Government Guarantees and Fiscal Risk", SM/05/120, and IMF (2005), "Public Investment and Fiscal Policy", SM/04/93.
4. This work was first documented in S.S. Golub (2003), "Measures of Restrictions on inward foreign direct investment for OECD countries", *Economics Department Working Papers*, No. 357, OECD.
5. Nicoletti, G., S.S. Golub, D. Hajkova, D. Mirza and K.Y. Yoo (2003), "Policies and international integration: Influences on trade and foreign direct investment", *Economic Department Working Paper*, No. 359, OECD; and OECD (2005), "The benefits of liberalising product markets and liberalising barriers to international trade and investment: the case of the United States and the European Union", *Economic Department Working Papers*, No. 432.
6. The EBRD Transition Report 2004 treated infrastructure investment as a main topic. It found that many of the problems with PPIs in the transition economies have to do with weaknesses in the general enabling environment rather than faulty design of the individual projects.
7. One example of guidance in this area is the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects.
8. A participant at the Expert Meeting on 3 March 2006 said that surveys of participants in public-private partnerships in the United Kingdom regularly identify a lack of commercial skills in the public sector as a top concern among the private participants.
9. Nestor, S. and L. Mahboobi (2000), *Privatisation of Public Utilities: The OECD Experience*.
10. A participant at the Expert Meeting on 3 March 2006 suggested that an apparently excessive number of renegotiations of infrastructure concessions in Latin America may reflect this point: if bidders know beforehand that they are at a serious informational disadvantage they may perceive a strengthened incentive to low-ball their bids.
11. This is occasionally supplemented by a second criterion, suggesting that the party that is more risk-willing should bear the risk.
12. An overview was provided by J. Winpenny (2005), "Guaranteeing Development? The Impact of Financial Guarantees", study prepared for the OECD Development Centre, mimeo.
13. Chile has pioneered a policy of offering foreign direct investors an "insurance" against corporate tax increases. Investors were offered a constant tax rate for a ten year period in return for paying a premium. Brazil's recent Infrastructure Trust Fund aims to provide infrastructure operators with insurance against risk arising at the sub-national level.

14. One of the most high-profiled activities is the Public-Private Infrastructure Advisory Facility (PPIAF), a multi-donor technical assistance facility hosted by the World Bank.
15. Quoted from *Connecting East Asia: A New Framework for Infrastructure*, Asian Development Bank, Japan Bank for International Co–operation and World Bank, 2005.
16. The *OECD Guidelines for Multinational Enterprises* recommend that enterprises "encourage local capacity building through close co-operation with the local community, including business interests, as well as developing the enterprise's activities in domestic and foreign markets…" (Section II, Point 3). Section III of the Guidelines deal specifically with corporate disclosure.
17. C. Harris (2003), "Private Participation in Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons", *World Bank Working Paper*, No. 5, is one among many examples.

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ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART I

Chapter 4

Outward Direct Investment: What Benefits to the Home Countries?*

This article, taking OECD work from the early 1990s as a starting point, updates new evidence on the effects of outward direct investment on the home economy. Focusing on three possible impacts, namely employment, foreign trade and technology transfers, it finds that outward investment almost invariably has a beneficial macroeconomic effect. Outward investment generally boosts exports as companies trade with their foreign affiliates, and in some cases investment abroad in the context of strategies equally aimed at boosting trade. Employment in the home economy also tends to benefit from outward investment, although this may not always be the case within the investing sector itself. A bit more uncertainty still relates to the technology effects. Some companies invest to acquire know-how abroad, while others do so to undertake knowledge-based activities such as research and development away from their home country. The latter generally benefits the investing enterprise, but the broader societal benefits are elusive.

* This article was prepared by Stephen Thomsen, an external consultant to the Investment Division, OECD. The views expressed are those of the author. They are not necessarily shared by the OECD or by the Organisation's member countries.

Introduction

Outward direct investment was once the preserve of a small number of particularly wealthy or highly developed countries. However, today almost every country is both home and host to multinational enterprises (MNEs). Globally there are an estimated 70 000 MNEs with ten affiliates each on average. Twenty-five economies have an outward stock of foreign direct investment (FDI) exceeding $50 billion – several of these located outside the OECD area and commonly referred to as "developing countries".

Public debate and, to a large extent, academic literature have shifted to reflect these changes. Traditionally most of the discussion of economic consequences of FDI has focused on the consequences of inward FDI for economic development. A vast body of relevant empirical and other evidence was surveyed by OECD (2002). However, as a growing share of the developing world, as well as virtually all OECD countries, have emerged as important outward investors, the question naturally arises what the long-term economic impact in the source – or "home" – country are likely to be.

This should not be taken to indicate that concerns about the potential impact of outward investment are a recent occurrence. Bergsten *et al.* (1978) find echoes as far back as the 1920s. In the Bretton Woods era, studies were commissioned in the United Kingdom (Reddaway 1968) and in the United States (Hufbauer and Adler 1968) to ascertain the effect of outward investment on the balance of payments. Other early studies focussed on employment questions (Hawkins 1973).

OECD countries' stock of outward FDI toward developing and emerging economies (Table 4.1) is still puny compared with intra-OECD investment. Even so, recently global and regional integration have sparked fears of a hollowing out of domestic manufacturing capacity as local firms establish production in low-wage countries. One recurrent concern voiced in public debate is the so-called "giant sucking sound" of jobs leaving the home economy. The recent enlargement of the European Union has also elicited fears in some quarters of delocalisation within the EU toward relatively cheaper locations in Eastern Europe.

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Table 4.1. **Outward FDI positions of selected OECD countries *vis-à-vis* non-OECD countries, 2003**

USD billion

	Argentina	Brazil	China	Hong Kong (China)	India	Russia	Singapore	South Africa	Chinese Taipei
France	2.1	6.2	2.8	1.9	0.8	1.4	4.2	0.7	0.2
Germany	1.0	4.5	8.8	4.0	2.0	2.7	6.3	3.2	0.5
Japan	0.0	4.9	15.3	5.7	1.5	0.0	9.8	1.1	4.3
Netherlands	1.4	6.1	2.2	3.7	0.9	3.9	6.6	0.9	2.7
Switzerland	1.1	3.1	1.9	3.2	0.5	1.3	7.3	0.9	0.6
United Kingdom	2.7	3.8	3.7	12.4	2.7	1.4	17.8	20.1	1.3
United States	10.9	31.7	11.5	37.6	4.8	1.8	50.3	3.8	12.1

Source: OECD International Direct Investment database.

1. The main issues

It is worth reminding that the overseas investment of MNEs is just one manifestation of broader structural changes in the global economy. The world economy might look much the same even if MNEs did not exist, with international trade by national firms causing industries to shift from one country to another in line with comparative advantage. If attention nevertheless tends to focus on overseas activities of MNEs, it is partly because of their weight in the world economy, accounting for a roughly one half of world trade and close to one half of global expenditures on research and development (R&D).[1] But it also reflects the fact that MNEs, owing to the rapidity with which their global networks can respond to changing fundamentals, act as bellwethers for the pressures and opportunities that an increasingly globalised economy will eventually bring to bear on all economic actors.

Discussions of outward FDI have tended to focus on its effect on the balance of payments, employment and technological capacity of the home country. The principal concern has been that foreign affiliate activities will substitute for equivalent jobs, exports or R&D at home. Employment issues have taken on a renewed urgency with the growth of China as a manufacturing and exporting powerhouse and with the expansion of outsourcing to India and elsewhere of many back-office services and technical functions which were previously considered to be immune from foreign competition.

Aggregate employment levels and trade balances both reflect the overall health and structural performance of the home economy. Outward FDI can have implications for the industrial composition of domestic production and trade flows and for the sectoral and regional distribution of employment.[2] Even within sectors, outward direct investment can influence the type of jobs which are retained at home or, in other words, the relative demand for skilled and unskilled labour. These changes can have important implications for income distribution in the source country.

Another issue is the impact of outward FDI on domestic productivity in the home country. Even if it can be shown that the parent firm improves its competitiveness from outward investment, the key policy question is whether these benefits, including possibly flows of know-how from affiliates to the parent, spill over onto the rest of the economy.

The following sections review the findings of recent empirical studies of the consequences of FDI on the home country's foreign trade, employment and technological development. It takes as a starting point a review of economic evidence undertaken in the context of an OECD Roundtable on FDI Trade and Employment in 1994 (Box 4.1), aiming to update previous thinking with some more recent academic and empirical developments. The findings of empirical studies vary greatly in terms of methodology, country selected and time frame, and they provide no unequivocal answers. But for the most part, they suggest that the home country as a whole benefits from outward investment. The last section suggests a few conclusions and policy lessons.

Box 4.1. **Past observations on delocalisation**

This text summarises some of the findings of studies commissioned for the OECD Roundtable on *FDI, Trade and Employment* on 2 March 1994.

Whatever delocalisation that might have occurred is a small part of global direct investment. Madeuf (1994) estimated that less than five per cent of the FDI stock held by French companies represents delocalisation in the strict sense of the word. (However, the study is 12 years old, and the author did caution that it is a process which may be gathering momentum.) Andersson (1994) argued in the case of Sweden that, although expansion by Swedish MNEs abroad has contributed to the growth of manufacturing at home as well, there have been periods when expansion abroad was accompanied by diminishing production at home, not just by the parent company but also by many domestic suppliers who could not follow their customers abroad.

Several studies have referred to job losses in textiles and clothing at home, not all of which can be attributed to technological change. Very little of this restructuring has involved MNEs. Jungnickel (1994) estimated that "the German textiles and clothing industry received almost 90 per cent of their voluminous imports of foreign products (both final and intermediate) from non-affiliated firms in the late 1980s". Concerning US outward investment, McGuire (1994) said that "at best, the open United States policy on inward and outward FDI has enhanced the employment of United States workers, and that, at worst, it has had minimal adverse impact on aggregate United States employment".

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2. Trade and employment

From a purely macroeconomic viewpoint, the overarching issue will usually be whether outward FDI – and the reallocation of certain productive activities that it implies – also leads to a net loss of factor income in the home economy. If so, foreign trade and employment pressures occur in consequence. However, in public debate fluctuations in foreign trade (especially at times of heightened concerns about currency reserves) and employment have often gained attention each in its own right. Empirical studies have addressed sometimes one, sometimes the other, of these consequences of outward FDI. In the present section they will be considered in unison.

A pioneering joint assessment of outward direct investment's effects on employment and trade was attempted by OECD at the event of a *Roundtable on FDI, Trade and Employment* on 2 March 1994. Four case studies (France, Germany, Sweden and the United States) provided static analyses of MNE employment growth at home *versus* in affiliates and considered policy options for home country governments. The general conclusion of the four case studies was that outward FDI has generally had a beneficial or at worst neutral effect on home country exports and domestic employment.

A word of caution is, however, warranted. First, authoritative studies are possible only in countries where comprehensive data for companies' overseas investment, and the main economic activities of their affiliates, are available for a reasonable span of time. In practice this is the case for only a few countries, notably the United States, Japan and Sweden, whose enterprises consequently account for most of the findings. A few "stylised facts" concerning the decades-long experience of MNEs in the United States are summarised in Box 4.2.

These large firms account for one fifth of the total outward stock of FDI and the US government provides almost unparalleled information on their activities abroad and at home. Second, empirical studies are by definition based on past trends. As global liberalisation moves forward and output continues to expand in places like China and India, there is greater scope for MNEs to devolve more and more responsibilities to affiliates abroad. The development of such "truly global" strategies could bend the trends of the past, affecting the relationships between FDI, employment, trade and R&D. However, the extent to which this will happen is at this point in time far from clear.

2.1. Foreign trade

Everybody agrees that the liberalisation of trade flows at a multilateral and regional level, together with the removal of restrictions on inward FDI in many countries, have vastly expanded the possibilities for firms to produce goods and services on a worldwide basis. Less clear are the implications for the trade flows and trade balances of individual countries. A couple of decades

Box 4.2. "Stylised facts" based on the experience with US-based multinational enterprises

a) Outward FDI rarely involves exports from foreign affiliates back to the home country:

- 90 per cent of sales of majority-owned foreign affiliates (MOFAs) are abroad, with only ten per cent back to the United States.
- Of total foreign sales by affiliates, 71 per cent are to the host country of the affiliate.
- Imports to the United States from MOFAs amounted to $211 billion in 2003, while the total deficit in US trade involving affiliates was only $34 billion – a small fraction of the total US trade deficit.
- Most of these imports come from high wage countries, with the exception of Mexico ($41 billion in 2003), but even for Mexican MOFAs, less than one quarter of total sales are to the United States.

b) Employment trends suggest that whatever changes have occurred have been incremental:

- Three quarters of the employment of US MNEs is in the United States, a share which has remained virtually unchanged for 25 years.
- Trends in parent company employment have mirrored those for the US economy as a whole, in the aggregate and across industries.
- US MNEs employ almost three million workers in developing countries or just over one third of total MOFA employment. Much of this is in manufacturing.

c) FDI is a two-way street:

- Most global FDI flows circulate among the same group of countries. Out of the top 25 destinations for FDI, 21 countries are also among the top 25 outward investors.
- While US-owned foreign affiliates employ 8.4 million persons abroad, foreign-owned firms employ 5.4 million in the United States.

ago, public and academic debate was preoccupied with "import substitution" as a likely consequence of inward FDI. According to this argument, a country inviting direct investment was likely to see a drop in imports because investors would shift to producing locally rather than importing from the mother companies. (As a corollary, the home country would normally see its exports drop.) However, this line of thinking, seen by many as having been influenced by the experiences of a few large developing countries with high import tariffs, finds less and less support in empirical studies.

The emerging consensus (as reviewed by OECD, 2002 and 2006) is that trade and direct investment are complementary. Rather than severing ties with their home countries, most direct investors aim to integrate their different production plants into truly global value chains, which tends to add further impetus to foreign trade. Intra-company trade accounts for a large – and by some accounts increasing – share of global trade flows, and by embracing inward and outward FDI a country gains enhanced access to participate in these.

With most of the interest concentrated on the effects of FDI on the host country's foreign trade (in many cases further focusing on developing countries), relatively few empirical studies have dealt specifically with home country experiences. Lipsey and Weiss (1981) examined US exports and overseas production by country and by industry from a data set based on 1970 and found not only that the two are complementary, but also that US-owned affiliate production in a country deterred exports from other countries to that market in that industry. In other words, overseas production would give US firms a competitive edge in those markets which in turn encourages greater US exports at the expense of exports from other countries. In a follow up study (Lipsey and Weiss, 1984) the authors looked at foreign production and US exports at the level of individual firms and by region instead of by country in order to remove any potential bias resulting from greater cultural affinity between the United States and certain national markets such as the United Kingdom. Once again they found a positive relationship: the higher affiliate production in a region, the greater US exports to that region.

Studies such as these have, however, been contested other researchers. Such empirical tests suffer from potential simultaneity, for both trade and investment flows can be broadly predicted by looking at geographical distance, together with the size and wealth of each market. Thus, even if there is no relationship between the two, trade and investment will appear to covariate. Graham (1996) corrected for possible simultaneity by including a gravity model to pick up these variables which influence exports and FDI jointly. He still found a complementary relationship between outward FDI and manufacturing exports for both US and Japanese MNEs.

Again, most OECD countries do not have the same detail on the foreign activities of their firms as the United States and Japan. One exception is Sweden where researchers have also tended to find that outward investment complements, rather than substitutes for, domestic production. Swedenborg (1979) estimated that ten dollars of investment increases exports by the parent company to that market by one dollar.[3] Blomström *et al.* (1988) looked at both US and Swedish direct investment and total home country exports instead of parent exports on the assumption that even if parent exports increased, they could come at the expense of exports from other home country firms. For

Swedish firms, the authors found that a krona of Swedish-owned production in a foreign country draws in more that a krona of Swedish exports.

To minimise the influence of simultaneity, they also looked at the relationship over time and found that the higher the initial level of Swedish-owned production in a host country, the larger the subsequent increase in Swedish exports in that industry to that country. Furthermore, the faster the growth in affiliate production in an industry in a host country, the faster the growth in Swedish exports in that industry to that country. Concerning US affiliates, the authors found that about 80 per cent of an industry's production in a country by MOFAs was either unrelated to or positively related to exports by US firms in the same industry and that complementarity is even stronger if one looks instead at minority-owned affiliates.

Lipsey *et al.* (2000) performed a similar test for outward FDI and exports by Japanese firms. They found that parent exports to a foreign region are positively related to affiliated production in that region. To give an idea of the order of magnitude, they estimate that for individual firms one million Yen more of affiliate production in a region is associated with one million Yen more of exports to that region. They also observed that employment in the parent firm tends to be higher, given its level of production, the more the firm produces abroad. Given the consistently complementary relationship between exports and outward FDI across three countries at different points in time and using various model specifications, the authors concluded that "larger production abroad has not, on average, been associated with lower levels of exports by parent firms or their industries in home countries, or with lower exports relative to home sales" (p. 12).

In conclusion, most studies of overseas production by domestic firms point towards a positive relationship between both parent firm exports and, more importantly, total exports from the home country. Furthermore, increasing overseas production does not appear to diminish exports over time. There is no one explanation for this apparent complementarity, since exports of intermediate inputs and capital goods are likely to explain only part of the story. It is also possible that overseas production increases foreign demand for the products of the MNE and for home country goods and services more generally. More indirectly, by producing overseas MNEs might expand growth in foreign markets, some of which will spill over onto demand for goods from the home country.

2.2. Employment

When examining the effects of outward FDI on employment (and in many cases production) in the home country, it is important to separate sectoral from economy-wide findings. There can be little doubt that a "delocalisation" of

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certain economic activities – *e.g.* in response to differences in unit labour costs or to chase more lucrative markets in other parts of the world – entail a near-term loss of employment at home within the categories of the labour force that are directly affected. However, it is not equally clear that the MNEs that undertake such outward direct investment diminish their staff overall in the home country as part of the process. And, it is even less clear that the home economy as a whole suffers an employment loss, especially when it is a trading partner of the countries that benefit from the re-location of productive activities.

Blomström *et al.* (1997) examined the effect of foreign production on the demand for labour at home, holding parent output constant for both Swedish and American firms. The authors asked whether foreign production in either developed or developing countries lowers the labour intensity of home production or its skill intensity. For US MNEs, the authors found that "each additional million dollars of parent net sales adds about six employees to the parent labour force but, given the parent sales level, each additional million dollars of affiliate net sales is associated with firms having one fewer employee".[4] The effect for FDI in developing countries is much greater, leading to a decline in home employment of 18 workers.

The Swedish results differ from those for US MNEs. Production by Swedish MNEs in both developed and developing countries has a positive effect on home country employment. An increase in foreign production by one million dollars is associated with an increase in domestic employment of one person, for any given level of domestic output, and the effect is even greater for FDI in developing countries. Somewhat surprisingly, Swedish firms' foreign activities are positively and significantly related only to blue collar employment with only a weak impact on white collar employment at home. To explain this paradox, the authors suggested that most Swedish investment is in developed countries and that Swedish firms undertake the most sophisticated work in their affiliates in countries such as the United States and Germany, while retaining basic production at home.

The study is also interesting because it found that any positive effect on domestic employment for Swedish firms is diminishing over time. This trend might help to explain why more recent tests of Swedish outward FDI have found some evidence of negative employment effect, especially in third-country markets (one example Svensson 1996). Earlier tests which tended to find a positive impact were often based on data from the 1970s. It remains to be seen whether the diminishing home country impact of foreign production for Swedish firms is a result of greater substitution of foreign for domestic labour or a weakening influence of foreign activities on domestic output levels.

Brainard and Riker (1997) shed light on why outward FDI might increase home country employment by looking at firm level data on the activities of US MNEs. They find that, though there may be some substitution at the margin between US and developing country employment, much of the production in developing countries tends to complement that at home through a vertical division of labour. Competition for FDI mostly arises between countries with similar skill levels where workers in developing countries compete with each other to perform the most cost-sensitive activities. For example, "when wages in developing countries, such as Mexico, fall 10 per cent, US parent employment falls 0.17 per cent, while affiliates in other developing countries, such as Malaysia, lay off 1.6 per cent of their workforce".[5]

In a companion paper, Riker and Brainard (1997) found that cross-wage elasticities of labour demand are positive and statistically significant among affiliates at similar stages of development. In other words, the more two locations are alike, the more production in one is likely to substitute for production in the other. But as differences between countries become greater, production in one location tends to complement that elsewhere through a vertical division of labour.

The changing production strategies of existing US MNEs are just one of the components of outsourcing which, if interpreted broadly, should include all imports of intermediate goods and services, whether or not they come from affiliates. These two studies nevertheless provide useful insights into the nature of the relationship between affiliate and home production. If there is complementarity in intermediate goods and substitution in final ones, then any test which looks at the overall effect on trade for each industry may well find that the two effects counteract each other. Of course the overall impact is the same, whether the two trade flows are separated or included together, but by separating the two, we can better understand why we find either complementarity or substitution. It also suggests the complexity of designing any policy to discourage outsourcing since increases in affiliate employment are in some cases accompanied by rising employment at home.

As firms from more countries become major outward investors and as data collection improves, studies of other countries can test whether the results for three of the most advanced developed countries can be generalised. Chinese Taipei offers an interesting case study because of the activities of its firms, including smaller ones, in the rest of Asia. Beginning in the mid-1980s at the time of the Plaza accord, the country witnessed rapid currency appreciation on top of rising labour costs. Partly as a result, production shifted rapidly first to Southeast Asia and then to China. With substantially lower labour costs and few geographical or cultural barriers in these markets, firms from Chinese Taipei were able to outsource their production while incurring minimal transactions costs.

Chen and Ku (2002) studied the effects of outward FDI from Chinese Taipei on domestic employment. The authors separated the effect of overseas production on the demand for domestic labour (substitution effect) from the

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influence of such production on the competitiveness of the firm and hence on domestic output (output effect). They found that the net effect is positive in most cases for individual firms. Holding output constant, overseas production reduces domestic employment by between 2 and 8 per cent, but this is more than offset by increases in output by the parent firm. To the extent that job displacement is found for individual firms, it tends to be smaller investors locating in China. Without overseas investment, these firms are precisely the ones whose output is most vulnerable to competition.

The most interesting aspect of this study is the separation of employment effects by labour group. The authors found that domestic technical workers benefit the most from FDI, followed by managerial workers, while blue-collar workers benefit the least, if at all. As with trade more generally, if imports of low-wage-intensive goods from foreign affiliates push down domestic prices of those goods, then, other things equal, this would have a magnified effect on factor prices. The end result is that unskilled workers could find themselves worse off in both relative and absolute terms. To the extent that outward FDI expands the scope for such imports beyond what could have been achieved by arm's length trade alone, then it contributes to the potential decline in earnings for low-skilled workers.

This discussion is part of the broader one on the distributional impact of trade and investment. The overall empirical findings on this issue were summed up by Moran (1998): "Overall, outward investment has three impacts on the home country labour market: first, it improves the job structure via an augmentation in the number of 'good jobs' in the overall labour mix; second, it joins other forces in increasing the wage gap between higher and lower skilled labour by driving up demand for the former to fill these good jobs; third, it possibly contributes to some worsening in the standard of living of those lower skilled individuals who are not equipped to take advantage of the new opportunities. In terms of magnitude, the impact of outward investment is almost certainly smaller than the impact of trade (which itself does not seem to be large), and much, much smaller than the impact of technological change."

3. Technology and productivity

For a home country the main hoped-for benefit from integrating into the global economy is a higher overall productivity. Productivity growth is the main source of higher personal incomes, more efficient use of resources and, ultimately, sustainable development. From the viewpoint of individual investors, productivity is also a main concern – though sometimes mixed with other objectives such as market access and the quest for incipient monopolies in certain activities or economies.

In today's increasingly knowledge-based economy, productivity – and competitive advantages more generally – are often linked with the possession of technologies and know-how. In consequence, a rising concern for policy makers, and a topic of intense academic interest, has been the effects on the home country's technological position from outward direct investment. In a nutshell, the political question has been "are our enterprises giving away our competitive advantages by investing and transferring technology to our competitors?". Conversely, most empirical studies have focused on outward investment as a way of acquiring competences and often find evidence of such gains.

A full review of international R&D trends and the transmission of technology through MNEs would, however, go beyond the scope of this article. Policy concerns with outward FDI involving R&D do not focus on technology sourcing *per se* but rather with the possible substitution of foreign for domestic R&D by home country firms. To the extent that overseas R&D serves merely as a listening post to tap into technologies developed elsewhere, it is not likely to cause concern. If it means that home firms prefer to undertake key R&D in more suitable locations abroad, it is a different matter.

3.1. Home country productivity

3.1.1. The enterprise level

Much empirical literature on the productivity and competitiveness implications of outward investment has focused on the implications for individual enterprises, or groups of enterprises. Encouragingly in terms of the generality of the findings, several recent pieces of work stem from countries not usually in the thick of MNE-related research.

Barba Navaretti and Castellani (2002, 2004) examined whether investing abroad affects the domestic performance of parent firms domiciled in Italy, basing their approach on the numerous studies which have looked at the effect of exporting on firm competitiveness. Rather than just comparing a sample of national and multinational firms from Italy, they looked at Italian firms which have become multinational and estimate whether their domestic performance relative to national firms has improved as a result. The authors found that home performance of Italian firms that invest abroad for the first time during the period analysed improves after the investment and that these firms outperform strictly national firms. Investing abroad leads to an 8.8 per cent higher growth rate in output and a 4.9 per cent higher growth rate in total factor productivity. In terms of subsequent employment trends, the investing firm is never worse off and under some tests even better off than under the counterfactual of purely national firms.

Most studies of home country effects of FDI look only at the impact on the parent firm itself. Vahter and Masso (2005) examined technology transfers from affiliates to the parent and then subsequent spillovers from the parent to other firms in the home country. Their test included both manufacturing and service firms. They found that outward investment from Estonia enhances the productivity of parent firms, much as inward investment is positively related to the productivity of the affiliate. This is in keeping with earlier studies and with the plausible assumption that firms invest abroad partly to improve their own competitiveness at home. The results concerning spillovers onto the rest of the Estonian economy depend both of the specification of the model and the sector in question. "The effects of FDI are certainly quite diverse for different host and home countries, different sectors and in different time periods, and are most likely to depend on the type of FDI."[6]

Studies of the impact of outward investment on parent firms' competitiveness and on the total factor productivity of the source country do not necessarily explain the nature of the reverse technology flow from affiliates to the parent, but, by establishing that it exists, they go a long way to explaining why exports and domestic employment increase as a result of outward direct investment. The remaining studies described below all look more specifically at R&D activities. While this is likely to capture only part of the potential competitiveness spillovers from outward FDI, it nevertheless has the advantages of being measurable. Patent citations leave a paper trail allowing us to follow the international transmission of technology from one firm to another.

3.1.2. Macro-productivity and outward FDI

It is notoriously difficult to establish causal links between macro-productivity and investment flows. For instance, if a given sector has a high productivity and a high stock of direct investment, should one conclude that productive industries are active investors, or that active investment spurs productivity?

Bitzer and Görg (2005) found that a country's stock of outward FDI by industry is negatively related to productivity in that industry, based on a sample of 17 OECD countries, involving ten manufacturing sectors between 1973 and 2000. The authors suggested that the negative relationship may reflect the decision by MNEs to locate the most productive parts of the production process abroad, thus reducing the overall productivity in that industry at home through a compositional effect, at least in the short run. They nevertheless found a positive relationship between FDI inflows and domestic productivity.

This test builds on an earlier one by van Pottelsberghe and Lichtenberg (2001) which found the opposite results: a positive influence of R&D spillovers through outward FDI on domestic productivity but not for inward investment.

In the absence of a multitude of tests of this sort, it is not clear why Bitzer and Görg made contrasting findings. In a follow up, Bitzer and Kerekes (2005) used the same data but with a slightly modified approach and found roughly the same result: while inward investment creates positive knowledge spillovers, outward investment does not. Indeed, the authors suggest that outward FDI might have negative effects on the output of the home country.

Perhaps the most interesting aspect of the Bitzer and Görg study is the finding that the results concerning outward FDI depend very much on the source country. While the overall relationship is negative, some countries show a positive and statistically significant relationship, notably France, Poland, Sweden, the United Kingdom and the United States. Furthermore, small countries experience smaller negative effects from outward FDI on domestic productivity than large ones. Explaining this apparent heterogeneity could provide key lessons for policymakers wishing to maximise inward technology flows.

3.2. Technology

With the growing prominence of technology in theories of economic growth and international trade, the international transmission of technology has taken on a renewed importance. The channels through which one country benefits from technological advances elsewhere are numerous, and discussion usually focuses on the potential roles of imports, inward direct investment and labour mobility. But it is increasingly recognised that both exports and outward direct investment can also provide feedback to the domestic company which can help to improve its productivity. In the former case, such competitiveness gains have been called "learning by exporting", where firms learn to "improve the quality of their products and production processes through contact with more advanced foreign competitors in global export markets".[7]

In the context of outward investment, it has long been recognised that firms might invest abroad not only to capitalise on their technological competences but also to acquire additional competences. Dunning (1993) calls such investment "asset seeking". Anecdotal evidence and surveys of investors provide ample evidence that firms are sometimes motivated by such considerations. The potential benefits which might accrue to a parent company from its affiliates abroad are diverse. As with exports, they might relate to product quality or production processes. Consumers abroad might be more demanding, managerial techniques or other business practices more sophisticated, or the regulatory environment more favourable. Through their foreign investments, for example, European state-owned infrastructure companies have sometimes been able to build experience in operating in a competitive environment as a prelude to privatisation at home.

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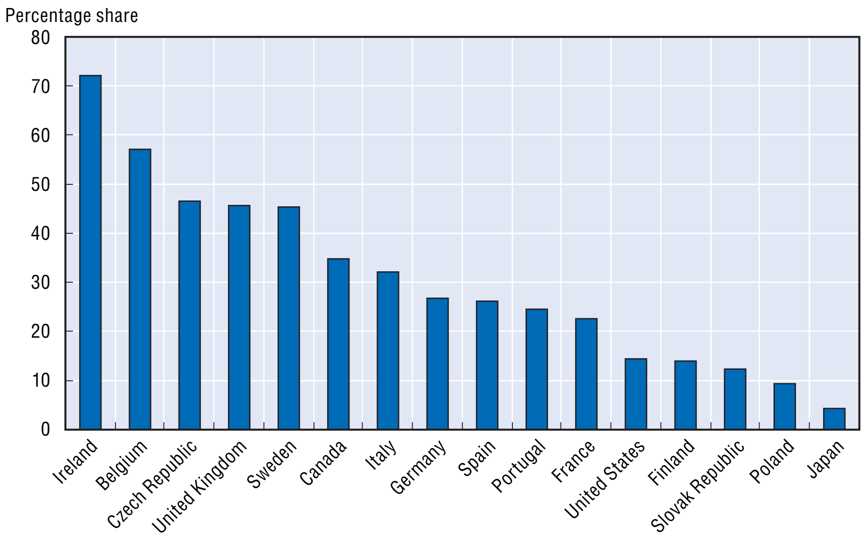
The benefits of "learning by investing" are not easily quantifiable, even when the discussion is limited to technology. "Knowledge… is seldom quantified or priced; it is sometimes codified, but more frequently tacit and in any case difficult or impossible to observe. All measures of knowledge are indirect, either inputs to (years of schooling, manuals) or outputs of (human capital, patents, the unexplained residual in growth accounting) its accumulation."[8] The studies described below all focus on research and development (R&D), relying most often on the abundant information which exists on patent citations. Also, some recent OECD data on the importance of R&D in the affiliates of foreign companies is displayed in Figure 4.1.

Figure 4.1. **R&D in foreign-owned enterprises, 2003**
(as share of total industrial R&D)



Source: OECD Foreign Affiliates Statistics.

3.2.1. Overseas R&D and technology sourcing

Firms perform R&D overseas for any of the following reasons: 1) *technology sourcing* – to acquire foreign technology, stay abreast of technological developments or gain access to foreign R&D resources, such as universities, public and private laboratory facilities, and scientists and engineers; 2) *product adaptation* – to customise products for local markets or to assist the parent company in meeting foreign regulations and product standards; and 3) *outsourcing* – to gain cost efficiencies.[9]

Sourcing technology abroad through foreign affiliates in key technology countries is a common competitive strategy for firms from countries which tend to be technological followers. Caves (1982) cited studies which found that "Japanese companies expanded their foreign investments in research-intensive countries such as the United States and West Germany in order to improve their access to technology flows after companies in those nations, conscious of the burgeoning Japanese competition, grew more reluctant to licence". This point is echoed more recently by Branstetter (2000) who argues based on a survey of Japanese investors that their investment in the United States is at least partly an attempt to access American technological strengths.

Even developing countries have encouraged and sometimes sponsored FDI by local firms in order to expand technological capacity. UNCTAD (2005b) cites the South African Finance Minister as saying, "The global expansion of South African firms holds significant benefits for our economy – expanded market access, increased exports and improved competitiveness". OECD (1999) provides the example of attempts by Malaysia to secure technology abroad: "The aim of acquiring foreign technology through outward investment is not only a corporate strategy, it is also an explicit policy of the Government… The purchase by… Malaysia's 'national' car producer of a majority stake in Lotus, the UK sports car and engineering group, in 1996 clearly fits in this recent tradition… [L]otus is to help with the design, engineering and technology for new models."

According to UNCTAD (2005a), firms from Korea and Chinese Taipei have a long tradition of establishing research centres in the United States, Europe and Asia in order to gain access to new technologies. They are now being followed by firms from China and India. The *Financial Times* reported recently that a major Chinese company, together with the Communist Party, was bidding to buy a car engine plant in Brazil. The plant had been built as a joint venture between Daimler/Chrysler and BMW and is considered to be one of the most sophisticated of its kind in the world. The investors are reputedly aiming to transport the entire plant back to China.[10]

In terms of the potential for R&D outsourcing in developing countries, there is substantial anecdotal evidence that interest in investing in a relatively group of developing countries is growing, although this is not conclusive proof that lower costs are the primary motivation. Recent trends in international R&D, together with anecdotal evidence, suggest that both China and India are likely to attract sizeable R&D investments in the near future.

In the United States, the National Academies which is an advisory group on science and technology surveyed 200 MNEs on their research centre decisions. According to the results, 38 per cent of the firms interviewed said they planned to change substantially the worldwide distribution of R&D over the next three years, with countries like India and China attracting the greatest interest.[11] According to MNE responses, their motivation was not so much lower wages as it was to access a large pool of available technicians. A similar survey of European firms found that "all service functions – including R&D – are now candidates for offshoring".[12]

Cost savings for certain types of R&D are likely to be substantial in China or India. "A three-month, pre-clinical toxicology study on one compound might cost $850 000 in the United States but only $100 000 in India."[13] But equally important is the related fact that both countries have an abundant pool of potential R&D workers. Skill shortages and high wage costs go hand in hand in home countries. According to UNCTAD (2005a), "it has been reported that the European Union lacks 700 000 scientists and engineers needed to meet its target of devoting on average three per cent of GDP to R&D".

While examples of this kind are legion, the extent to which outward FDI is motivated by technology sourcing should not be exaggerated. Box 4.1 presents some stylised facts concerning overseas R&D by US MNEs which put the possible importance of technology sourcing in perspective. Also, rapid expansion of R&D in China and India does not necessarily imply a decrease at home, and it should be kept in mind that this expansion is starting from a very low base. In the case of India, for example, outsourcing of software design to Indian engineers has captured the imagination of some in the United States. To the extent it is occurring, it is a miniscule part of total R&D performed by US MNEs at home. R&D by US-owned firms in India amounts to only $81 million or 0.04 per cent of the level of business R&D conducted in the United States.

3.2.2. Technology spillovers

As the idea of technological sourcing has gained currency, empirical studies have proliferated based on many different approaches but nevertheless almost all pointing in the direction that the overseas activities of MNEs, particularly research and development, provide spillovers to the parent company, although not necessarily to the home country.

Branstetter (2000) looked at international spillovers at the firm level in the context of Japanese direct investment in the United States. Based on a review of patent citations, he found evidence that "FDI increases the flow of knowledge spillovers *both from and to* the investing Japanese firms". In interviews with Japanese investors as part of the study, he found that the desire to access American technological know-how is often an explicit part of the decision to invest. "By purchasing a firm in the United States, Japanese firms potentially acquire not only the proprietary knowledge assets of the acquired firm by also entrée into the informal technological networks and knowledge sharing relationships possessed by the research personnel of the acquired firm."

Even for greenfield investments, a local presence allows the investor to track technological developments in universities and among the local competition. This is especially true for investments which involve setting up a US research facility. Based on regression elasticities, Branstetter estimated that "setting up an additional R&D lab in the United States leads to a 2.3 per cent increase in spillovers from US inventors"[14] but creates very few spillovers in the other direction. Most of the spillovers to American firms from Japanese FDI come from the broader measure of FDI which includes all types. The spillovers to the Japanese parent arise both from R&D facilities and from the broad measure of FDI.

Box 4.3. **The worldwide R&D operations of US MNEs**

Evidence from the United States suggests that R&D activities are still closely tied to the home country. US MNEs still perform most of their R&D at home, and when they do go abroad, they focus on very few possible locations. Almost half of their spending is in only three countries: the United Kingdom, Germany and Canada. The same is true for R&D in the United States by foreign-owned firms: the top three countries (Germany, the United Kingdom and Switzerland) account for one half of total R&D performed by affiliates.

A study prepared for the US Office of Technology Assessment (OTA 1994) examined the record of R&D both by US firms abroad and by foreign firms in the United States. The Report found that overseas R&D lagged far behind other indicators of globalisation. In spite of "higher rates of external patenting, more rapid diffusion of technology across borders, increasing rates of overseas R&D activity, and the growing prevalence of international technical alliances", MNEs still developed core technologies at home in the early 1990s.

The same is true in aggregate terms today. US parents undertake over six times as much R&D as their foreign affiliates, and royalty and licence fees paid to parents from affiliates are 12 times higher than those from parents to affiliates. Furthermore, the R&D intensity of affiliates – measured by R&D performed by affiliates as a percentage of their total sales – actually fell from 0.9 per cent in 1989 to 0.8 per cent in 2003. In comparison, parent R&D as a percentage of sales amounted to two per cent in 2003.

Since the United States is reputed for its innovative activities, it might be reasonable to expect that there is more R&D taken in the United States by foreign firms than by US firms abroad, and this is indeed what we find. While US direct investment abroad is one third higher than that in the United States, foreign firms nevertheless conduct 23 per cent more R&D in the United States than do US MNEs abroad.

Alazzawi (2004) also used patent citations to estimate two-way knowledge flows between foreign investors and domestic firms from 30 countries. She found a strong positive effect of FDI on knowledge flows: "1) domestic firms are 57 per cent more likely to receive knowledge from foreign firms when the latter are located in the same country; 2) foreign firms are 78 per cent more likely to receive knowledge from domestic firms when they are located in the same country; 3) an extra $1 million in FDI leads to an average 4 per cent increase in knowledge flows between the investing firm and host nations."[15] For those outward investments which are motivated in large part by technology sourcing strategies, it is logical to assume that investors will choose to locate where innovation is greatest. The tests support this hypothesis: Investing in one of the three leading world innovators (the United States, Japan or Germany) seems to be the single most important source of knowledge flows. These findings from so many countries, comprising 1.8 million patents, provide a generalised confirmation of the results of Branstetter (2000).

Driffield and Love (2003) examined spillovers involving foreign investment in the United Kingdom and found that technology generated by British-owned firms spills over to foreign investors located in the country. Griffith *et al.* (2005) found evidence of reverse technology flows between research facilities of UK-owned firms in the United States and the home UK parents. Driffield and Love (2005) examined one aspect of technology sourcing, namely the spillovers which occur between foreign firms in a particular host country. They found that foreign investors in the United Kingdom appropriate spillovers not only from locally-owned firms but also from other foreign investors in the country, especially in relatively R&D-intensive industries.

Branconier *et al.* (2000) looked at the influence of inward and outward FDI on R&D spillovers in Sweden. They found no evidence of positive FDI-related spillovers. The only variable that consistently affects total factor productivity is the R&D undertaken by the parent itself. These studies do not distinguish between the different types of R&D undertaken by MNEs abroad. A review by UNCTAD (2005a) suggests that "the scope for positive effects on the productivity of firms in the home country is large when foreign affiliates undertake 'innovative' R&D that tap into advanced knowledge centres abroad". The review argues that the lack of evidence of spillovers in the Swedish case may be a result of the high share of Swedish R&D abroad which is adaptive. While adaptive R&D may provide few technological spillovers at home, it can nevertheless be an important tool for increasing market share abroad.

Jaumotte and Pain (2005b) find that when foreign-owned firms in the United States expand their US-based R&D, this has a significant negative effect on the rate of growth of business sector R&D in the home country. In other words, foreign firms appear to be switching R&D activities away from their home country and towards the United States which boasts a fertile regulatory climate and a large pool of technical workers in which to foster innovation. This possibility was hinted at in the test of Swedish outward investment by Blomström *et al.* (1997).

4. Concluding remarks and policy considerations

Most of the more recent empirical studies have confirmed OECD's findings in the early 1990s that fears of the harmful effects of outward investment are mostly unfounded. Outward FDI tends to increase output, employment and exports in the parent firm in the home country, in part because of the positive impact on the parent's competitiveness. These competitive gains stem not only from experience gained by competing in all major world markets but also because, under certain conditions, affiliates also serve as a conduit for reverse technology flows back to the parent.

An international division of labour, whether by national firms operating at arm's length or through the agency of the MNE, is one of the traditional benefits associated with international trade. Any policy which sought to limit the ability of a domestic firm to establish operations abroad would have a negative macroeconomic impact equivalent to the effect of erecting trade barriers. The empirical studies of trade, employment and technology effects from outward investment suggest strongly that the parent firm benefits in terms of competitiveness from these activities. The academic literature is divided over the degree to which these benefits accrue to a broader segment of the home economy through spillovers and other externalities. However, if parent companies benefit by investing abroad, then the corollary must also be true that their competitiveness would suffer from any attempt to discourage those foreign activities.

One area where the record for home countries is particularly hard to ascertain based on academic literature is the societal benefits of R&D conducted abroad. On the one hand, there are still compelling reasons to conduct research at home and that is what many MNEs do. Research and development represent a fundamental source of competitiveness for the multinational enterprise, which provides a good reason for the MNE to keep its core technological development close to home. To the extent there has been any outsourcing of R&D activities, it has up to recently been into the United States and a few other highly developed economy. On the other hand, the picture may be about to change. As developing and emerging economies develop large pools of human capital, close to some of the world's most rapidly evolving markets, MNEs' incentive to outsource R&D and other knowledge-intensive activities is growing.

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The main conclusion for policy makers would seem to be that no economy is a passive beneficiary or a hapless loser in the process of globalisation through outward direct investment: policies matter. The macroeconomic benefits of outward investment are well established, so the first conclusion must be that keeping an open and non-discriminatory investment environment is the overall interest of the home economy.

Secondly, many of the benefits to the home economy occur through productivity gains in selected sectors, which mostly have a positive or neutral effect on labour demand as a whole, but may create frictions in some parts of the labour markets. The implication of this is that policy makers need to couple their policies of openness to investment with efforts to enhance labour market adaptability, as well as more targeted measures to help affected groups obtain gainful employment in other segments of the domestic economy.

Thirdly, the real issue is not de-localisation, but the declining competitiveness of the home country in certain activities, of which off-shoring is the most visible manifestation. One of the principal examples is the globalisation of knowledge intensive activities and outward investment in pursuit of them. Insofar as pressures arise, these should not be seen as a consequence of outward FDI, but rather of inadequate investment in human capital and technological development in the home economy. Policy makers have it in their power to redress such lacunae through general and targeted measures to build national competences.

Notes

1. UNCTAD (2005a), p. xxvi.
2. An idea of why the composition of production matters for a country can be seen in Moran (1998). He quotes a study which finds that jobs in export industries pay 13-15 per cent more than non-exporting firms (in the United States, for example), provide 11 per cent higher benefits, experience 20 per cent faster employment growth and are 9 per cent less likely to go out of business.
3. Lipsey *et al.* (2000) argue that the ratio would have been closer to one to 0.3 if Swedenborg had used value added or gross product instead of net sales.
4. Blomström *et al.* (1997), p. 7.
5. Brainard and Riker (1997), p. i.
6. Vahter and Massa (2005), p. 40.
7. Branstetter (2000), p. 2.
8. Barba Navaretti and Tarr (2000), p. 1.
9. OTA (1994), p. 76.
10. Keith Bradsher, “China seeking auto industry, piece by piece”, *Financial Times*, 17 February 2006.

11. Steve Lohr, "Outsourcing is climbing the skills ladder", *The New York Times*, 16 February 2006.
12. Survey by UNCTAD and Roland Berger, cited in UNCTAD (2005a), p. xxiv.
13. UNCTAD (2005a), p. 194.
14. Branstetter (2000), p. 17.
15. Al Azzawi (2004), p. 1.

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 INTERNATIONAL INVESTMENT PERSPECTIVES: 2006 EDITION – ISBN 92-64-02689-4 – © OECD 2006

ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART I

Chapter 5

Building Investment Policy Capacity: The OECD Peer Review Process*

The awareness of the economic benefits of private investment, be it of foreign or domestic origin, has rarely been as strong and widely shared across countries as is the case these days. Investment-enhancing policies have consequently moved to the forefront of governments' agendas. Building the necessary capacity to deliver policy reform is, however, often a complex and enduring task. Modern learning theory and more than forty years of experience with the implementation of OECD's investment instruments show that "peer reviews", OECD's most distinctive working method, is a helpful tool for building such policy capacity. The "Policy Framework for Investment" endorsed by the 2006 OECD Ministerial is expected to further enhance the contribution of OECD and other investment policy reviews in improving investment climates. This article highlights the origins, purposes, content and lessons learned from OECD Investment Policy Reviews.

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Executive summary

This article highlights the main features of the OECD investment policy peer reviews (IPRs), and more particularly, what makes them unique as a government-to-government process devoted to building investment policy capacity. It summarises the key lessons learned from forty years of experience with such peer reviews in the context of the implementation under the OECD investment liberalisation instruments and co-operation with non-members. The *Policy Framework for Investment* endorsed by the 2006 OECD Ministerial is expected to further enhance the contribution of OECD and other IPRs in creating better investment climates worldwide.

The awareness of the economic benefits of private investment, be it of foreign or domestic origin, has rarely been as strong and widely shared across countries as is the case these days. Investment-enhancing policies have consequently moved to the forefront of governments' agendas. Building the necessary capacity to deliver policy reform is, however, often a complex and enduring task. The task is made even more complex by the fact that most socio-economic contexts involve a large number of policy communities, institutions and influences involved (formal and informal, government and business, domestic and international), from the diversity of human interactions and economic transactions that take place and from exogenous factors such as technological or structural change, not to mention geography, climate and resource endowments.

The most direct consequence of this is that there are no one-fit-all solutions – the same policy action in two different environments can have two different impacts. Policy-makers need to find their own solutions; but they need not be alone in this undertaking. They may learn from each other by exchanging information and experiences, giving each other advice or assistance and over time develop a "pool of good policy practice" on which they can draw to develop their own policies. International organisations can also help by creating "international communities of investment policy practices" on which policy practitioners can draw to pursue their own reform efforts.

Peer dialogue and review lie at the very heart of the OECD. It is the Organisation's most distinctive for comparing policy experiences, seeking answers to common problems, identifying good practice and co-ordinate domestic and international policies of its members, in a nutshell, fulfilling its mandate.

Peer reviews have also been the single most important tool for promoting the liberalisation of international investment under the framework of the OECD Declaration on International Investment and Multinational Enterprises and the OECD Codes of Liberalisation. They have been a privileged channel of communication and policy dialogue with non-OECD member countries, notably with major world investment players such as China and Russia and the nine countries which have adhered to the Declaration. Forty years of experience have shown that they have been instrumental in helping governments design and implement better and more open investment policies. The lessons learned can be summarised as follows:

- Governments need each other to find their own path in promoting a better investment climate. They need to share experiences and understand good practices. They need friendly advice and an "outsider" critical eye of their "peers" to evaluate or measure progress.
- "Peers" should involve government officials with a substantive role in the investment policy decision-making and implementation process.
- Peer review works best when recognised benchmarks for evaluation and recommendation, such as the ones derived from the OECD investment instruments and related jurisprudence, are available and used.
- Effective investment policy peer review requires a significant engagement on the part of the country reviewed and other actors in the process. OECD experience shows that this entails a thorough inter-agency preparation by the reviewed government and readiness to follow through the review's recommendations and peer monitoring. While it has costs, it also benefits coherent, whole of government approaches to investment.
- The participation of countries from different regional perspectives and levels of development is an advantage.
- Investment policy reviews should be conceived as a living tool allowing for flexibility in taking up new issues. They can be an input into the collective development of new best practices.
- Publication of the results is desirable. It contributes to transparency and provides support for domestic reform efforts.

In the future, OECD and non-OECD peer reviewers will also be able to draw on the Policy Framework for Investment developed in 2006 by government representatives from some 60 OECD and non-member economies to assist countries better frame and assess the policy challenges they face in improving their investment environments and evaluate their progress.

1. Building capacity and the role of "Communities of Policy Practices"

The challenge of building capacity within national authorities to enhance the enabling environment for investment has received considerable attention lately. Among other contexts, it is one of the main underlying themes of the Doha Development Agenda, the Johannesburg Declaration on Sustainable development and the UN Monterrey Consensus. The question is how to achieve it in practice and, in particular, how to achieve it in a multinational setting.

Recent research on the behaviour of policy actors suggests that the "communities of policy practice model" is particularly well suited for building capacity for enabling regulatory environments. The model assigns a critical role to the improvement of human capital in devising better policies. Policy practitioners need to learn from their colleagues at home and abroad to build a sufficient knowledge of policy options applicable to their own environment. This model is preferable essentially due to the complexity of the task of integrating the necessary skills, institutions and societal aspirations that influence investment decisions into policy-making.

1.1. Adult learning theory

Sociologists that have studied adult learning in complex, group situations have shown that learning is not based mainly on transmission of abstract knowledge "from the head of someone who knows to the head of someone who does not".[1] Unlike school-based learning for children, adult learning about complex phenomena cannot rely solely on didactic, authoritarian approaches.[2]

Adult learning is necessarily a collective effort and involves collaboration. It is a process in which the learner comes to understand and share the view of past experiences accumulated by the group – as reflected in the stories of these experiences that the group has developed. In this context, "understanding" means, in particular, that the learner shares the views contained in the descriptions and, perhaps more importantly, can use them in dealing with problems encountered in its own environment. Learning is thus a process in which the learner becomes a member of a group that shares the same "stories" and acquires the ability to use these stories as a guide for action. Such groups have been referred to as "communities of practice".[3]

Research has also confirmed the importance of establishing a learning community or "communities of practice" in effecting systemic organisational change and transformation.[4] Communities of practice or learning communities may arise on their own or they may be deliberately established by bringing together individuals and groups with diverse knowledge and experience. Their knowledge and experience enables or facilitates better gathering of information, building and sharing of knowledge and best practices, and engaging in complex problem solving. Some additional findings are summarised below:

- ***The nature of the learning process.*** While adult learning involves individuals that may be less sensitive to differences in style and setting than younger persons, a few key findings about the nature of the learning process nevertheless offer themselves:
  - *Adversarial and coercive relationships may undermine learning.* Adversarial and coercive relationships have been found to often undermine effective learning by taking away the responsibility, opportunity and motivation to learn.[5] By contrast, opportunities for learning are usually enhanced when risks can be taken without fear of punishment, there is a climate of trust, and open and honest communication is honoured.[6] Similar arguments have been advanced for explaining why peer learning can help in promoting compliance with international agreements (see Box 5.1).
  - *Evaluation stimulates learning.* Evaluation promotes learning in a number of ways. First, it assists those whose performance is being evaluated to identify their strengths and weaknesses, understand more clearly their

Box 5.1. **Peer learning and compliance with international agreements***

The role of co-operative or consensus-based approaches in promoting learning has been reinforced by research on ways to improve countries' compliance with international agreements. This research emphasises that there are many different reasons why government actors fail to meet prescribed standards and suggests that co-operation can play an important role in enhancing countries' compliance. At least six different reasons have been articulated for countries' non-compliance with prescribed standards. First, governments and/or units of governments may perceive that the benefits of non-compliance exceed the costs of non-compliance and deliberately chose not to comply. Second, non-compliance may result from a lack of resources. Third, non-compliance may follow from administrative or technological incapacity to implement the standard or policy as planned. Fourth, the standard may not be clear and may be susceptible to more than one meaning. Fifth, the actions taken to meet the standard may be on the "right track" but not yet have achieved their goal. Sixth, non-compliance may result from inadvertence. Often, more than one reason will be responsible for any particular act of non-compliance. Co-operative, learning based approaches are likely to be most useful in tackling the second to sixth reasons for non-compliance.

* See in particular, A. Chayes and A.H. Chayes, *The New Sovereignty. Compliance with International Regulatory Agreements*, Harvard University Press (1995).

roles and duties, as well as ways in which they could perform better. Second, it enables the evaluator to have a clearer idea of the challenges faced by those being evaluated and what they need to be able to perform better. The utility and success of evaluation in promoting learning is generally enhanced when those whose performance is being evaluated are active participants in the process and are encouraged to engage in self-assessment.[7] The kinds of activities that are believed to best promote learning include asking questions, identifying and challenging values, beliefs and assumptions; reflection; dialogue; collecting, analysing and interpreting data; developing plans of action based on what has been learned; and implementation.[8] Among other things, these activities assist in making more clear the motivations and rationales for action, creating the possibility of acting in other ways.[9]

- ***The types of information conveyed.*** Not all kinds of information are equally well conveyed in a model such as the "communities of policy practice". For example:
  - *Abstract knowledge has limitations.* There is also the need to integrate abstract policy advice with knowledge of local conditions. The literature on learning underscores the limitations of abstract knowledge when trying to make even moderately complex decisions or to solve even relatively simple, open ended problems.[10] While such knowledge is certainly useful, it is rarely sufficient. Credit must be given to the knowledge and experiences of those who make and implement policy in the domestic environment.
  - *Narrative descriptions are useful.* Learning theory has underscored in this context the usefulness of narrative descriptions. The value of narratives is in that they help organise and deal with information.[11] Adults have been found to learn better when their past experiences and personal knowledge is respected and used as a resource for learning, and when they have an opportunity to talk about and share their experiences.[12] Story construction and telling is also valuable because it provides a richer description of problems faced and of how and why various actions were taken. The resulting stories serve as repositories of accumulated information and understanding, which are useful when encountering similar challenges in the future. When one has a clearer understanding of how and why previous decisions were made, what has worked and what has not, and the nature of problems or obstacles faced, it is easier to make new decisions of better quality. For similar reasons, narratives enable the making of more accurate assessments of performance.
- ***Continued learning.*** Building capacity requires that there be sustained opportunities for learning. Ideally, the learning should continue after the policy intervention is finished. The delivery of best practice policy

recommendations, without more, provides little in the way of learning opportunities. Nor does it promote ownership of the recommendations. To reinforce what is being learned, to best determine its utility, and be able to resolve uncertainties about how the policy advice should be implemented in practice, there should be opportunities to put into practice what has been learned while the learning is occurring. One of the benefits of establishing a community of practice is that it provides a context for sustained interactions between the members of the community, including after the immediate objectives for the establishment of the community have been achieved.

1.2. Peer review as a form of adult learning

Peer review mechanisms, as applied by OECD and other international organisations, share several of the features and functions of the "communities of practice" policy capacity mode. They may, in particular, fulfil the roles of:

- *Assembler of policy practitioners*. Peer reviews may bring together policy practitioners that broadly share the same values and objectives and have the authority and/or the expertise to address and correct the problems they are confronted with. The greater is their involvement, the greater is the likelihood that improvements in policy making will eventually materialise.
- *Peer learning and dialogue*. Peer reviews provide a neutral and friendly forum for exchanging information, attitudes and views on policy decisions and their application and for understanding their rationale and motivations. Participants also learn from each other about best policies and practices and how they might be applied in their own policy context. This is also referred by regulatory economists as competitive benchmarking; the idea being that by judging their own performance relative to other colleagues, policy makers may be able to progress in pursuing their own reforms.
- *Policy advice and policy convergence*. The mutual trust and collegial approach that characterises peer reviews are favourable to an *objective and neutral evaluation* of the performance of a given country by its peers and its general acceptability by the recipient country. This process may lead the peers to offer policy advice and make constructive proposals on the relevant policy dilemmas facing the reviewee. It may also force them to evaluate their own policies. The reviewee, on the other hand, may use the group to test the effectiveness or acceptability of a particular idea, opinion, or point of view. Over time, peer review may encourage policy co-operation and convergence.
- *Information gathering and dissemination*. Peer reviews often entail the collection of information about the policies of the participants and other useful factual information on their particular situation. If this information is made public, it also benefits private actors and the general public. Peer reviews can play an important role in enhancing transparency.

- *Compliance monitoring*. Peer reviews can also be used to enhance progressive compliance with internationally agreed policies, standards, and principles. The soft law nature of peer review may prove better suited to encouraging incremental improvements in policy making than a traditional enforcement mechanism by focusing on achievable goals which take into account a country's policy objectives and its performance in a historical and political context.
- *Technical expertise and assistance*. Peer review may supply expertise in policy-making that is scarce in certain countries. For example, training of government officials can occur informally through the interaction of secretariat staff and government officials during the peer review process.[13]
- *Delivering the message*. This is an extension of the policy advice role. By providing countries with policy recommendations on certain topics, peer reviews may disseminate the prevailing consensus and best practice to governments and policymakers worldwide, and provide international support for reviewed governments' reform efforts.

2. OECD Investment Policy Reviews: a tool to help attract and maximise the benefits of investment

2.1. The context of OECD's Investment Policy Reviews

2.1.1. A catalyst to liberalisation

The origins of OECD Investment Peer Reviews (IPR) go back to the creation of the Organisation itself. In 1961, the OECD Codes of Liberalisation[14] mandated OECD to promote the progressive liberalisation of capital movements and services across national frontiers through a consultation process giving precedence to understanding and persuasion over negotiation. This was done by inviting member countries to notify restrictions standing in the way to free circulation of capital, right to establishment and cross-border financial and other services and to submit themselves to periodic examinations designed to make suitable proposals for the progressive elimination of their restrictions.[15] Peer reviews became the main mechanism for *monitoring* and *compliance* of members obligations under the Codes. They were used as a leverage for *locking in* past liberalisation gains and as well as a vehicle for identifying and encouraging progressive elimination of non-conforming measures under the Codes.[16]

The adoption of the OECD Declaration on International Investment and Multinational Enterprises in 1976 launched an unprecedented effort devoted to the improvement of the investment climate, the encouragement of the positive contribution multinational enterprises can make to economic and social progress and the minimisation and resolution of difficulties which may arise from conflicting requirements imposed on foreign investment and incentives and disincentives. The Declaration asked two major commitments from OECD countries, namely to accord *national treatment*[17] to foreign-controlled enterprises operating on their territories and to recommend to multinational enterprises operating in for from their territories the observance of the *guidelines* for responsible business conduct annexed to the Declaration. Peer reviews were again chosen as the main tool for promoting the objectives of the Declaration. Indeed, member governments were invited to notify their exceptions to national treatment and submit themselves to periodic reviews of their exceptions.

Following the adoption of new procedures for strengthening the implementation of the National Treatment instrument of Declaration in early 1990s, a new format was introduced for conducting more comprehensive and integrated foreign direct investment policy assessments of OECD countries, and for elaborating more robust policy recommendations to OECD authorities. This format was also used for the examination of the six countries which became members of the Organisation during the 1994-2000 period.

In 2000, two new decisions were taken to enhance the application and influence of the Declaration. The OECD Guidelines were extensively revised to reinforce the economic, social and environmental elements of the sustainable development agenda and new procedures were introduced to ensure their effectiveness. In the same year, the OECD Ministerial Communiqué invited the Organisation to encourage non-members to adhere to the Declaration on International Investment and Multinational Enterprises. Investment policy reviews were again chosen as the basis for determining whether the non-member applicant was "able" and "willing" to live up to the Declaration's undertakings. All 30 OECD countries (and nine non-member countries – see below) to the Declaration have benefited from the review of their investment policies by their peers.[18] These reviews represent an impressive pool of knowledge and experiences on these countries' policies and are at the root of important liberalisation steps.

This does not give full justice, however, of all the work accomplished over the years. In addition to "country" reviews, peer reviews have also been conducted horizontally. These "horizontal" reviews have prepared the ground for major updates and extensions of the Code's obligations, such as that carried out on financial services at the end of the 1980s. Horizontal peer reviews have also been conducted as means of discussing in depth what might be considered "pockets of resistance" to liberalisation, such as those conducted more recently on foreign acquisition and real estate, and foreign direct investment (FDI) in professional services and telecommunications services. They have been an indispensable transparency tool[19] and have led to robust policy recommendations endorsed at the highest level of the Organisation.

2.1.2. A privileged avenue of co-operation with non-member partners

OECD IPRs were originally conducted only among its member countries. However, the political developments of the 1990s, including in Central and Eastern Europe, created an unprecedented demand on the Organisation to share its knowledge and expertise with the rest of the world. In the investment field, the Organisation developed at first technical assistance programmes in the form of investment guides for transition economies, conferences, seminars and internships. It is not until towards the latter part of the decade that investment policy reviews were conducted on non-member countries, namely in connection with Argentina's, Brazil's and Chile's applications for observer status in the OECD Committee on Investment and Multinational Enterprises.

Since the 2000 Ministerial Decision to open up adherence to the Declaration to any non-member willing and able to meet its obligations – peer reviews have become one of the most important outreach activities of the Investment Committee. In addition to the reviews of the six new adherents to the Declaration (Slovenia, Estonia, Latvia, Lithuania, Israel and Romania) flagship peer reviews have been completed with China (2003 and 2006) and Russia (2004 and 2006). The pro-active strategy adopted by the Investment Committee in March 2005 on the participation of non-members in Committee work states its intention to make peer review "an important vehicle for policy dialogue" with non-member countries. In particular, IPRs are expected to play an important role in expanding OECD investment policy co-operation programmes with leading developing countries, Africa (NEPAD), the Middle East and North Africa (MENA), and other regions, as well as in regard to the implementation of the Organisation's recently developed "Policy Framework for Investment".[20]

2.2. Contents of an Investment Policy Review

The content of OECD investment policy reviews has significantly evolved over time, gaining much breadth and depth in the process. One of the most significant changes has been the shift of emphasis from blatant discriminatory measures to the consideration of broader and "behind the border" regulatory impediments to inward direct investment. In this connection, the reviews have increasingly highlighted the fact that regulatory transparency, adequate property rights protection, non-discrimination and other general principles of investment policy are of broader benefit to the business community – both domestic and foreign. Another change has been toward a more in-depth analysis of the beneficial effects of foreign investment to the local economy. The Organisation has, in addition, paid increased attention to the way in which reviewed economies translate internal liberalisation into international commitments, either at the bilateral, regional or multilateral levels.

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These changes have aimed to reflect the important policy changes which have taken place in the field. In the last twenty years, formal discriminatory measures have receded across countries, uncovering the importance of regulatory barriers affecting investment generally. The international investment policy community has also gained a better understanding of the interfaces between investment policy and other policy areas and the implications that malfunctioning in these areas may have on the investment climate. The spectacular growth of international investment globally and a better realisation of its positive contribution to sustainable economic development have created a strong demand for identifying remaining obstacles to foreign investment.

In addition, greater attention has been given to making the peer reviews more user friendly to government officials, the business community and other interested parties. This has been achieved by presenting the information in more concise and laymen language. Another important decision has been to publicise the results of the reviews to promote investment policy transparency and enhance the hands of investment policy reformers.

Today's IPRs are divided into three parts. The first part examines the economic dimension of FDI in the reviewed country; the second reviews the regulatory environment, including the degree of openness and receptiveness to FDI; and the third sets out a number of policy recommendations.

2.2.1. Impact of FDI on the reviewed economy

This first part of the review consists of a general assessment of the country's performance in attracting FDI, direct investment's contribution to the economy and the channels through which this contribution is realised. It aims more precisely to situate the country in the globalisation map, identify its most pressing needs and evaluate future trends. The analysis make use of various indicators such as the importance of FDI inward and outward flows and stocks, country and sectoral composition, percentage to GDP, current account and domestic capital formation. Available data on foreign enterprises assets and employees, their contribution to trade and technology are also exploited. Statistical tables and charts and bibliographical references are also provided.

While the Secretariat relies on its own independent research and data base to prepare the background material for this part of the review, it also often seeks concrete input from government economists and renowned research institutes in the reviewed country. This not only presents the advantage of the work done by local specialists to the attention of investment policy makers in OECD countries, but more importantly, their contribution helps to understand better the economic rationale underpinning the reviewed country's policies towards foreign investment.

2.2.2. Informing about and understanding regulations

The second part involves a thorough review of the country's regulatory framework for FDI and domestic business operations. The approach followed is an integrated and comprehensive analysis of the investment interface of a broad range of public policy areas. Its main objective is to identify the main impediments to inward direct investment.

The basic laws and regulations governing business activity are addressed first. These include in particular those dealing (at all level of government) with company law, authorisation and registration or other administrative requirements, exchange controls, acquisition of real estate, employment, competition policy, intellectual property and corruption. While the analysis may reveal the existence of discrimination, it more often brings to light non-discriminatory impediments to investment in the form of over regulation, implementation or red tape.

This is followed by an analysis of restrictions in key economic sectors such as finance, energy, transport, or telecommunication. These are also the areas where discriminatory measures limiting foreign participation are usually found, although their scope is now much more reduced that in the past. "Market access" barriers in the form of public or private monopolies or concessions have also been traditionally lodged in individual sectors but their importance has also declined in recent years with deregulation and privatisation.

The last part of the regulatory review is devoted to more in-depth analysis of selected issues of particular importance to foreign investors. Privatisation has been a recurrent theme of peer reviews in transition or developing economies. Increased competition for mobile investments has generated great a interest for a cost/benefit analysis of fiscal and non-fiscal incentives. Corporate governance and market integrity issues, such as corruption and administration of justice have also come in the limelight in many countries.

Finally, as a result of the rising number of bilateral investment treaties, regional agreements and double taxation agreements, most recent reviews have paid increased attention to obligations contracted at the bilateral or multilateral levels. This analysis is particularly useful in assessing the extent to which domestic reforms have been locked in the form of international commitments.

2.2.3. Evaluation

The third part contains an evaluation of the general performance of the reviewed country and a number of policy recommendations addressed to the national authorities concerned.

For countries wishing to subscribe to the OECD Declaration on International Investment and Multinational Enterprises, the Committee must determine whether the applicant's proposed exceptions to National treatment

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"are not incompatible with the overall level of liberalisation expected from adherents to the National Treatment Instrument". It must also be satisfied that the applicant will undertake the necessary steps to promote effectively the OECD Guidelines for Multinational Enterprises, notably the establishment of a National Contact Point. In addition to the fulfilment of these "legal requirements", the reviews under the Declaration lead to the formulation of specific recommendations to the country's national authorities on how to further promote a favourable business climate. These recommendations are approved by the OECD Council, the highest organ of the Organisation. They form part of the Council decision's to acquiesce the applicant country request to adhere to the Declaration and are expected to be implemented the national authorities concerned. The results of the peer review are finally published by the OECD.

For investment policy reviews conducted outside the framework of the Declaration, as those recently conducted by the Investment Committee on China and Russia as part of its expanding co-operation with influential non-OECD investment players, the diagnosis of the Investment Committee is accompanied by constructive suggestions for enhancing the country's regulatory and institutional capacity to attract foreign investment. These are adopted by the Investment Committee. The results of the review are published by the OECD.

Finally, it is not unusual for recommendations to be accompanied by an invitation to report progress on their implementation. This has been the case with the investment policy reviews of Israel and Romania. The 2004 Investment Policy Review of the Russian Federation also evaluated the progress made by this country in responding to the recommendations formulated in 2001 on the investment environment and identified further offers options for improving it further during the next cycle of co-operation which is currently underway.

2.3. Practical modalities: investigation and review

Together with the expanded coverage the investment policy reviews and their enhanced concern for investment policy capacity building, the procedures for conducting an investment policy review have also significantly improved. Today's conduct of a peer review involves three distinct phases, namely: *a)* the preparatory or investigation stage; *b)* the examination stage; and *c)* the dissemination and follow-up stage. It also involves three main protagonists – the reviewed, the OECD peers and the Secretariat. Each of them is called upon to make a "substantive investment" into the conduct of the review, be it in terms of time, human resources or money.

The holding of a peer review can be either "demand driven", or "instrument-driven" or "Committee driven". In the first instance, the reviewee makes the request to the Organisation. For instance, a non-member application for adherence to the Declaration must clearly spell out the applicant government's willingness to subject itself to a full review of its investment policies by the Investment Committee. Accession requests to the Organisation also require the conduct of an investment policy review of the prospective member. IPRs are also an important element of Investment Committee's co-operation programmes with Africa (NEPAD), the Middle East and North Africa (MENA) and other regions.

In the second instance, the Committee may indeed be required by the OECD instruments to conduct peer reviews on a country-by-country basis or across countries on a particular issue. In the third instance, the Committee takes advantage of peer reviews to engage in a more in-depth policy dialogue with major non-member investment players.

A peer review is formally launched when the Organisation and the reviewed country agree on the practical modalities for conducting the review. This includes the timing of the peer review – which needs to be integrated in the Committee's work programme – and the sharing of the inputs and cost of the examination between the reviewee and the Organisation.

2.3.1. The preparatory/investigation stage

The objective of this initial stage is the preparation of a background analytical note by the Secretariat for the peer review to be conducted under the aegis of the Investment Committee. The background note is prepared by the Secretariat in close co-operation with the reviewed country authorities.

As a first step, the reviewee's authorities are requested to submit a memorandum providing basic information on their country's regulatory investment regime and other information normally covered by the review (as described in the previous section). In the case of an application for adherence to the Declaration, the applicant is also requested to provide a tentative list of its proposed exceptions to National Treatment instrument and to indicate the government's intentions as regard to the establishment of a National Contact point for the implementation of the Guidelines for Multinational Enterprises.

The memorandum paves the way to a two-to-three day mission by two to three staff members of the Investment Committee to the reviewed country. It involves meetings and interviews with key governmental agencies responsible for various aspects of economic and investment policy as well as other interested parties including business, civil society and academics. The visit is usually organised by the Ministry of Foreign Affairs or the Ministry of the Economy which act as the focal point for the review.

Government officials normally consulted include officials from the Central Bank and Ministry of the Economy for the assessment of general foreign investment trends and their impact on the national economy, central government agencies for the assessment of the investment climate and strategic governmental priorities or ongoing reforms, regulatory agencies and

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line departments regarding the administration of specific regulatory requirements, restrictions, or investment incentives and investment promotion agencies. In recent years, the consultations have extended to privatisation agencies, competition policy councils, and independent regulatory agencies as well judiciary institutions (regarding issues such as corruption and money laundering). The Ministry of Foreign Affairs or the Ministry of the Economy is the interlocutor on international obligations.

Greater attention has also been paid in recent years to the views of non-governmental stakeholders. Separate meetings are organised with representatives of the domestic and foreign investment communities, independent research institutes or academics as well as accredited civil society representatives (such as local chapters of Transparency International). Foreign embassies and local representatives of international development banks occasionally consulted as well. These consultations have proven to be particularly helpful in identifying sensitive issues that might eventually surface during the examination itself. All precautions are taken to protect confidential information.

In addition, the Secretariat seizes the opportunity of the visit to "coach the 'reviewee'" to better prepare for the review. The visit provides the occasion to explain how the examination will be conducted and what would be expected from the reviewed delegation.

2.3.2. The peer review

The Secretariat circulates on its own responsibility its background investigation note to the Investment Committee delegates no later than two weeks before the date of the examination. In the case of an application to adhere to the Declaration, the Secretariat also prepares a draft report to Council for the consideration by the Committee.

Once the date of the policy review is confirmed and the background note is circulated, the Investment Committee *takes over complete ownership and control* of the process. Lead reviewers, normally in the number of three, are chosen by the chair on the basis of their particular knowledge of the policy issues to be addressed during the review and due consideration for regional balance. The review takes place in the OECD as part of the Investment Committee meeting (usually half a day) in the presence of the applicant's delegation.

At the opening of the meeting, the head of the reviewed delegation (usually a deputy minister or an assistant deputy minister ranking official) is invited to make a short policy statement. The chair then explains how the examination will be conducted and invites the first examiner to start the review. An allocated time is given to each lead examiners and follow-up question periods corresponding to different parts of the investigation report.

The Committee proceeds afterwards with the examination of the draft report to Council containing recommendations or options for further action. After the necessary modifications, the report is transmitted to the Council for a final decision if the review is part of an accession or adherence process. The reviewed party is invited to react to the draft conclusions. Delegations may also formulate separately policy recommendations to the reviewed authorities.

This Committee's input is unquestionably IPRs most valuable contribution to investment policy capacity building. The 39 countries which participate in the review have different economic backgrounds. They bring to bear on the discussion different points of views which reflect their own experiences. The collegial approach constitute a guarantee to the reviewed authorities that they would not be asked to implement policy actions that the peers would not, individually, or collectively be prepared to undertake. They also take full account of the reviewed country policy objectives and constraints. It is not unusual for the reviewed country to report back progress in implementing the Committee's recommendations. IPRs create a partnership of trust which endures a long time after completion of a review.

2.3.3. Publication

Final IPR reports are approved by the Investment Committee and published. This is usually followed by a press release, summarising the main findings of a review for the media. While the publication of the IPR reports puts the reviewed country "on the spot", it also underscores international support for reform efforts, The reviews are also a valuable source of information for, and a basis, of discussion among investors and other civil society stake-holders. Often reviewed countries have translated the reports into domestic language, organised seminars and given a circulation to the public.

3. Concluding remarks

The strengths of the OECD Investment Policy Reviews include, first, the fact that they are run by a group of what has been termed "investment peers". OECD IPRs are conducted by the investment policy-makers themselves. These are the middle to high-ranking officials who are responsible on a day-to-day basis for the elaboration and administration of government's policy toward foreign investment and who usually monitor regulatory matters affecting the investment environment. They negotiate investment treaties, represent their country at international meetings and may even be held accountable for the activities of domestic enterprises abroad. They are "the" government experts on the complex investment policy questions arising in today's globalised world.

Secondly, the "peers" involved in IPRs speak on behalf of the world's largest investment players. The 30 OECD countries and 9 non-OECD adherents to the Declaration which participate in an IPR account for the bulk of world international investment flows. The views of OECD reviewers are thus truly representative of the views of the countries which play a determinant role in the field of international investment. They bring into the process a wealth of experiences and practices matched so far by no other inter-governmental investment peer learning forum. Some additional features adding credibility to the IPRs are the following:

- *Guidance by recognised policy benchmarks*. OECD IPRs constitute the main implementation tool of the most developed set of multilateral investment rules in existence today – namely the OECD Codes of Liberalisation and the OECD Declaration of International Investment and Multinational Enterprises. The commonly shared valued embodied in these instruments not only provide a unique sense of purpose to the reviews but also objective benchmarks for assessing the individual policies and practices of its signatories and monitoring their progress.
- *Comprehensiveness*. OECD IPRs cover all investment regulatory barriers. They seek to understand their motivations, to assess their economic effects and to identify ways to dismantle them taking into account the particular circumstances of the reviewed country, without compromising the achievement of legitimate public goals. Their recommendations benefit both foreign and domestic investment.
- *Fairness and objectivity*. Participants have different economic backgrounds and experiences. The collegial approach of the process constitutes a guarantee that the reviewed authorities would not be asked to undertake policy actions that the peers would not, individually or collectively, be prepared to undertake. OECD IPRs create a partnership of trust which endures a long time after a completion of a peer review.
- *Openness to new "peers"*. OECD IPRs are no longer reserved to OECD member countries. Non-members countries may participate in this process by adhering to the OECD Declaration on International Investment and Multinational Enterprises. Furthermore, IPRs are a central component of the Committee's proactive strategy towards the participation of non-members in its work. IPRs are expected to play a key role in putting into action the Policy Framework for Investment.
- *Follow-up by the reviewed authorities*. OECD recommendations are addressed to high level government officials in the reviewed country. They culminate a process designed to build consensus among domestic constituencies in the reviewed country and achieve a "whole government" approach to

investment. These recommendations are normally implemented. Progress reports and subsequent peer reviews allow for monitoring of results and mid-course adjustments where needed.

- *Publication of main findings*. OECD IPRs are published by the Organisation. Publication reinforces the hands of policy reformers and provides a basis for discussion among investors and other civil society stake-holders. They provide a valuable and objective source of information on the reviewed country.

OECD investment policy reviews have shown a great capacity to adapt to the needs of the "peers" and "open up" to new ones in recognition of the growing complexities of the global economy and the development aspirations of the developing world. They have become the Investment Committee's most prominent outreach tools. In the future, IPRs are expected to play an important role in the promotion and implementation, with due regard to national circumstances and needs, of the *Policy Framework for Investment* which has recently elaborated by the Investment Committee in partnership with non-OECD countries and the support of the World Bank and other organisations.[21]

Notes

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2. T. Morrison, Actionable Learning. A Handbook for Capacity Building Through Case Based Learning, Asian Development Bank Institute (2002).
3. Lave, Jean and Etienne Wenger (1999), Situated Learning: Legitimate Peripheral Participation. Cambridge University Press, Cambridge.
4. See, for example, T.A. Kochan and M. Useem, "Achieving Systemic Organizational Change", in T.A. Kochan and M. Useem (eds.) (1992), Transforming Organizations, Oxford University Press.
5. See also T. Morrison, Actionable Learning. A Handbook for Capacity Building Through Case Based Learning, Asian Development Bank Institute (2002), pp. 24-25, 40, 52.
6. H. Preskill and R.T. Torres, "The role of evaluative enquiry in Creating Learning Organizations", in M. Easterby-Smith, L. Araujo and J. Burgoyne, Organizational learning and the learning organisation, Sage Publications (1999), p. 94.
7. H. Preskill and R.T. Torres, "The Role of Evaluative Enquiry in Creating Learning Organizations", in M. Easterby-Smith, J. Burgoyne and L. Araujo (eds.), Organizational Learning and the Learning Organization, Sage Publications (1999).
8. *Ibid.* at 92, 94.
9. *Idem.*

10. See, for example, T. Morrison, Actionable Learning. A Handbook for Capacity Building Through Case Based Learning, Asian Development Bank Institute (2002), p. iv, highlighting that learning should not be inert, but should be "tied to building the capacity to act for improvement".
11. T. Morrison, *Actionable Learning. A Handbook for Capacity Building Through Case Based Learning*, Asian Development Bank Institute (2002), citing to J. Bruner and H. Amsterdam, *Minding the Law*, Cambridge: Harvard University Press (2000).
12. T. Morrison, *Actionable Learning. A Handbook for Capacity Building Through Case Based Learning*, Asian Development Bank Institute (2002), p. 25.
13. Chayes, A. and A. Chayes (1995), The New Sovereignty: Compliance with International Regulatory Agreements, Harvard University Press, Cambridge, MA, p. 198.
14. See OECD Codes of Liberalisation of Capital Movements and of Current Invisible Operations, User's Guide, OECD, 2003.
15. Article 12 of the Code of Liberalisation of Capital Movements and Code of Invisible Operations.
16. See Forty Years' Experience with the OECD Code of Liberalisation of Capital Movements, OECD, 2002.
17. The National Treatment instrument defines national treatment as the commitment by a country to treat enterprises operating on its territory, but controlled by the nationals of another country, no less favourably than domestic enterprises in like situations.
18. Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania, Slovenia and Romania.
19. A major update of the lists of exceptions notified under the NTI has been completed in December 2004 is part of a broader effort by the Investment Committee to promote transparency in international investment policy. See *www.oecd.org/dataoecd/32/21/1954854.pdf*.
20. The OECD Council adopted on 11 May 2006, the Policy Framework for Investment with the aim of assisting governments to mobilise private investment to support broadly based economic growth and sustainable development, *www.oecd.org/daf/investment/development*.
21. The core objective of the *Policy Framework for Investment* is to encourage policy-makers to ask appropriate questions about their economy, their institutions and their policy settings in order to identify their priorities, to develop an effective set of policies and to evaluate progress. See OECD work on investment for development *www.oecd.org/daf/investment/development*.

PART II

Special Focus on International Investment Agreements*

The proliferation of bilateral agreements to promote and protect investment is widely recognised to be one of the most important international policy developments in years. While South/South agreements are on the rise, OECD countries are still partners to close to 80 per cent of the BITs that are in force. To secure a degree of consistency in their commitments the governments of many OECD countries have formulated Bilateral Investment Treaty "models", which have been used as a template, or a starting point, for formulating new agreements. The models have been subject to occasional reviews and improvements, including in recent years.

A key feature of most investment treaties is investor-state dispute settlement providing rights to foreign investors to seek redress for damages arising out of alleged breaches by host governments of investment-related obligations. The multiplication of investment agreements with investor-state dispute settlement provisions has raised the risk of multiple and conflicting awards. Investors are sometimes able to claim breaches of different BITs and to seek relief through different arbitration proceedings in respect of a single investment and regarding the same facts. In this evolving landscape of investment arbitration, consolidation of claims has been attempted as a way around potential problems.

This Special Focus includes the following reports:

* The articles in the special focus benefited from discussions, comments and a variety of perspectives in the OECD Investment Committee. The documents as factual surveys do not necessarily reflect the views of the OECD or those of its member governments. They cannot be construed as prejudging ongoing or future negotiations or disputes pertaining to international investment agreements.

ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART II

Chapter 6

Novel Features in Recent OECD Bilateral Investment Treaties*

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Introduction

For over forty years bilateral investment treaties (BITs) have been used as a tool for protecting international investment and ensuring a more predictable and fair treatment of investors. By last count, an estimated 1,700 BITs have come into force worldwide, about 80% of which involving OECD countries.[1]

To secure a degree of consistency in their commitments the governments of many OECD countries have formulated Bilateral Investment Treaty "models", which have been used as a template, or a starting point, for formulating new agreements. The models have been subject to occasional reviews and improvements. The last few years saw a fresh outbreak of interest among OECD country governments in updating their BIT models. The purpose of the present article is to illustrate recent trends in the BITs and BIT models of OECD members.

Half of the models have been revised in the last four years. Canada's Foreign Investment Protection and Promotion Model Agreement (FIPA) and United States Model BIT have undergone a major face-lift 2004. The Czech Republic, France, Germany and Spain have also released new Models in the first half of 2005.

Increased exposure[2] and broader experience with their implementation, together with the rise of investment disputes may explain the increased attention being paid to such model agreements. For instance, the Canadian government has stated that its new FIPA Model "reflects the lessons learned from its experience with the implementation and operation of the investment chapter of NAFTA".[3] The US Administration has also indicated that "the new model BIT" contains provisions… to address the investment negotiating objectives of the Bipartisan Trade Promotion Authority Act of 2002.[4]

There may be other reasons for the changes as well. Countries part of the last wave of EU enlargement had to eliminate incompatibilities between their BITs and the EU treaty prior to their accession to the Union. Some EU members (Austria, Denmark, Finland and Sweden) have also recently been invited to take appropriate steps to eliminate existing incompatibilities between the EU Treaty and the BITs they signed prior to joining the European Union.[5]

BIT models, however, serve only as a template for discussions between partner countries. Their provisions remain subject to negotiation and further refinement by negotiating parties to a given agreement. Thus, although BITs models are helpful in ensuring consistency between agreements entered by individual countries, it remains necessary to look at individual clauses to assess the impact of an agreement.

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The remainder of the article carries out a more detailed analysis of OECD BITs following the most commonly used categorisation of the substantive and procedural provisions found in these agreements. The main findings are summarised in the last section. An overview of the main substantive and procedural provisions of recent BITs and BIT models is moreover provided in Tables 6.1-6.3.

1. Objectives, purposes and scope

1.1. Preamble

Investment treaties' preambles normally serve the purpose of outlining the objectives pursued by the substantive and procedural provisions of the agreements. This is an important function since they provide a "context" for interpreting individual treaty clauses, notably by arbitration tribunals to investment disputes.[6] Preambles may also signal core or novel features in the agreements.

Beyond the general goal of strengthening economic co-operation, BITs traditionally stress the importance of creating favourable conditions for investments and/or investors of both parties and underline the benefits that may flow from the reciprocal promotion and protection of such investments and/or investors. Interesting additions or clarifications may nevertheless be observed in the preambles of recent agreements.

1.2. Scope and coverage[7]

Absent an explicit "scope and coverage" article, the scope and coverage of BITs are determined by their objects and the measures which apply to those objects. The new BIT generation appears to follow a *broad approach*. For example, all recent OECD BITs seem to have chosen a *broad asset-based definition of "investment"* (as opposed to an enterprise-based definition) covering investments directly or indirectly controlled by investors of either Party. Furthermore, the list of covered assets is an open one except for the new Canadian Model FIPA which, in this respect, continues to use the NAFTA approach which is a broad yet closed asset definition.[8]

Likewise, recent BITs also seem to have opted for a *broad definition of "investor"*, encompassing both nationals and companies of the parties and, as in the case of the United States, branches. "Applicable measures" usually refers to laws, regulations, procedures, requirements or practices. The agreements generally apply to investments made before or after the coming into force of the agreements.[9] The contracting parties' responsibilities can also extend to acts and/or omissions of sub-sovereign entities or sub-federal entities or sovereign rights under international law (such as maritime areas) of each Contracting Party, hereafter defined as the exclusive economic zone and

Table 6.1. **BIT models in OECD countries and non-member adherents to the Declaration**[1]

	Previous model	Last model
OECD countries		
Australia	Draft model 1980	Draft model 1995
Austria	Draft model 1997	In process of updating
Belgium-Luxembourg	Draft model 2002	In process of updating
Canada	No	Model 2004
Czech Republic	Draft model 1999	Draft model 2005
Denmark	Draft model 2000	In process of updating
Finland	Draft model 2001	Draft model 2004
France	Draft model updated in 1998 and 2000	Draft model 2005
Germany	Model 1991	Model 2005
Greece	Draft model 1999	Draft model 2001
Hungary		In process of updating
Iceland	No	No
Ireland	No	No
Italy		Draft model 2003
Japan	No	No
Korea	No	No
Mexico	No	No
Netherlands	Draft model 1990	Draft model 1997
New Zealand	No	No
Norway		
Poland		
Portugal	Draft model 1992	Draft model 2002
Slovak Republic		Draft model 2004
Spain		Draft model 2005
Sweden		Draft model 2002
Switzerland	Draft model 1986/1995	In process of updating
Turkey	Draft model 2000	Draft model 2005
United Kingdom	Draft model 1991	Draft model 2005
United States	Model 1994	Model 2004
Other adherents to the Declaration		
Argentina		
Brazil	No	No
Chile		Draft model 1994
Estonia		Draft model 2000
Israel	Draft model 2003	Current model (2003) under revision
Latvia		Draft model 2005
Lithuania		
Romania		
Slovenia		Draft model 2003

1. "Declaration" refers to the OECD Declaration on International Investment and Multinational Enterprises (*www.oecd.org/daf/investment/instruments*).

Table 6.2. **Substantive provisions in recent BITs**

	Definitions/scope/coverage				Umbrella clause	Admission			Post admission			Investment protection			
	Asset based		Investment											Expropriation	
	Open list	Closed list	Direct	Indirect		NT	MFN	Performance requirements	NT	MFN	Performance requirements	Standard of treatment	Transfers	Direct	Indirect
German Model	+				+				+	+		+	+	+	+
French Model	+		+	+					+	+		+	+	+	+
Belgium-Luxembourg Model	+		+	+	+				+	+		+	+	+	+
Canadian Model		+	+	+		+	+	+	+	+	+	+	+	+	+
US Model	+		+	+		+	+	+	+	+	+	+	+	+	+
Germany-China BIT	+		+	+	+				+	+		+	+	+	+
Germany-India BIT	+				+				+	+		+	+	+	+
Japan-Korea BIT	+		+	+		+	+	+	+	+	+	+	+	+	+
Mexico-Korea BIT	+								+	+		+	+	+	+

	Key personnel	Transparency	Exceptions					Financial services	Taxation	Environment	Labour	Investment facilitation	CR
			EIA[1]	General exceptions	Security interests	Prudential measures	Country exceptions						
German Model	+		+						+				
French Model	+		+			[2]			+				
Belgium-Luxembourg Model	+		+		+				+	+	+		
Canadian Model	+	+		+	+	+	+	+	+	+			
US Model	+	+			+	+	+	+	+	+	+		
Germany-China BIT	+		+						+				
Germany- India BIT	+		+	+	+				+				
Japan-Korea BIT	+	+	+	+	+	+[3]	+		+	+			
Mexico-Korea BIT			+			[4]			+				

1. Economic Integration Agreements (*i.e.* membership or association with a custom or economic union, a common market or a free trade area).
2. Article on BOP (Balance of Payment) safeguards.
3. The same article also includes a BOP Clause.
4. BOP Clause provided in the Protocol.

Source: OECD Investment Division.

the continental shelf outwards the territorial sea of each Contracting Party over which they have, in accordance with International Law, sovereign rights and a jurisdiction with a view to prospecting, exploiting and preserving natural resources (French Model).

1.2.1. Defining "investment"

"*Every kind of asset*" is normally used as the leading formula to a non-exhaustive definition of investment. Such definition may include traditional property rights, interests in companies ("*share of companies or other kinds of interest in companies*"), claims to money used to create an economic value and titles to performance having an economic value ("*rights to money and any performance under contract having a financial value*"), intellectual property rights and business concessions under public law, including concessions to search for, extract and exploit natural resources ("*business concessions conferred by law or under contract, including concessions for mining and oil exploitation*").[10] There are some noticeable differences either in the coverage or language used, however. For example:

The **2004 US Model BIT** departs from NAFTA's closed definition of investment in favour of the open-ended definition of the 1994 Model. Furthermore the definition is more detailed and accompanied by explanatory footnotes. Article 1 defines "*investment*" as "*every asset… that has the characteristic of an investment…*". Footnote 1 gives examples of forms of debt that are more likely to have the characteristics of an investment as well as of other forms that are less likely to have such characteristics. Footnote 2 provides indications as to whether or not a particular type of license, authorisation, permit or similar instrument has the characteristics of an investment. Footnote 3 clarifies that the term "investment" does not include an order or judgment entered in a judicial or administrative action.

The new **Canadian Model** has replaced the 1994 FIPA Model's non exhaustive asset-based definition with the finite but more comprehensive definition of investments based on NAFTA's Article 1139 definition.

In Article 1.2 of the **Belgium-Luxembourg Model (2002)**, investment is defined as "*any kind of asset and any direct or indirect contribution in cash, in kind or in services, invested or reinvested in any sector of economic activity*".

Article 1.2 of the **Japan/Korea BIT (2003)** provides a straightforward definition of investment that includes namely "*… an enterprise;… shares, stocks or forms of equity participation… bonds, debentures, loans and other forms of debt, including rights derived there from,… rights under contracts,… claims to money and to any performance under contract having a financial value, intellectual property rights,… any other tangible and intangible… property*". In addition, the term investment includes "*the amounts yielded by investment, in particular profit, interest, capital gains, dividends, royalties and fees*".

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While Article 1 of the **Mexico/Korea BIT (2002)** explicitly provides for a non-exhaustive definition of investment, it also provides a negative definition of investment "*… but investment does not include, a payment obligation from, or the granting of a credit to a Contracting Party or to a state enterprise… but investment does not mean, claims to money that arise… from:* i) *commercial contracts for the sale of goods or services by an investor in the territory of a Contracting Party to a company or a business of the other Contracting Part, or* ii) *the extension of credit in connection with commercial transaction…* iii) *any other claims to money that do not involve the kinds of interests set out in subparagraphs* a) *through* e)".

1.2.2. Defining "investor"

The definition of investors may rely on one, or any combination of, the following three criteria, namely that of incorporation, that of seat and that of control. Although this would not appear to be the general rule, some recent BITs may also continue to offer two definitions, one relating to one Party and the other relating to the second Party. In particular:

Germany provides an example of two definitions of investors. For instance, in **the Germany-China BIT**, the definition of a German investor covers: 1) in general "*any natural person who is national of Germany under its applicable law*"; and 2) "*any judicial person as well as any commercial or other company or association with or without legal personality having its seat in the territory of the federal Republic of Germany, irrespective of whether or not its activities are directed at profit*" (Article 1.3 of the 2005 German Model and Article 1.2.a of the 2003 Germany-China BIT). Chinese investors are defined as: 1) "*nationals/ individuals – natural persons*"; and 2) "*economic entities, including companies, corporations, associations, partnerships and other organisations, incorporated and constituted under the laws and regulations of and with their seats in the People's Republic of China, irrespective of whether or not for profit and whether their liabilities are limited or not*" (Article 1.2.b). The **Germany-India BIT** generally includes under the term investors "*nationals or companies of a Contracting Party who have effected or are effecting investment in the territory of the other Contracting Party*" (Article 1.c following the 2003 Indian Model, Article 1).[11]

The **French Model (2005)** sets forth for a single definition of investors which applies to both contracting parties. It also relies on a combination of three criteria to define investors, namely the concept of incorporation ("*any legal person constituted on the territory of one Contracting Party*"), the concept of seat (*siège social*) and the concept of control ("*any legal person controlled directly or indirectly by nationals of one Contracting Party or by legal persons having their head office in the territory of one Contracting Party and constituted in accordance with the legislation of that Party*") (Article 1.3).

The same approach is followed by the **Belgium-Luxembourg Model (2002)** although it combines two concepts to define the nationality of companies, the concept of incorporation ("*any legal person constituted in accordance to the legislation...*") and the concept of seat ("*… and having its registered office in the territory…*"). No references are made to the situations of the legal persons controlled directly or indirectly (such as for example the case of affiliates/subsidiaries) (Article 1.1).

In the **Mexico/Korea BIT**, investors which are juridical persons are defined as any entity "*incorporated or constituted in accordance with the laws and regulations of that Contracting Party, including an enterprise that is owned or controlled by the former Contracting Party*" (Article 1.3.b). This definition relies on the concepts of incorporation and control.

The same approach is followed by the **Korea/Japan BIT**. The definition of an investor includes "*a legal person or any other entity constituted or organised under the applicable laws and regulations of a Contracting Party, whether or not for profit, and whether private or government-owned or-controlled, and includes a company, corporation, trust, partnership, sole proprietorship, branch, joint venture, association or organisation*" (Article 1.b).

Following the NAFTA precedent, both the **Canadian and US Models** have a definition for an "investor of a Party" and an "investor of a non-Party". The definitions are very similar. In the US Model, an "investor of a Party" means "a Party or state enterprise thereof, or a national or an enterprise of a Party that *attempts to make, is making, or has made an investment in the territory of the other Party*"… Investor of a non-Party, means, with respect to a Party, "*an investor that attempts to make, is making, or has made an investment in the territory of that Party, which is not an investor of either Party*". The terms "enterprise" and "enterprise of a Party" are also broadly defined. "Enterprise" means "*any entity constituted or organized under applicable law, whether or not for profit, and whether privately or governmentally owned or controlled, including a corporation, trust…; and a branch of an enterprise*" while an enterprise of a Party means "*an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there*" (Article 1).

It should also be noted that both the **Canadian and US Models** have a "scope and coverage" article (Article 2) which immediately follows the definitions article. This article makes it clear that the treaty applies to "*measures adopted or maintained by a Party relating to… investors of the other Party*" and "*covered investments*".[12] It also makes it clear that the substantive obligations of the Parties apply to a state enterprise or other person when it exercises any regulatory, administrative or other delegated governmental authority as well as to political subdivisions of that Party. In addition, under Article 17 of the US Model BIT and Article 18 of the

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Canadian Model, "*a Party may deny the benefits*" of the BIT to an enterprise of the other Party if "*… the enterprise has no substantial business activities in the territory of the other Party*" and investors or persons of a non-Party "*own or control the enterprise*".

2. Treatment of investor and investment

Foreign investors may encounter restrictions of a regulatory nature when they attempt to enter a market, are in process of making an investment or are already established in a home country. The restrictions may apply to all of these phases or alternatively to some of them. Issues related to Most-Favoured-Nation treatment and National Treatment (see below) lie at the heart of these measures. Other issues include whether investors are being guaranteed an absolute standard of treatment (fair and equitable treatment standard and full protection and security), are subject to performance requirements or are allowed to employ foreign key personnel. In addition, foreign investors are looking for transparent and predictable rules in carrying out their activities.

These are also among the most important substantive issues dealt with by BIT negotiators and differences stand out as to the way they have handled these over the years. For instance, the treatment provisions of Canadian and US BITs apply to both the pre-establishment and post-establishment phases where European BITs have traditionally covered only the second phase. Another major distinction is that Canadian and US BITs contain disciplines on the imposition of a number of performance requirements while European BITs usually do not.[13] These differences appear to have been carried over in recent BITs. This situation can be contrasted with that of other OECD BITs, notably some which are reviewed here (Japan and Korea) and which contain innovations of their own.

2.1. Most-Favoured Nation and National Treatment

The principle that foreign investors are not discriminated against relative to other foreign investors (Most-Favoured-Nation treatment, or MFN) or domestic counterparts (National Treatment) is central to investor protection. Based on recent developments, the following observations can be made:

The newly released **French and German Model BITs** continue to provide in a leading article (Article 2 in both cases) a best endeavour undertaking as regards the promotion and admission of investment by investors of the other party with the qualification "*in accordance with its legislation and the provisions of this Agreement*" (French Model) or "*in accordance with its laws and regulations*" (German Model). This is followed by a NT/MFN treatment article which subjects investments "*in its territory*" owned or controlled by investors of the other Party, and to investors of the other Party as regards activities relating to such investment, to treatment no less favourable than it accords to investment of its own investors/its own investors or to investments/ investors of any third State. The language may vary somewhat without extending the coverage of these provisions to pre-establishment. For instance, in the **Germany-India BIT** (1998), the NT/MFN treatment provisions (Article 4) refers to the treatment accorded to investments of investors of the other Party, "*including their operation, management, maintenance, use, enjoyment or disposal by such investors*".[14] In **the Germany-China BIT** (signed in 2003), the language used is "*Each… Party shall accord to investments and activities associated with such investments… treatment no less favourable than that accorded to investments… by its own investors… or by investors of any third State*" (Article 3).

The new **Canadian and US Models** are similar to NAFTA Articles 1102 and 1103 and apply to "*the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory*". Both Models now include a clause which requires sub-national governments (Article 3.3 of the Canadian Model) or regional level of government (Article 3.3 of the US Model) to accord National treatment as defined by the Model. The Canadian Model contains in addition a footnote to the MFN treatment clause (Article 4) stating that "*for greater certainty, the treatment accorded by a Party under this Article means, with respect to sub-national government, treatment accorded, in like circumstances, by that sub-national government to investors, and to investments of a non-Party*".

The BITs concluded by **Japan** with **Korea** (2003) and **Vietnam** (2005) cover both the pre and post-establishment phases. The National Treatment provision (Article 2.1) provides "*treatment no less favourable than the treatment it accords in like circumstances to its own investors and their investments respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposal of investment…*". A similar language is used for the MFN treatment clause (Article 2.2). Article 3 provides, in addition, for "*no less favourable treatment… in like circumstance with respect to access to the courts of justice and administrative tribunals and agencies in all degrees of jurisdiction, both in pursuit and in defence of such investors' rights*". These provisions may be contrasted with the **Japan-Pakistan BIT** (2002) where the National Treatment and MFN treatment clauses state that "*Investors of either Contracting Party shall within the territory of the other Contracting Party be accorded treatment no less favourable than accorded to investors of such other Contracting Party or any third country in respect to investments, returns and business activities in connection with the investment*" (Article 3.1 and 3.2). Article 4 of this agreement is almost identical to Article 3 of Japan-Korea and Japan-Vietnam BIT except for the additional phrase "*in like circumstances*".

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The **Korea-Mexico BIT** (2002) has two separate provisions on NT/MFN treatment. One (Article 3.1), provides that each Party "*shall in its territory accord to investment and returns of investors (underlined added), of the other… Party treatment no less favourable than that which it accords to investments and returns of its own investors or investments and returns of investors of any third State, which ever is more favourable to investors*". Article 3(2) provides that each Party shall provide to investors of the other Party "*as regards the operation, management, maintenance, use, enjoyment or disposal of their investments (underlined added), treatment no less favourable than that which it accords to its own investors or to investors of any third State…*". These provisions therefore do not apply to pre-establishment even if some of the terms used appear to have been influenced by NAFTA.

2.2. Transparency

It can be inferred from the BITs reviewed that only a few in the new generation of BITs include transparency requirements. For example, the new German, French or Belgium-Luxembourg Model BIT do not have provisions in this respect. There are, however, some interesting developments in the Canadian, Finnish and US Models and in the Japanese-Korea BIT. In particular:

Both the **Canadian** and **US Models** reproduce NAFTA Chapter 18 provisions regarding the prompt publication of "*laws, regulations, procedures and administrative rulings of general application*" as they relate to any matter covered by BITs.[15] Article 10 of the US Model extends the obligation to "adjudicatory decisions" consistent with the 1994 Model. The new US Model contains, in addition, a transparency article (Article 11) which reflects the marriage of the 1994 US Model BIT and transparency chapters of US FTAs. This article concerns the designation of contact points to facilitate communication between the Parties, the publication in advance, to the extent possible, of new measures, enquiries and administrative proceedings. No investor may have recourse to dispute settlement under Article 11 however (as in the case of the transparency article of the Canadian Model).

Both the **Japan-Korea BIT** (Article 7) and the **Finland Model** (Article 15) state that each Party "*shall promptly publish, or otherwise make publicly available, its laws, regulations, administrative rulings and judicial decisions of general application as well as international agreements which pertain to or affect investment and business activities*" as well as, "*upon request, respond to specific questions on these matters*". This cannot to be construed as obliging any Party to disclose confidential information however.

2.3. Performance requirements

As the 1967 OECD Model did not establish any provision precluding the Party's ability to impose performance requirements and as the Trade-Related Investment Measures (TRIMs) Agreement came into force only in 1995, the inclusion of performance requirements clauses in BITs has not emerged as a generalised practice. Those BITs which do contain such clauses either replicate the TRIMs Agreement obligations or are largely based on NAFTA.

The **2004 Canada Model FIPA** and the **2004 US Model BIT** are inspired by the article on performance requirements established in NAFTA. They are different from both the Canadian and the American 1994 BIT Models since they establish separately the preclusion to "*impose or enforce*" a requirement or "*enforce any commitment or undertaking*" from the preclusion of the imposition of requirements as a condition for "*the receipt or continued receipt of an advantage*". [Article 7(3) of Canada Model FIPA and Article 8(2) of the 2004 US Model BIT]. Both models refer to the same type of performance requirements and also add the prohibition "*to supply exclusively from the territory of the Party the goods it produces or the services it supplies to a specific regional market or to the world market*".

The new models also add several provisions that establish exceptions to the preclusion of imposing performance requirements in certain cases. Hence, parties are not prohibited from conditioning the receipt of an advantage "*on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory*". Other exceptions apply in cases related to the export promotion and foreign aid programmes, procurement by a Party or State enterprise, and to the contents of goods necessary to qualify for preferential tariffs or preferential quotas. In the case of the US, the Article on Performance Requirements adds exceptions related to the authority of a Party to adopt or maintain measures, including environmental measures, in order to secure compliance with laws and regulations; necessary to protect human, animal or plant life or health; and related to the conservation of living or non-living exhaustible natural resources. The Canadian Model addresses such measures in Article 10(1).

Regarding the preclusion of the imposition of requirements related to the transfer of technology, a production process or other propriety knowledge, the **US Model** states that it does not apply "*when a Party authorizes use of intellectual property right in accordance with Article 31 of the TRIPS Agreement, or to measures requiring the disclosure of propriety information that fall within the scope of, and are consistent with, Article 39 of the TRIPS Agreement…*" and when the requirement is imposed or enforced by a court, administrative tribunal, or competition authority. In the same regard, the **Canadian Model** states that "*A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with…*" the prohibition of imposing requirements on technology transfer. The **Japan-Korea BIT** contains a reference to TRIPS Agreement stating that "*… while providing that the Parties shall not impose requirements such as…* f) *to transfer technology, a production process or other proprietary knowledge to a natural or legal person or any other entity in its territory, except when the requirement:* i) *is imposed or enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws; or* ii) *concerns the transfer of intellectual property and is undertaken in a manner not inconsistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 1C of the Marrakech Agreement Establishing the World Trade Organization*".

The **2004 US Model BIT** provides that the Article on Performance Requirements "*does not preclude the enforcement of any commitment, undertaking, or requirement between private parties, where the Party did not impose or require the commitment, undertaking or requirement*".

2.4. Key personnel

Several BITs require the host country to give favourable consideration to investor's applications for licences, sojourn of personnel, entry of employees, working permits, etc. This might be explained because foreign investors may generally expect to bring into the host country expatriates for positions requiring special skills. In particular:

The **Germany-China BIT** provides that: "Subject to its laws and regulations, either Contracting Party shall give sympathetic consideration to applications for obtaining visas and working permits to nationals of other contracting Party engaging in activity associated with investments made in the territory of the Contracting Party" (Article 2.3). The **2005 German Model** contains such provision in the Protocol (Article 3.c). In different terms, the **Germany-India BIT** provides that "Neither contracting Party shall place any constraints on the international movement of goods or persons directly connected with an investment being transported subject to bilateral or international agreements governing such transports, which are in force between the contracting Parties".

The **French Model** in its Article 4 requires each Contracting Party to give favourable considerations to applications for entry/residence/work/travel of nationals of one Contracting Party in relation to an investment made in the territory/maritime areas of the other Contracting Party. Article 5 also provides that expatriates ("… nationals authorized to work…") may enjoy the material facilities relevant to the exercise of their professional activities.

The **Belgium-Luxembourg Model** in its Article 2.2 requires each Contracting Party to authorise the conclusion and the fulfilment of license contracts and commercial, administrative or technical assistance agreements, as far as these activities are in connection with such investment. References to sojourn and entry of personnel in relation with the investments as well as to the grant of material facilities relevant to the exercise of professional activities of nationals authorized to work in the territory of one Contracting Party are not explicitly contained in the article. It might be considered that these aspects are acknowledged in the Article 2.2.

Key personnel provisions are included in the **2004 Canadian Model**. Article 6.3 provides that "Subject to its laws, regulations and policies to the entry of aliens, each Party shall grant temporary entry to nationals of other Party, employed by an investor of the other Party, who seeks to render services to an investment of that investor in the territory of the Party, in a capacity that is managerial or executive or requires specialized knowledge". Following the approach of several FTAs, the Canadian Model contains provisions on senior management and boards of directors.[16]

Like the Canadian Model, the **2004 US Model BIT** contains very similar provisions on senior management and boards of directors (Article 9). It differs from the 1994 Model, in which provisions on senior management and boards of directors are included in Article VII, on the entry/sojourn of aliens, a subject that is not included in the 2004 US Model.[17]

The **Korea-Japan BIT** also includes provisions on key personnel. Article 8.1 states that "Subject to its laws relating to entry, stay and authorisation to work, each Contracting Party shall grant temporary entry, stay and authorisation to work to investors of the other Contracting Party for the purpose of establishing, developing, administering or advising on the operation in the territory of the former Contracting Party of an investment to which they, or an enterprise of that Contracting Party that employs them, have committed or are in the process of committing a substantial amount of capital or other resources, so long as they continue to meet the requirements of this Article". The treaty also contains a provision on senior management and boards of directors. Its Article 8.2 provides that "Neither Contracting Party shall require that an enterprise of that Contracting Party that is an investment of an investor of the other Contracting Party appoint, as executives, managers or members of boards of directors, individuals of any particularly nationality".

2.5. Environment and labour

As a general rule, OECD countries' BITs do not include special provisions bearing on the protection of the environment and labour market rights. However, a few exceptions bear mentioning:

With two separate articles on environment and labour, the **Belgium-Luxembourg Model** stands out as a major exception to the general practice of EU member countries BITs. Article 5 and 6 of this Model specifically recognise that each Party has the right to establish its "own levels of domestic protection" in these policy areas, that it "shall strive to ensure that its legislation provide for high levels of environmental protection" or "labour standards consistent with internationally recognised labour rights", and that "it is inappropriate to encourage investment by relaxing domestic environmental and labour legislation". The Parties must also agree to fulfil their international commitments (including those of the ILO Declaration on Fundamental Principles and Rights at Work) in these fields.

These striking features of the Belgium-Luxembourg Model are also among the most innovative provisions of features of the new **US Model BIT**, which contains two new articles on Investment and the Environment (Article 13) and Investment and Labour (Article 13) borrowed from NAFTA and more recent FTAs. One such principle is that "it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental or labour laws". Consultations may be requested by a party which considers that such an encouragement has been offered. The Canadian Model BIT also contains an article on Health, Safety and Environmental Measures (Article 11) that is similar to Article 12(1) of the US Model. The other principle reflected in the US Model, which is unique to the Environment Article, is that "Nothing in this Treaty shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Treaty that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns". These articles are not subject to any dispute settlement recourse however.

3. Investment protection

BITs have traditionally included three important provisions to protect foreign investors, namely: *a)* fair and equitable standard and full protection and security; *b)* guarantees of investors' property rights, for instance through compensation provisions that can be invoked should an investment be expropriated by the host state; and *c)* an obligation to provide for the free transfer, conversion and liquidation of any form of capital, proceeds, payments, profits and others without restraints.[18] These are "absolute" and "non-contingent" obligations since they limit a State's ability to impose measures on foreign investors even if these measures are applied equally to that State's own investors.

3.1. Fair and equitable treatment and full protection and security

A major survey has recently been conducted under the OECD Investment Committee's auspices on the fair and equitable standard in international investment law.[19] One new development is the change in the minimum standard of treatment provision of the Canadian and US models. Following are some illustrations:

> The new **German Model BIT** now regroups under a single article the three standards but the language previously used in the 1991 Model remains unchanged: "*Each Contracting State shall…accord fair and equitable standard as well as full protection under the Treaty*" (Article 2.2) and "*Neither Contracting Party shall in any way impair by arbitrary or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of investors of the other Contracting State*" (Article 2.3). These obligations follow a best endeavour undertaking "to promote as far as possible investments by investors of the other Contracting State and admit such investments in accordance with its legislation" (Article 2.1). The three standards appear in the Germany-China BIT (Article 2) in the Germany-India BIT.
>
> In the most recent **French Model**, the fair and equitable standard is covered by a stand-alone article which provides that each Party "*shall extend fair and equitable standard in accordance with the principle of international law… and shall ensure that the exercise of this right shall not be hindered by law or in practice*" (Article 4). The standard of "*full and complete protection and safety*" provision appears as the leading paragraph of Article 6 on Dispossession and indemnification.
>
> In the **Belgium-Luxemburg Model BIT**, Article 3 on Protection of Investments provides for the three standards but the exclusion of any unjustified or discriminatory measure is part of the standard of continuous protection and security. The article reads:
>
> "*Except for measures required to maintain public order, such investments shall enjoy continuous protection and security,* i.e. *excluding any unjustified or discriminatory measure which could hinder, either in law or in practice, the management, maintenance, use, possession or liquidation thereof*".
>
> In the **Japan-Korea BIT**, the obligation to accord fair and equitable standard and full and constant protection and security is combined with the provisions on expropriation (Article 10). There is no provision on the non-discriminatory principle.

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In the **Korea-Mexico BIT**, all the three principles are combined into a single paragraph of the article on the Promotion and Protection of the Investments (Article 2).

In terms of recent developments, the US and Canada Model BITs stand out. Contrary to the 1994 Model, where contingent and non-contingent standards were prescribed in a single article, the **2004 US Model BIT** contains a separate article devoted only to Minimum Standard of Treatment (Article 5). This article provides that:

"1. *Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.*

For greater certainty, paragraph 1 prescribes the customary international minimum standard 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. The obligation in paragraph 1 to provide:

a) '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) 'full protection and security' requires each Party to provide the level of police protection required under customary international law.

2. *A determination that there has been a breach of another provision of this Treaty, or of a separate international agreement, does not establish that there has been a breach of this Article.*

3. *Notwithstanding Article 14 [Non-Conforming Measures] (5)(b) [subsidies and grants], each Party shall accord to investors of the other Party, and to covered investments, non-discriminatory treatment with respect to measures it adopts or maintains relating losses suffered by investments in its territory owing to armed conflict or civil strife.*

4. *Notwithstanding paragraph 4, if an investor of a Party, in the situations referred to in paragraph 4, suffers a loss in the territory of the other Party resulting from:*

a) requisitioning of its covered investment or part thereof by the latter's forces or authorities; or

b) destruction of its covered investment as part thereof by the latter's forces or authorities, which has not been required by the necessity of the situation,

the latter Party shall provide the investor restitution, compensation, or both, as appropriate, for such loss. Any compensation shall be prompt, adequate, and effective…"

An additional interpretative provision in Annex A states the parties' shared understanding of the meaning of "customary international law" as "*a general and consistent practice of States that they follow from a sense of legal obligation*"… "*the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens*".

Canada's new FIPA Model[20] also links in its Article 5 the obligations regarding "fair and equitable treatment" and "full protection and security" to the minimum standard. According to its article:

"1. *Each Party shall accord to covered investments treatment in accordance with customary international law minimum standard of treatment of aliens, including fair and equitable and full protection and security.*

2. *The concepts of 'fair and equitable treatment' and 'full protection and security' in paragraph 1 do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.*

3. *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.*"

3.2. Expropriation and compensation

Virtually all BITs contain clauses describing the conditions under which a lawful expropriation may be made and a standard for compensation of the expropriated property.[21, 22] They also usually cover both direct and indirect expropriation. Only recently, however, has the distinction between compensable and non-compensable regulatory actions been addressed.[23] This is the case for the new Canadian and US Models BITs which include criteria articulating the difference between indirect expropriation and non-compensable regulation. A major survey has recently been conducted under the Committee's auspices on indirect expropriation and the right to regulate.[24]

Following are some illustrations of the manner in which these various issues relating to expropriation have been handled in recent BITs.

Article 4 of the **German Model** provides that "*investments by investors of either Contracting State shall not be directly or indirectly expropriated, nationalised or subjected to any other measure the effects of which would be tantamount to expropriation… except for the public benefit and against compensation*". It also incorporates a provision on most-favoured nation treatment: "*Investors of either Contracting State shall enjoy most-favoured-nation treatment in the territory of the other Contracting State in respect of the matters provided for in this article*". Concerning the amount of compensation, the Model provides that it "*shall be the equivalent to the value of the expropriated investment immediately before*

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the date on which the actual or threatened expropriation… has become publicly known". Furthermore such compensation "*be fully realizable, freely transferable and without delay*". Finally, Article 4 stipulates the availability of judicial review as a separate requirement.[25]

In the **French Model**, expropriation provisions are contained in a short article on "Dispossession and indemnification" (Article 6). This article states that "*Neither Contracting Party shall take any measures of expropriation or nationalization or any other measures having the effect of dispossession, direct or indirect, of nationals or companies of the other Contracting Party of their investments on its territory and in its maritime area, except in the public interest and provided that these measures are neither discriminatory nor contrary to a specific commitment*" (underlined added). Any measure of dispossession shall give rise to "*prompt and adequate compensation*" the amount of which shall "*be equal to the real value of the investments concerned and shall be set in accordance with the normal economic situation prevailing prior to any threat of dispossession*". Compensation shall also be "*fully realizable, freely transferable and without delay*".

The provisions are largely the same in the **Japan-Korea BIT**. Article 10.2 stresses that investments by investors of either Contracting State shall not be *directly or indirectly* expropriated except for *the public purpose, on a non6Hdiscriminatory basis, against prompt, adequate and effective compensation and in accordance with the due process of law*. Concerning the amount of compensation, it shall be equal *to the fair market value of the expropriated investments immediately before expropriation occurred*. This fair market value shall not reflect changes in value occurring because the expropriation became publicity known earlier (Article 10.3). Such compensation shall be *effectively* realizable, freely *convertible* and *transferable* and shall be made without delay (Article 10.2). Investors have also "*the right to access to the courts of justice or administrative tribunals or agencies of the Contracting Party making the expropriation for a review of the investor's case and of the amount of compensation*".

Article 5 of the **Korea-Mexico BIT** opts for a more general formula stating that investments by investors of either Contracting State shall not be *directly or indirectly* expropriated except for *the public purpose* and against *just compensation*. It also adds that *the expropriation shall be carried out on a non-discriminatory basis in accordance with legal procedures* (Article 5.1). Concerning the amount of compensation, it shall be equal *to the fair market value of the expropriated investments immediately before expropriation was taken or before impending expropriation became public knowledge, whichever is the earlier, shall include interest at the applicable commercial rate from the date of expropriation until the date of payment…* (Article 5.2.) Such compensation shall be *effectively* realizable, freely *convertible* and transferable and shall be made without *undue* delay (Article 5.2).

Both the *Expropriation* article of the **Canadian** and **US Models** (Article 13 and Article 6 respectively) largely reproduce NAFTA Article 1110 language – which itself embodied Canada's and US BIT practice at the time. There are some differences however. For example, indirect expropriation is being referred to as "measures having an effect *equivalent*" (and not *tantamount*) to… expropriation. The **US Model BIT** contains detailed provisions on the determination of market value in the cases of a freely and non-freely usable currency. Both Models now contain a special provision on compulsory licenses.[26] However the most innovative features are the inclusion of annexes containing clarifications on how the provisions on direct and indirect expropriation should be interpreted. Annex B[27] of the US Model BIT specifically provides that:

"1. *Article 6 [Expropriation and Compensation](1) is intended to reflect customary international law concerning the obligation of States with respect to expropriation.*

2. *An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a tangible or intangible property right or property interest in an investment.*

3. *Article 6…(1) 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.*

4. *The second situation addressed by Article 6…(1) 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, non-discriminatory 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."

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Annex B.13 of the updated **Canadian Model** contains a similar definition of indirect expropriation. Paragraph (a) stipulates that "indirect expropriation results from a measure or series of measures …that have an effect equivalent to direct expropriation. Paragraph (b) provides criteria to be considered on a case-by-case basis to determine what may constitute an expropriation. Paragraph (c) provides, in addition to the clarification of paragraph 4(b) of the US Model, an example of the 'rare circumstances' where non-discriminatory measures" could be compensated. This would be the case "*when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith*".

3.3. Transfers

As one of the core provisions in BITs, transfers articles set forth a host country's obligation to allow free flow of all investment related transactions, guaranteeing the transfer, conversion and liquidation of any form of capital, proceeds, payments, profits and others without restrains. In general, they provide very similar provisions to the one incorporated in the **Japan-Korea BIT**, which establishes that:

"1. *Each Contracting Party shall ensure that all payments relating to an investment in its territory of an investor of the other Contracting Party may be freely transferred into and out of its territory without delay. Such transfer shall include, in particular, though not exclusively:*

a) the initial capital and additional amounts to maintain or increase an investment;

b) profits, interest, dividends, capital gains, royalties or fees;

c) payments made under a contract including a loan agreement;

d) proceeds of the total or partial sale or liquidation of investments;

e) payments made in accordance with Articles 10 and 11;

f) payments arising out of the settlement of a dispute under Article 15; and

g) earnings and remuneration of personnel engaged from the other Contracting Party in connection with an investment.

2. *Neither Contracting Party shall prevent transfers from being made without delay in freely convertible currencies at the market rate of exchange existing on the date of the transfer.*

3. *Notwithstanding paragraphs 1 and 2 above, a Contracting Party may delay or prevent a transfer through the equitable, non-discriminatory and good faith application of its laws relating to:*

a) bankruptcy, insolvency or the protection of the rights of creditors;

b) issuing, trading or dealing in securities;

c) criminal or penal offences; or

d) ensuring compliance with orders or judgments in adjudicatory proceedings."

Although the provision on transfers generally varies little from treaty to treaty, there have been recent BITs that have included new provisions allowing safeguard measures that restrict transfers in cases of serious balance-of-payments or financial difficulties.

3.4. "Umbrella" clauses

An estimated 40% of the BITs in force contain an "umbrella" clause seeking to ensure that each Party to the treaty will respect specific undertakings towards nationals of the other Party. Recent jurisprudence has given greater weight to the view that these clauses can elevate contract breaches into breaches of international law. (An overview of the history and context of umbrella clauses is provided in a later article in this publication.) Switzerland, Germany and Japan provide examples of different formulations of these clauses.[28] In particular:

Article 10(2) of the **Swiss Model BIT** provides that "*Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party*".

Article 8 of the **German Model BIT** states that "*Each Contracting Party shall observe any obligation it has assumed with regard to investments in its territory by nationals or companies of the other Contracting Party/investments in its territory by investors of the other Contracting State*".

Article 2(3) of the **Japan- Hong Kong BIT 1997** reads "*Each Contracting Party shall observe any obligation it may have entered into with regards to investments of investors of the other Contracting Party*". This is to be contrasted with Article 3(3) of the Japan-Russia BIT 1998 providing that "*Each Contracting Party shall observe any of its obligations assumed in respect of the capital investments made by an investor of the other Contracting Party*".

In other cases however, the umbrella clause may serve as a means of qualifying the scope of application of dispute settlement to investor-state contracts. For example:

The umbrella clause in the majority of **Mexico BITs** state that "*disputes arising from such obligations shall be settled under the terms of the contract underlying the obligation*".

Article 13(2) of the **German-India BIPA**"Application of other rules" provides that "*Each Contracting Party shall observe any other obligation it has assumed with regard to investments in its territory by investors of the other Contracting Party; with dispute arising from such obligations being only redressed under the terms of the contracts underlying the obligations*".

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The **US Model BIT** no longer contains a "standard" umbrella clause.[29] However, Article 24 (1) permits investors to bring breaches of an "investment agreement" to investor-to-state dispute settlement as follows:

"*… the claimant may submit to arbitration under this section a claim that the respondent has breached… c) an investment agreement*".

An "investment agreement" means:

"a written agreement between a national authority of a Party and a covered investment or an investor of the other Party, on which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself, that grants rights to the covered investment or investor:

a) with respect to natural resources that a national authority controls, such as for their exploration, extraction, refining, transportation, distribution, or sale;

b) to supply services to the public on behalf of the Party, such as power generation or distribution, water treatment or distribution, or telecommunications; or

c) to undertake infrastructure projects, such as the construction of roads, bridges; canals, dams, or pipelines, that are not for the exclusive or predominant use and benefit of the government."

The investor must nevertheless waive its rights to other remedies.

"No claim may be submitted to arbitration under this section unless:

… b) the notice of arbitration is accompanied

i) for claims submitted to arbitration under Article 24(1) by the claimant's written waiver… of any right to initiate or continue before any administrative tribunal or court under the law of either Party or other dispute settlement procedures, any proceeding with respect to any measure alleged to constitute a breach referred to in Article 24."

4. Exceptions

The scope of the substantive obligations may also be limited by "exceptions". There may be three types of exceptions: exceptions to National Treatment and MFN Treatment, general exceptions and country exceptions. General exceptions refer to the adoption or maintenance of measures to meet policy goals (such as the protection of human life, the conservation of exhaustible resources, national security, and prudential measures for the financial sector…). When such provisions are included in BITs, their language is often drawn from standard general clauses such as those of Article XX of GATT, Articles XIV and XIV *bis* of the GATS, and the GATS Annex on Financial Services. A new development is the inclusion of provisions on the relationships between investment and environment and investment and labour. *Country exceptions* are those which provide for the adoption or maintenance of non-conforming measures to the substantive obligations of the agreement. The central question is whether they contain liberalisation commitments and whether they follow a bottom up or top down formulation.

4.1. Exceptions to National Treatment/MFN Treatment

Exceptions related to membership of customs and economic unions, common markets and free trade areas are relatively common in BITs. They are included in the **German, French** and **Belgium-Luxembourg Models** as well as in the **Japan-Korea** and **Mexico-Korea BITs**. Some specific examples are:

Article 4.2 of the **Belgium-Luxembourg Model** provides as follows "This treatment shall not include the privileges granted by one Contracting Party to investors of a third State by virtue of its participation or association in a free trade zone, customs union, common market or any other form of regional economic organisation". The **French Model** contains a very similar provision, but refers to nationals and companies of a third State instead of investors (Article 5). The **German Model** and **German BITs with India and China** provide such clause respectively in Articles 3.3, 3.4 and 4.2. The **Mexico-Korea BIT** in its Article 3.4 provides that the treaty "shall not be construed so as to oblige one Contracting Party to extend to the investors of the other Contracting Party the benefit of any treatment, preference or privilege resulting from its participation in any existing or future free trade area, customs, union, economic union, regional economic integration agreement or similar international agreement".

The Korea-Japan BIT states that "*The provisions of paragraph 2 of Article 2 [Most-Favoured Nation Treatment] shall not be construed so as to oblige a Contracting Party to extend to investors of the other Contracting Party and their investment any preferential treatment resulting from its membership of a free trade, a customs union, an international agreement for economic integration or a similar international agreement*" (Article 22.3).

Intellectual Property Rights are included as an exception to NT/MFN treatment in the **Korea-Japan BIT**. They are contained in the definition of investment of most BITs. The Korea-Japan BIT includes them in its Article 1.f. and also provides a distinct provision. Article 6 states as follows: "*Nothing in this Agreement shall be construed so as to derogate from the rights and obligations under international agreements in respect of protection of intellectual property rights to which the Contracting Parties are parties, including the Agreement on Trade-Related Aspects of Intellectual Property Rights, Annex 1C of the Marrakech Agreement Establishing the World Trade Organization and other international agreement concluded under the auspices of the World Intellectual Property Organization*" (6.1). Paragraph 2 of the article specifies that nothing in such agreement shall be construed so as to oblige either Contracting Party to

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extend to investors of other Contracting Party and their investment the treatment which is accorded to investors of any third state and their investment by virtue of international agreements regarding protection of intellectual rights to which the former Contracting Party is a party.

The US and Canadian Models follow a different approach (see sections on Performance Requirements and Country Exceptions).

Another group of exceptions concerns **tax matters**. The **Belgium-Luxembourg Model** provides that "*The provisions of this article* (national treatment and most favoured nation treatment) *do not apply to tax matters*" (Article 4.4; also Article 5 of the **French Model**). The **German Model** specifies that "*the treatment granted under this article shall not relate to advantages which either Contracting States accords to investors of third States by virtue of a double taxation agreement or other agreement regarding matters of taxation*" (Article 3.4; Article 3.4.b of the Germany-China BIT; Article 4.3 of the Germany-India BIT).

Korea-Japan BIT follows a similar approach (Article 19). The **Mexico-Korea BIT** in its Article 3 "Treatment of Investments" acknowledges that "this *Agreement shall not be applicable to tax measures*" and that "*Nothing in this Agreement shall affect the rights and obligations of either Contracting Party derived from any tax convention*". It also specifies that "*In the event of any inconsistency between the provisions of this Agreement and any tax convention, the provisions of the latter shall prevail*".

Exceptions to national treatment and MFN treatment related to tax matters are also contained in the **US** and **Canadian Models**. Article 21 of the US Model provides that, except as provided in Article 21 (which only addresses obligations on expropriation and performance requirements), nothing in Section A shall impose obligations with regard to taxation measures and in case of any inconsistency between the Model and any tax convention, that convention shall prevail to the extent of the inconsistency. The Canadian Model follows a very similar approach (Article 16). However it also adds that "*Nothing in this Agreement shall be construed to require a Party to furnish or allow access to information the disclosure of which would be contrary to the Party's law protecting information concerning the taxation affairs of a taxpayer*" (Article 16.2).

4.2. General exceptions

The inclusion of general exceptions clauses in BITs is a relatively new development and would appear to be linked, in certain cases, to the rise of new concerns, especially regarding environmental and labour policies. It also appears that a larger number of agreements now contain clauses on national security or public order although this does not appear to be a general practice.

Neither the new **German**, **French** or **Dutch Models** contain "general" exceptions. It is true that their NT/MFN treatment clauses do not apply to preferential treatment accorded under economic integration agreements or tax matters and that the "Definition" article of the French Model contains a general carve-out for cultural and linguistic diversity. The **Finland Model BIT** provides, on the other hand, an example of a general exception clause for actions taken for the protection of essential security interests "*in time of war or armed conflict, or other emergency in international relations*" as well as the maintenance of public order.

The new **US Model BIT** now contains an essential security clause (Article 18),[30] an exception for prudential measures relating to financial services [Article 20(1)], and certain exceptions for taxation measures (Article 21).

Unlike NAFTA Chapter 11 and the new **US Model BIT**, Article 10 of the **Canadian Model** includes a modified GATT Article XX-like general exceptions provisions that apply to all obligations in the model treaty. These general exceptions cover in measures to protect human, animal or plant life or heath, to ensure compliance with law and for conservation purposes. They also provide carve outs for "*reasonable measures for prudential reasons*", *measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange policies*, actions "*necessary for the protection of essential security interests*" or "*in pursuance of the United Nations Charter for the maintenance of international peace and security*". Paragraph 6 of the same article also provides that the agreement "shall not apply to investments in cultural industries".

The **Japan/Korea BIT** contains a broader article (Article 16) listing various general exceptions a Party may take "*which it considers necessary for the protection of its essential security interests… taken in time of war;… relating to implementation of national policies or international agreements relating to the non-proliferation of weapons;… in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security; necessary to protect human, animal or plant life or health;… for the maintenance of public order… but only where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society*". When taking such measure(s) however, the Party is under the obligation "to notify" the other Party "*prior to or as soon as possible*" thereafter of its nature, motivation and scope application of the measure in question. Article 6 is a *suis generis* exception in respect to the protection of intellectual property rights.[31]

4.3. Country exceptions

For those countries which "admit investment in accordance with their laws and regulations", no special article on country exceptions is to be found in their BITs. This is the general situation for most European BITs. When the

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agreements combine the pre- and post establishment phases, however, they also provide country lists which either describe the sectors or activities which the party is prepared to keep free of restrictive measure (bottom up approach) or those sectors or activities which will remain restricted (top down) after the entry into force of the agreement. Under the latter approach, new activities which may materialise in the future are also *a priori* free unless stated otherwise. The country lists may also reflect new liberalisation commitments. Consistent with OECD's approach under its instruments, it is commonly accepted that the top down approach facilitates broader coverage and provides for greater transparency.

A careful analysis of the regulatory situation prior and after the agreement is nonetheless necessary to identify where the new liberalisation commitments are. This work has not systematically been done in this phase of the stocktaking exercise. Moreover, as a large number of BITs limited to post establishment subject MFN treatment and/or National Treatment to "existing laws and regulations", it would appear that they do not contain, as a general rule, new liberalisation commitments.

> Both the **Canadian** (Article 9) and **US Models** (Article 14) provide for top down lists for existing "non-conforming measures" to the obligations on NT/MFN treatment, key personnel and performance requirements (*i.e.*, transfer, expropriation, minimum standard of treatment obligations are not included). These lists mainly "grandfather" existing non-conforming measures with respect to "sectors, sub-sectors or activities" listed. The prerogative of introducing new non-conforming measures in the future is also provided in a separate list. Annex III of the Canadian Model provides that the MFN treatment obligation does not apply to treatment accorded under existing treaties, and it extends the exception to future treaties, as well, but only to certain specified types of treaties listed in the annex.[32] This means that foreign investors under the new Model cannot reach back and try to obtain protection afforded by previous treaties and it preserves the government room of manoeuvre in future treaties. In addition, both models contain certain derogations in respect of intellectual property rights, government procurement and subsidies and grants.
>
> The **Japan/Korea BIT** (Article 5) also provides that a Party "may maintain any exceptional measure, which exists on the date on which this Agreement comes into force, in the sectors or with respect to the matters specified in an annex (to the Agreement)". But such measures must be notified and motivated and the Party concerned "*shall endeavour to progressively reduce or eliminate*" the measures notified. Another annex prevents the Parties "*to adopt any new exceptional measure in the sectors or with respect to the matters specified in that annex*" except, provided adequate warning and justification, "*in exceptional financial, economic or economic circumstances*".

5. Dispute settlement

In most BITs, two distinct dispute settlement mechanisms are provided: one for disputes between two contracting Parties concerning the application and interpretation of an applicable BIT and another for disputes between the host country and an injured foreign investor.

5.1. *State-State disputes*

Provisions on State-State disputes continue to be provided in all new BITs. The sample of treaties considered in this paper contains very similar provisions in this respect. Namely, any dispute between Parties concerning the interpretation or the application of the treaty has to be resolved through consultations or other diplomatic channels. If that fails, Parties may submit the dispute to arbitration for a binding decision or award by an *ad hoc* tribunal. The arbitration tribunal shall reach its decision by a majority of votes and, the decisions shall be final and legally binding upon both contracting Parties.

In addition, the Belgium-Luxembourg Draft Model provides that in the absence of a settlement through diplomatic channels, the dispute may be submitted to a joint commission consisting of representative of the two Parties. Such commission shall convene without delay at request of the first party to take action. If the commission fails to settle the dispute, then the latter shall be submitted at the request of either Contracting Party to an "arbitration court" (Article 13).

5.2. *Investor-State disputes*

Granting an investor the right to bring autonomously an action in an international tribunal against a State with regard to an investment dispute has been an early common feature of BITs. This mechanism gives practical significance to the treaties and enables them to guarantee an effective protection of investments and foreign investors. Most recent BITs provide a separate international arbitration procedure for the settlement of these disputes, and allow the investor to refer a dispute to international arbitration without requiring prior exhaustion of local remedies or establishing a "fork in the road".

The mechanism works as follows. In the event of an investment dispute, the investor and the State must first try to resolve the conflict thought consultation and negotiation. If that fails, the claimant may submit the dispute to an international arbitration, often under the auspices of the ICSID (International Centre for the Settlement of Investment Disputes).[33] Generally, by concluding a BIT, each Party gives the required consent to submit claims within the scope of the BIT to arbitration and to establish ICSID or other arbitral jurisdiction as set out by the applicable treaty (Article 25 of the US Model BIT, Article 28 of the Canadian Model, Article 12.2 of the Belgium-Luxembourg Model; Article 15.3 of the Japan-Korea BIT and Article 9 of the Mexico-Korea BIT).

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A major survey has recently been conducted under the Committee's auspices on the issue of transparency and third party participation in investor-state dispute settlement procedures[34] and work is continuing on the improvement of investor-state dispute settlement mechanisms.[35] Table 6.3 records a few representative clauses of investor-state dispute settlement schemes in recent BITs.

5.2.1. *Substantive claims*

Article 24.1 of the **US Model BIT** permits a claimant to submit an investor-State arbitration claim on its own behalf or on behalf of an enterprise that is a juridical person that the claimant owns or controls directly or indirectly. Such claim may allege that the respondent State has breached: *a)* an obligation under Articles 3 through 10 (national treatment, MFN treatment, minimum standard of treatment, expropriation, transfers, performance requirements, senior management and boards of directors, publication of laws and decisions respecting investments); *b)* an investment authorisation; and *c)* an investment agreement, and that the claimant (or its enterprise, as the case may be) has incurred loss or damage by reason of, or arising out of, that breach. The Model does not authorize investor-state arbitration over breach of the provisions governing investment and environment and investment and labour. The **Canadian Model** (Articles 22-23) and the **Mexico-Korea BIT** (Article 8) follow a similar approach. The three **European Models** generally refer to "*any dispute concerning investment between an investor*" (or "*a national or company of the other contracting Party*" for the French Model) and the other Contracting Party[36] and together with the **Korea-Japan BIT**, they do not distinguish between claims by an investor of a Party on its own behalf and/or on behalf of an enterprise. This **Korea-Japan BIT** in its Article 15 states that "*For the purpose of this Article, an investment dispute is a dispute between a Contracting Party and an investor of the other Contracting Party that has occurred loss or damage by reason of, or arising out of, an alleged breach of any right conferred by this Agreement with respect to an investment of an investor of that Contracting Party*".

5.2.2. *Fork-in-the-road and exhaustion*

The 1994 US Model in its Article IX(3) a contained a fork-in-road provision specifying that investor-state arbitration under the treaty was not available if the investor had previously submitted the dispute for resolution to courts or administrative tribunals of the host country. The **2004 US Model** BIT modified this approach and provides in Article 26.2 that initiation of arbitration under the BIT forecloses the claimant investor from thereafter initiating or continuing a proceeding before local counts or administrative tribunals of the host State. However, the commencement of, or participation by, the investor in a domestic court or other dispute settlement proceeding no longer precludes

Table 6.3. **Dispute settlement in recent BITs**

	State/State	Investor/State	Specific Investor/State provisions														
			Claims by an investor of a Party on its own behalf and on behalf of an Enterprise	Prior Consent	Waivers of initiating/continuing a proceeding before local courts/non-exhaustion of local remedies	Participation by the non-disputing Party	Transparency (access to filing, minutes, transcriptions and decisions)	Open hearings	Protection of sensitive information	*Amicus curiae* submissions	Monetary awards and no punitive damages	Comment period before effectiveness of awards/delay of enforcement	Enforcement	Interim measures	Experts	Consolidation	Applicable law
German Model	+	+											+				
French Model	+	+															
Belgium-Luxembourg Model	+	+		+	+ (non-exhaustion of host state remedies)								+				
Canadian Model	+	+	+	+	+	+	+	+	+	+	+	+ (delay of enforcement)	+	+	+	+	+
US Model	+	+	+	+	+	+	+	+	+	+	+	+ (delay of enforcement)	+	+	+	+	+
Germany-China BIT	+	+											+				
Germany-India BIT	+	+											+				
Japan-Korea BIT	+	+		+									+		k		
Mexico-Korea BIT	+	+	+	+	+						+	+ (delay of enforcement)	+			+	+

an investor from later pursuing investor-state arbitration under the BIT. Another important aspect of prior and current US. BITs is that the investor is not required to exhaust host country remedies before initiating the investor-state arbitration. This approach is also followed by the **Canadian Model** and the **Mexico-Korea BIT**. The **Korea-Japan BIT** specifies in its Article 15.8 that "*Nothing in this Article shall be construed so as to prevent an investor from seeking judicial or administrative settlement in the territory of the other Contracting Party in dispute*". **The Belgium-Luxembourg Model** requires that prior consent implies that both Parties waive that right to demand that all domestic administrative or judiciary remedies be exhausted (Article 12.2).

5.2.3. Participation and transparency

Only the **US Model BIT** and the **Canadian Model** provide that the BIT non-disputing Party will always be entitled to make oral or written submissions before an investor-state arbitral tribunal regarding the interpretation of the BIT (Article 28.2 of the former and Article 35 of the latter). Thus both Parties will be entitled to be heard by the arbitrators with regard the interpretation of the treaty. In addition to the ability to participate, a joint decision of the Parties declaring their interpretation of a provision of the BIT shall be binding on the tribunal and any decision or award issued by the tribunal must be consistent with this decision (Article 30.3 of the **US Model BIT** and Article 14.2 of **the Mexico-Korea BIT**). The **Canadian Model** follows this approach, (Article 35.1), but like the NAFTA, the Model provides for the establishment of a commission to supervise the implementation of the treaty (Article 27.2). In fact, the commission's interpretation of a provision of the BIT is binding on the tribunal (Article 40.2 of the Canadian Model).

Provisions to promote transparency are only provided by the **US** and **Canadian models**. Tribunals are required to conduct hearings open to the public, subject to the appropriate logistical arrangements. Respondents are required to make available to the public all filings in the arbitration, all minutes or transcriptions of the hearings and all decisions of the tribunal, subject to procedures for protected information (Articles 29 of the US Model and 34 of the Canadian Model).[37] The **Canadian Model** also states in its Article 38.7 that "*the tribunal shall not require a Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the Party's law protecting Cabinet confidences, personal privacy or the financial affairs and accounts of individuals customers of financial institutions, or which it determines to be contrary to its essential security interests*". Article 29.3 of the **US Model BIT** also follows this approach, but it refers to Articles 18 and 19. Under Article 18, protected material may include information about essential security interests. Under Article 19, protected material may include confidential information the disclosure of which would impede law enforcement or otherwise be contrary to the public interests or the disclosure of which would prejudice the legitimate commercial interests of a public or private enterprise. Article 29.4 of the **US Model BIT** provides that if an objection to confidentiality is raised, the arbitral tribunal has authority to determine whether or not information has been properly designated as protected information.

The **US Model BIT** moreover contains a provision concerning amicus curiae submissions: arbitrators are entitled to accept amicus curiae submissions from other interested parties (Article 28.3). The **Canadian Model** also allows submissions by a non-disputing private party. In particular, its Article 39 provides a very detailed procedure for non-disputing individuals and organisations to seek leave to file amicus curiae submission.

5.2.4. Other main issues

Monetary Awards and No punitive damages. The **US** and **Canadian Models** as well as the **Mexico-Korea BIT** provide that an investor-state tribunal constituted under the treaty may only award monetary damages or restitution of property in the final award. If the tribunal awards restitution, its award must also provide for the possibility of pecuniary compensation in lieu thereof where restitution is not practicable. Punitive damages may not be awarded.[38]

Comment period and delay of enforcement. Under Article 28.9 of the **US Model BIT**, the tribunal is required, if requested by any disputant, to forward its proposed award to the disputants and to the non-disputing party for a sixty-day comment period. The apparent aim of this procedure is to permit corrections of errors before the finalization of the award and also to give both treaty Parties the opportunity to make their views known as to the impact of the award on an issue of public interest. Under Article 34.6, enforcement of a final award is subject to a further mandatory time period, after the expiration of which, parties are required to abide by and comply with the award without delay (also Article 15.7 of **the Mexico-Korea BIT** and Article 45.3 of the **Canadian Model**).

Interim measures of protection. The **Canadian Model** contains a provision regarding interim measures of protection. Article 43 provides that a tribunal may order an interim measure of protection to reserve the rights of a disputing party, or to ensure the tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the tribunal's jurisdiction. The provision specifies that for the purpose of this article, an order includes a recommendation. The **US Model BIT** follows a similar approach (Article 28.8). In addition, Article 26.3 of the **US Model BIT** states that even after investor-state arbitration has commenced, "*the claimant or the enterprise… may initiate or continue an action that seek interim injunctive relief and does not involve the payment of monetary damages before a judicial or administrative tribunal of the respondent, provided that the action is* *brought for the sole purpose of preserving the claimant's or the enterprise's rights and interests during the pendency of the arbitration*". That **Canadian Model** contains a similar provision (Article 26.1.e).

Consolidation. A mechanism for consolidation is provided by the **US** and **Canadian Models** and by the **Mexico-Korea BIT**. When two or more claims have been submitted separately and the claims have a question of law or fact in common and arise out of the same events or circumstances, any disputing party may seek consolidation of the separate proceedings into a single proceeding by the new tribunal (Article 33 of the US Model, Article 32 of the Canadian Model and Article 11 of the Mexico-Korea BIT).

Appellate Body. There are no specific appellate provisions in any of the models and BITs under consideration. Provisions of the **US Model BIT** contemplate the possibility of future appellate mechanisms, however. Under Article 28.10, if a multilateral agreement creating an appellate body for investor-state arbitration comes into force, the Parties to the treaty "*shall strive to reach an agreement*" that this body will have appellate jurisdiction to review investor-state arbitration awards under the BIT. In addition, Annex D provides that "*Within three years after the entry into force of this Treaty, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 34 in arbitrations commenced after they establish the appellate body or similar mechanism*".

6. Main findings

For over forty years bilateral investment treaties have been used as a tool for protecting international investment and ensuring a more predictable and fair treatment of investors. By last count, an estimated 1,700 BITs have come into force worldwide, about 80 per cent of which involving OECD countries. In pursuit of a consistency of approach an increasing number of countries have put in place Model BITs serving as a starting point for bilateral negotiations of investment treaties. Others have recently updated and broadened the scope of their existing models. These recent developments can be summarised below.

The pursuit of high standards. The pursuit of high standards in investment policy has historically been a major driving force behind OECD investment agreements. Never before, however, has this quest been so far reaching than that of the OECD agreements negotiated in recent years. This can be assessed by the gradual broadening, deepening and clarification of the scope of application of the substantive and procedural provisions of the agreements, the increased attention paid to regulatory transparency, investment promotion and investment facilitation as well as increased liberalisation. While this movement has largely been led by trade agreements with investment content, it has also spread to innovative new BITs (*e.g.* Japan-Korea and Germany-China).

High standards are spreading worldwide. Developing countries are the main partners of OECD agreements. While diversity can be observed between agreements reflecting different country situations, developing countries' growing adoption of internationally agreed standards is contributing to the propagation of these high standards worldwide. This trend is also contributing to the improvement of countries' domestic investment policies as well as their investment policy capacity.

More public interest safeguards have been introduced. An increasing number of agreements refer to the role of governments to pursue other policy goals. Specific provisions have been incorporated, in particular, that address governments' regulation to pursue certain objectives such as health, safety, the environment and internationally recognized labour standards. This is the case, for example, with respect to BITs recently negotiated by Belgium-Luxembourg. Often these agreements also recognise that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental or labour laws (*e.g.* the preambles of Japan-Korea and Japan-Vietnam BITs).

There is also an increased recourse to various sorts of general exceptions pertaining to taxation, essential security, the protection of human, animal or plant life or health, the conservation of exhaustible natural resources, prudential measures for the financial sector and culture (European BITs, Canadian Model BIT, and US Model BIT as regards essential security). Although not a general practice, greater use is also being made of safeguards affecting transfer obligations to deal with serious short-term balance of payments difficulties (French BIT Model and Japan-Korea BIT).

From the traditional focus of investment protection towards the inclusion of more extensive liberalisation provisions. An important impetus to a recent rise in IIAs standards has emanated from new trade agreements replicated in some BITs (*e.g.* Japan-Korea and Japan-Vietnam and US-Uruguay). Increased liberalisation is also promoted by the wider use of the negative list approach and the increased application of the standstill principle and ratchet effect to country exceptions – which facilitates broader coverage, progressiveness and transparency to liberalisation. Practically all IIAs contain provisions on key personnel while the prohibition of certain performance requirements appears to be less frequent (mainly limited to the US, Canada or Japan IIAs). A relatively large number of BITs covering the post-establishment phase contain regional or economic integration clauses (notably all European BITs).

New attempts have been made to provide greater precision to the asset-based definition of "investment". The broad asset-based definition of investment has now become the norm in recent IIAs. Because of its far reaching implications, however, there has been a move away from a totally open-ended definition so as not to cover operations which are not deemed to be "real" investments.

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Different approaches have emerged. The new US Model has adopted a circular definition which defines "investment" as those assets that have the characteristics of an investment. At the other end, the 2004 Canada Model defines "investment" in terms of a finite list of categories of assets. Other BITs define investment as assets used for economic purposes.

Key investment protection provisions have also been redefined. The new Canadian and US Model BITs define the protection accorded under the "fair and equitable standard" (and "full protection and security") as not going beyond the minimum standard of treatment to aliens in accordance to customary international law. Some other IIAs also link the standard with international law. But the fair and equitable standard is not included in all agreements.

New language has been added to guide the application of the expropriation articles. Virtually all new OECD IIAs contain clauses describing the conditions under which a lawful expropriation may be made and a standard for compensation of the expropriated property. There is a debate, however, on what degree of interference with property rights is required for a government action or a series of government actions to constitute an "indirect", "creeping" or "*de facto*" expropriation. Provisions in the new Canadian and US Model BITs identify criteria on how to distinguish between compensable and non-compensable regulatory actions on a case-by-case basis. The inclusion of interpretative notes and clarifications is concomitant to the growing body of experience with investor/state arbitration.

A more widely shared recognition of the values of transparency. Until recently, transparency requirements were limited to the exchange of information between States. More agreements also include obligations on the publication of laws and decisions respecting investment. They may, in addition, contain provisions to enhance the transparency of the regulatory process and provide a reasonable opportunity to interested investors to be consulted on proposed regulatory changes and to obtain from contacts points information on matters covered by the agreement (as in the 2004 Canada and US Model BITs). These latter obligations are typically not subject to investor-state dispute settlement however, as they do not constitute substantive provisions, a breach of which would establish the proper actionable grounds for an investor-state claim. Nonetheless, the state-to-state dispute settlement procedures may be invoked to consider the proper interpretation or applications of any provision contained in the Agreements.

Investment promotion and facilitation is becoming an important dimension of investment agreements. An increasing larger number of agreements provide for identification of investment opportunities and exchange of information, the establishment of mechanisms for the encouragement and promotion of investment and work towards harmonized and simplified administrative procedures.

Investor-state dispute settlement is becoming more widely accepted. Most recent agreements provide for "prior consent" without "prior exhaustion of local remedies" or establishing a "fork on the road" foreclosing recourse to international arbitration. Furthermore, fewer exceptions are also applied to the ISDS coverage. This can represent a major shift of policy (as in the case of China in the Germany-China BIT).

The cumulative number of known treaty-based cases brought before ICSID or other arbitration facilities under IIAs in the last ten years was estimated at approximately 174 at the end of June 2005 as compared to two at the end of 1994. Well over half of the known claims were filed within the past there years. Almost all of them were initiated by investors. Some claims have involved large sums and the arbitration proceedings costs are usually very high.

Innovations have also been brought to the arbitration process. First, there is concern for greater predictability and control over the arbitration process by means of more detailed guidance on arbitral proceedings and binding interpretations on tribunals. The US Model BIT foresees, in addition, the possibility of creating an appeal mechanism. Second, judicial economy is encouraged by special provisions dealing with frivolous claims, multiple or parallel proceedings or consolidation of claims. Third, increased attention is being given to allowing civil society scrutiny through increased transparency of arbitral proceedings and awards, and the institutionalisation of the possibility of non-disputing parties to make their views known through "amicus curiae" briefs.

Notes

1. A number of 2 500 BITs has been mooted. However, it includes a number of treaties that have been negotiated but not yet ratified.
2. The MAI negotiations and discussions in the Doha Round have provided unique opportunities to reflect on the role and content of investment agreements.
3. *www.dfait-maeci.gc.ca/tna-nac/what_fipa-en.asp*.
4. Regarding foreign investment, the "2002 TPA" stated that "… The principle negotiating objectives of the US… are to reduce or eliminate artificial or trade barriers to foreign investments" and "… to secure for investors important rights comparable to those that will be available under US legal principles and practices…".
5. In accordance with Article 307 of the EC Treaty, member States are obliged to take all appropriate steps to eliminate incompatibilities with the EC Treaty arising from international agreements they have concluded before their accession. Austria's, Denmark's, Finland's and Sweden's BITs provisions permitting the free transfer of funds relating to investments between the signatory countries. In the Commission's view these clauses cut across the EU Council of Ministers' exclusive powers to adopt on behalf of the EU as whole measures on the movement of capital to and from non-EU countries (by virtue of Articles 57.2, 59 and 60 of the EC Treaty). See *http://europa.eu/int:comm/secretariatgeneral/sgb/droitcom/indexen.htm*.

6. Article 31 of the Vienna Convention of the Law of the Treaties notably states: "1) A treaty shall be interpreted in good faith with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose. 2) The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its *preamble* (emphasis added) and annexes…"

7. This section will essentially review provisions in Definition, Scope and Coverage or Application articles.

8. The only significant change in the definition of "investment" in the new model is the exclusion of government issued debt securities.

9. This does not normally apply, however, to investment disputes concerning investments which have arisen before the entry into force of the Agreement. See in particular Article 18 of the 2002 Korea-Mexico BIT.

10. See Article 1 of the 1991 and 2005 German Model; Article 1 of the Germany-China BIT and the Germany-India BIT/Article 1 of the 2003 Indian Model.

11. This article reads: "'Investors' means any national or company of a Contracting Party".

12. "Covered investment" means, with respect to a Party, an investment in its territory of an investor of the other Party "in existence as of the date of entry into force [of the BIT] or established, acquired, or expanded thereafter".

13. See "*Relationships between International Investment Agreements*", OECD Working Paper on International Investment 2004(1), *www.oecd.org/dataoecd/8/43/31784519.pdf*.

14. Article 11 of that BIT also states that provided otherwise, all investments shall be governed by the laws in force in the territory of the Contracting Party in which such investment are made.

15. In the Canadian Model (Article 19), the publication is subject to the qualification "to the extent possible".

16. Under Article 6.1, a Party may not require that an enterprise of that Party, that is a covered investment, appoint to senior management positions individuals of any particular nationally. Under Article 6.2, a Party may require that a majority of the board of directors of an enterprise that is a covered investment be of a particular nationality or resident in the territory of that Party, provided the requirement does not materially impair the ability of the investor to exercise control over its investment.

17. Article VII of the 1994 Draft Model provides as follows: "1.(a) Subject to its laws relating to the entry and sojourn 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 or other resources…"

18. For further reference see the 1967 OECD BIT Model.

19. See *Fair and Equitable Standard in International Investment Law*, OECD Working Paper on International Investment 2004/3, *www.oecd.org/dataoecd/22/53/33776498.pdf*.

20. For the text of the new FIPA model see *www.dfait-maeci.gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf*.

21. Dolzer and Stevens, "Bilateral Investment Treaties", ICSID 1995, Chapter four.

22. A majority of BITs subscribe to the "Hull" formula of "prompt, adequate and effective compensation".

23. See footnote 37, p. 7.
24. See "*Indirect Expropriation and the Right to Regulate in International Investment Law*", OECD Working Papers on International Investment 2004(4), *www.oecd.org/dataoecd/22/54/33776546.pdf*.
25. There may be variations in BITs contracted. For example, Article 5 of the Germany-India BIT uses the term for *public purpose* as the justification. The Germany-China BIT incorporates the provision on most-favoured nation treatment but not in the Germany-India BIT. The Germany-China BIT and the Germany-India BIT include an independent requirement that expropriations be subject to judicial review.
26. This provision states that: "The Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, 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".
27. Annex A (Customary International Law) also refers to Annex B (Expropriation). It confirms the Parties understanding that "customary international law" … as specified in Annex B "results from a general and consistent practice of States that they follow from a sense of legal obligation".
28. According to Article 31 of the Vienna Convention of the Law of Treaties, the proper interpretation of an umbrella clause depends on the specific wording of the particular treaty, its ordinary meaning, context, the object and purpose of the treaty as well as on negotiating history or other indications of the parties' intent.
29. In former Models such a clause typically reads as: "*Each Party shall observe any obligation it may have entered into with regard to investments*".
30. This clause states that "Nothing in the treaty shall be construed to preclude a party form applying measures that it considers necessary for the fulfilment of its obligations with respect to the maintenance of restoration of international peace or security, or the protection of its own essential security interests".
31. It specifically provides that nothing in the agreement shall be construed so as to derogate from international rights and obligations in respect to the protection of intellectual property rights or to oblige any Party to extent treatment to third party foreseen in international agreements in respect of the protection of intellectual property rights.
32. This provision seems to prevent the treaty shopping situation which arose under the Maffezini v. The Kingdom of Spain (2001). See Andrew Newcome, *op. cit*.
33. For example, the Mexico-Korea BIT in its Article 8 contains a standard formula: "A disputing investor may submit the claim to arbitration under:
    a) The Convention on the Settlement of Investments Disputes between States and Nationals of other States (ICSID Convention) provided that both the disputing Party and the Contracting Party of the investor are parties to the Convention;
    b) the Additional Facility Rules of ICSID, provided that either the disputing Contracting Party or the Contracting Party of the Investor, but not both, is a party to the ICSID Convention; or
    c) the Rules of arbitration of the United Nations Commission on International Trade Law (UNCITRAL Arbitration Rules)."

    This formula is included in most BITs. Some treaties also adds that if the claimant and respondent agree, the dispute may be submitted to any the arbitration institution or under any other arbitration rules (for example the US Model BIT, the

Canadian Model, the Korea-Japan BIT). The Belgium-Luxembourg Model also refers to other two institutions: the Arbitral Court of the International Chamber of Commerce in Paris and the Arbitration Institute of the Chamber of Commerce in Stockholm (Article 12.3).

34. See "*Transparency and Third Party Participation in Investor-State Dispute Settlement Procedures*", OECD Working Paper on International Investment 2005/1, *www.oecd.org/dataoecd/25/3/34786913.pdf*.

35. See "*Improving the System of Investor-State Dispute Settlement: An Overview*", OECD Working Paper on International Investment 2006/1, *www.oecd.org/dataoecd/3/59/36052284.pdf*.

36. Article 11 (model I-II) of the German Model and Article 9 of the German BITs with China and India; Article 7 of the French Model; Article 12 of the Belgium-Luxembourg Model.

37. Article 34.1 of the Canadian Model refers to the "evidence that has been tendered to the Tribunal; *b)* copies of all pleadings filed in the arbitration; and *c)* the written argument of the disputing parties…".

38. Article 34.1,4 of the US Model BIT; Article 44.1,3 of the Canadian Model; Article 15.1,4 of the Mexico-Korea BIT.

ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART II

Chapter 7

Improving the System of Investor-state Dispute Settlement: An Overview*

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Introduction

Investor-state dispute settlement mechanisms embodied in most investment treaties provide rights to foreign investors to seek redress for damages arising out of alleged breaches by host governments of investment-related obligations. The system of investment dispute settlement has borrowed its main elements from the system of commercial arbitration despite the fact that investor-state disputes often raise public interest issues which are usually absent from international commercial arbitration. Investor-state arbitration may often call for reconciliation of public international law doctrines with the private legal principles of contract law. This hybrid source of rights is generating new questions and in particular challenges relating to the quality of awards and jurisdictional issues.

Investment arbitration has expanded in the past decade thanks in part to the more than 2500 BITs now in place around the world as well as the recently concluded Free Trade Agreements, the NAFTA and other regional and multilateral investment treaties such as the Energy Charter Treaty. As the number of investment agreements has risen, the cases brought to dispute settlement have become increasingly complex too, encompassing multiple contracts and hence multiple parties and issues. The multiplication of investment agreements with investor-state dispute settlement provisions has raised the risk of multiple and conflicting awards, as the same dispute can lead to awards under different treaty regimes, as well as under different contracts. The more options parties have to resolve their international disputes in different fora, the greater the risk of multiple and conflicting awards.

Although the experience up to now does not show major inconsistencies among arbitral awards, addressing cross-cutting provisions, some decisions considered inconsistent by certain parties and the evolving landscape in investment arbitration led to discussions within the OECD Investment Committee as well as in the context of the International Centre for the Settlement of Investment Disputes (ICSID) on the possibility of the creation of an appeal mechanism. Discussions on establishing an appeal mechanism were not conclusive at this stage but some ideas emerged for the improvement of the system, in particular by enhancing the uniformity in the review process. Although strengthening of transparency was one of the main measures proposed for the improvement of the system, it will not be discussed in this note since it has been the subject of a stand alone, detailed survey[1] and a public statement by the OECD Investment Committee.

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The present paper: *i)* deals with issues related to the quality of arbitral awards; *ii)* examines issues related to multiple and parallel proceedings; and *iii)* deals with challenges of jurisdictional nature. In this examination of issues, some proposals were made for possible improvement of the system of investment arbitration.

1. Dealing with issues of quality of awards

There are a number of procedures addressing the quality of arbitral awards. The main procedure for challenging an award is the procedure to review or set aside the final award. The review, which is different for ICSID Convention and non-ICSID Convention awards, is based on limited grounds and does not have as broad a potential scope as an appeal.

Another procedure used to help assure the quality of awards is the independent "scrutiny" of draft awards, before they are final, which is a unique feature of the International Court of Arbitration. It does not correspond to a review but constitutes an additional layer of quality control. It currently applies only to disputes brought under the International Chamber of Commerce, which include also a limited number of investment disputes.

This section describes the current system of review for both ICSID and non-ICSID awards, including the discussion on the feasibility of a proposal to create an Additional Annulment Facility in the context of ICSID; summarises the discussion on the feasibility of an appeal mechanism and explores the possibility of the application of the "scrutiny" procedure to investment arbitration outside the ICC.

1.1. Review of awards: the current system and a proposal

Review of arbitral awards is designed to preserve the interests of the Parties. Where a defeated Party is dissatisfied with the arbitral Tribunal's award, it may seek to set it aside. The possibilities of challenging the award differ according to the system of arbitration chosen by the Parties, institutional or *ad hoc*. Although the ICSID Convention system prevents domestic courts from reviewing any of its decisions, recourse to any other kind of arbitration gives a prominent role to national courts which may have a local bias or be subject to the influence of the host government.

1.1.1. The ICSID Convention Arbitration

The ICSID Convention mechanism is self-contained, providing for internal control which includes provisions on the interpretation, revision and annulment of awards. These provisions allow either Party to request a review of the award of an ICSID Tribunal when:

- The dispute concerns the meaning or scope of the award (interpretation of awards by the same or a new tribunal, Article 50 of the Convention).

- New facts have emerged which may affect the award decisively and were unknown to the tribunal and to the party seeking to introduce these facts; the latter's ignorance was not due to negligence (revision of awards by the same or a new tribunal, Article 51 of the ICSID Convention). The new elements must be ones of fact and not law and the facts must be of such a nature that they would have led to a different decision had they been known to the tribunal.[2]
- Either party can ask for the annulment of the award by a separate *ad hoc* Committee (Article 52 of the ICSID Convention). The *ad hoc* Committee can only annul the decision of the Tribunal under one or more of the following narrow grounds:
  - the Tribunal was not properly constituted;
  - the Tribunal has manifestly exceeded its powers;
  - there was corruption on the part of a member of the Tribunal;
  - there has been a serious departure from a fundamental rule of procedure; or
  - the award has failed to state the reasons on which it is based.

Eight requests for annulment had been registered with ICSID until 2004.[3] These requests involved *Klöckner v. Cameroon* (twice),[4] *Amco v. Indonesia* (twice),[5] *MINE v. Guinea*[6] *SPP v. Egypt*,[7] *Wena Hotels v. Egypt*,[8] *Vivendi v. Argentina*.[9] In 2004 and 2005, eight new annulment requests were registered.[10] Annulment of an arbitral award can also lead to submission of the dispute to a new Tribunal. For example, Vivendi has been resubmitted to a new tribunal. Wena Hotels is subject to a request for interpretation.

The decisions rendered by the *ad hoc* Annulment Committees have usually involved the same grounds: manifest excess of powers, serious departure from a fundamental rule of procedure and failure to state reasons. Despite the criticisms of this procedure after the first few cases, the system seems currently to work well and to meet the satisfaction of most arbitrators and clients.

Annulment is different than appeal. This is apparent from Article 53 which provides that the award shall not be subject to any appeal or to any other remedy except those provided for in the Convention. Moreover, it does not extend beyond the closed list of grounds to errors on the merits, *i.e.* errors of law or fact in the award. The result of a successful annulment procedure is the invalidation of the original decision; in contrast, an appeal may result in the modification of the decision.[11] In theory, an appellate body could substitute its own decision for that of the first tribunal or require that tribunal to rectify its mistakes.

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1.1.2. Non-ICSID Convention arbitration

Where arbitration is not conducted under the ICSID Convention, awards or their enforcement can be challenged under the commercial arbitration framework established by national law, the New York Convention and other relevant treaties. Therefore, the national law at the place of arbitration controls the losing party's request to set aside the award, or as the case may be, to refuse enforcement.

National arbitration laws prescribe various grounds on which arbitration awards can be challenged. Most modern arbitration statutes provide a limited list of grounds for review and many follow the 1985 UNCITRAL Model Law on International Commercial Arbitration which generally track the list of grounds for non-enforcement of awards contained in Article V of the New York Convention: 1) incapacity of the parties to enter into the arbitration agreement or invalidity of the arbitration agreement; 2) lack of proper notice to a party or incapacity to present its case; 3) inclusion in the award of matters outside the scope of submission; 4) irregularities in the composition of the tribunal or the arbitral procedure; 5) non-arbitrability of the subject matter and 6) violation of domestic public policy.

In practice, the most common grounds found by the courts as a reason for set-aside or non-enforcement, are that arbitrators had decided issues outside the scope of their authority or that the award violates public policy.[12]

In most countries, the grounds for vacating arbitral awards are mandatory: the parties cannot contract around them. In some countries however, the grounds for vacating international arbitration awards are default rules, at least for arbitrations involving foreign parties.[13]

However, an award set aside or vacated at the place of arbitration could be enforceable under other jurisdictions. Because the New York Convention exception to enforcement based on set aside or *vacatur* at the place of arbitration is worded permissively, some courts have enforced awards that were set aside in foreign courts.[14]

While most countries have implemented legislation that limits the grounds on which an award may be set aside, the opportunity remains in some cases to reopen the merits of the case, either by application of a broad arbitration statute or broad interpretation of a narrow one.[15]

1.1.3. An Additional Annulment Facility: a proposal

As mentioned above, the self-contained ICSID mechanism provides for Annulment of ICSID awards by *ad hoc* Annulment Committees. This mechanism applies however, only to ICSID awards between Washington Convention Parties

(142 today). Any revision of a non-ICSID award, *e.g.*, an award under the ICSID Additional Facility Rules or under the UNCITRAL Rules, is in the hands of national courts under national arbitration laws and the New York Convention provisions.

For countries which are not Parties to the Washington Convention, ICSID provides for Additional Facility Rules which authorise the Secretariat of ICSID to administer certain categories of proceedings between States and nationals of other States that fall outside the scope of the ICSID Convention. These are: *i)* fact-finding proceedings; *ii)* conciliation or arbitration proceedings for the settlement of investment disputes between parties one of which is not a Contracting State or a national of a Contracting State; and *iii)* conciliation and arbitration proceedings between parties at least one of which is a Contracting State or a national of a Contracting State for the settlement of disputes that do not arise directly out of an investment, provided that the underlying transaction is not an ordinary commercial transaction. These Rules have been adopted by the Administrative Council.

By adopting and applying these Additional Facility Rules, ICSID has created a certain form of uniformity at least in the administration of disputes handled by the Centre. One proposal would be to extend this uniformity at the review level by creating an Additional Annulment Facility that could be used as an adjunct to whatever arbitration rules are applicable.[16]

By doing so, non-ICSID members would also have access to the self-contained ICSID system of Annulment and any request for review would be submitted to an *ad hoc* Annulment Committee instead of national courts. Hence, it may limit the number of cases submitted for review to national courts and could serve one of the main purposes of investment arbitration: investor-State disputes would be resolved all way by means of mechanisms governed by international standards and procedures rather than these of the host State and its domestic courts.

This proposal has been seen as an interesting way to achieve some of the quality control sought by the proponents of an appeals mechanism, though with considerably narrower scope. It remains however an open question whether creation of such an Additional Annulment Facility could be accomplished simply by the drafting of rules that would be adopted by ICSID's Administrative Council. It would also need to be examined whether an arbitral award under such rules be effectively shielded from set-aside or annulment procedures under the arbitral law of the seat of the arbitration without some provision being made in the domestic arbitration law, *e.g.* pursuant to a treaty.

This proposal raises a number of other questions. What would be the case for example of awards issued under NAFTA which in its Article 1136 explicitly contemplates set aside proceedings under domestic law? Could the Additional Annulment Facility be made the exclusive annulment option for

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arbitration under the Additional Facility Rules and if so, would this be only with regard to future consent to arbitration under these Rules or should the possibility be explored of extending it to existing consents? An option would be the drafting of an optional set of rules requiring other statutory, treaty-or contractual based demonstrations of consent.

However, because of all the questions rose above as well as the limited need for reforming the existing system this is not considered at this stage, a desirable improvement measure.

1.2. The discussion on an appeals mechanism

One of the advantages of investment arbitration for foreign investors are that investor-State disputes are resolved by means of mechanisms governed by international standards and procedures and do not rely on standards of the host State and the domestic courts. The finality of arbitration proceedings, *i.e.*, that an arbitration award is binding and not subject to appeal on the merits, has generally been seen as an advantage over judicial settlement.

There is a view, however, that though finality is one of the main advantages of international arbitration – for the savings it brings in costs and time – it may sometime come at the risk of having to live with flawed or inconsistent awards on the same or very similar questions or facts. Discussion on the possibility of appeal for investment disputes started among scholars as far back as the early 90s[17] while the first discussion at the governmental level took place during the MAI negotiations.[18] Some countries have recently decided to develop an appeal mechanism for investment disputes and have inserted specific provisions regarding such a mechanism in their investment agreements. By mid-2005, several countries have signed treaties with provisions concerning an appeal mechanism.[19]

As a result, governments and legal experts have debated its possible advantages and disadvantages in investor-state arbitration. The OECD Investment Committee and ICSID held a joint meeting of legal experts in order to get the reaction of arbitrators on this issue. The discussions focused on: *i)* developments with respect to the creation of an appeal mechanism and the possible consequences, if any, for the OECD member countries; and *ii)* the rationale for creating such a mechanism, *i.e.* its advantages and disadvantages.

1.2.1. Developments regarding an appeal mechanism in new investment agreements and their possible consequences

The US Trade Act of 2002, which granted trade promotion authority to the Executive Branch of the US Government[20] and has been the basis for the conclusion of several recent US Free Trade Agreements, set down a number of objectives with respect to foreign investment.[21] These included a negotiating objective of an appellate mechanism for investment disputes under free trade agreements:[22] "… providing for an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions in trade agreements…".

As a result of this Act, the following specific language on an appellate mechanism was inserted in the recent US Free Trade Agreements with Chile,[23] Singapore[24] and Morocco,[25] and the 2004 US Model BIT.[26]

Within three years after the date of entry into force of this Agreement, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under article… in arbitrations commenced after they establish the appellate body or similar mechanism.

More recently, the language of the US-Dominican Republic-Central America FTA,[27] – the US FTA with five Central American countries and the Dominican Republic – sets out a very specific schedule for establishing a Negotiating Group to advance the development of an appellate body, and a number of issues to be considered:

"Within three months of the date of entry into force of this Agreement, the Commission shall establish a Negotiating Group to develop an appellate body or similar mechanism to review awards rendered by tribunals under this chapter. Such appellate body or similar mechanism shall be designed to provide coherence to the interpretation of investment provisions in the Agreement. The Commission shall direct the Negotiating Group to take into account the following issues, among others:

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 may be selected under Articles 10.16 and 10.25; 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 Commission shall direct the Negotiating Group to provide to the Commission, within one year of establishment of the Negotiating Group, a draft amendment to the Agreement that establishes an appellate body or similar mechanism. On approval of the draft amendment by the Parties, in accordance with Article 22.2 (Amendments), the Agreement shall be so amended."

Any future decisions by the parties to such agreements to establish such an appellate body or similar mechanism would mean in practice the creation of an *ad hoc* appeal tribunal under each such treaty. Alternatively, one single, preferably institutionally-managed and widely-accepted appeals mechanism could be created. Concerned with a risk of fragmentation of the dispute settlement system that could ensue under the first scenario and may itself affect the consistency of law, ICSID had offered some ideas on the creation of an optional ICSID Appeals Facility, established and operated under a set of Appeals Facility Rules.

It is possible that some appeal mechanism on investment disputes may become operational within a short period of time. Although only a few countries are currently addressing the idea of an appellate mechanism in their agreements, their actions may have implications for others. Such implications may increase if an appellate mechanism becomes a reality and begins to issue decisions. The decisions of such an appeal body would have legal implications and an influence on the traditional case law; they could create precedents. There could be perceptions that these are higher level tribunals whose decisions should have a higher precedential value, although in essence they will be issued from the same legal community as the first instance arbitral tribunals. They could also have political implications, since the availability of such a mechanism in some countries could encourage constituencies in other countries to ask forcefully for such a mechanism in their own agreements.

There has been also a concern that certain Most Favoured Nation clauses might bring an appeal mechanism into play under treaties that had not envisaged appeal. The parties to existing and new BITs will therefore need to consider the potential interaction between their investment agreements and any future appellate mechanism to which they may decide to subscribe.

The experts consulted were overwhelmingly of the view that, even though they were not all convinced of the objective necessity of an appeals mechanism for investor-state awards, if some countries were ready to establish one, it would be better by far to have a single mechanism.

1.2.2. Why an appeal mechanism in investment disputes? Advantages and disadvantages

There was a vivid discussion among the legal community over the advantages and disadvantages of an appellate mechanism. It is however difficult to dissociate the rationale for appeal from the approach to be taken *vis-à-vis* the specific modalities of such an appeal mechanism.

i) Advantages. The main advantages put forward in discussions were consistency, the possibility of rectification of legal errors and, possibly serious errors of fact, the fact that the review would be confined to a neutral tribunal instead of national courts and that it would enhance effective enforcement.

- Consistency

  One of the main advantages for the creation of an appellate mechanism advanced by its proponents is consistency. Consistency and coherence of jurisprudence create predictability and enhance the legitimacy of the system of investment arbitration. The inconsistent decisions based on the same or similar facts rendered for instance in the *CME v. Czech Republic*[28] and *Lauder v Czech Republic*[29] cases have attracted widespread attention. While there is no guarantee that the inconsistencies would have been avoided if these awards had been submitted subsequently to an appeal, the chances for consistency would be reinforced by the existence of a common appeals body which would handle not only ICSID awards, but also UNCITRAL awards and awards rendered by ICC, SCC and other *ad hoc* arbitral tribunals.

  The notion of consistency has been viewed to go beyond the situation when two panels constituted under different agreements deal with the same set of facts and give conflicting opinions or reach a different conclusion. It might also encompass coherence of interpretation of basic principles which may underlie differently worded provisions in particular agreements and therefore might enhance the development of a more consistent international investment law. However, it was also pointed out that one needs to approach the question of consistency with some caution and clarity in terms of one's objectives. For example, the discussions in the OECD Investment Committee on the substantive obligations in investment agreements has revealed that countries' intent with respect to the interpretation of a similar provision in their investment agreements may differ in some respects. Thus, the development of consistent international legal principles needs to be balanced by respect for the intent of the parties to specific agreements. Even where the intent of the countries may differ in some respects in relation to similar provisions in their investment agreements, it was argued that, there is value in encouraging consistency in interpretation across the agreements of a particular country or countries where the intent of the parties do not differ.

  Finally, an appellate mechanism could provide a more uniform and coherent means for challenging awards if traditional bases for annulment were incorporated and it became the exclusive means to challenge an award.

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- Rectification of legal errors and possibly serious errors of fact

  Another possible advantage is to allay public concern that awards affecting important public policy issues and interests could be enforced despite serious error. This could enhance support for investor-state arbitration at a time of growing numbers of cases.

- Review confined to a neutral tribunal *versus* national courts

  While arbitral awards may not be appealed on the merits under the current arbitration system, the system reserves a limited but real role for national courts in reviewing the non-ICSID awards. There was some concern that, in some instances, national courts are exceeding their authority to review awards, thereby compromising a central advantage of international arbitration.

  The creation of an appeal mechanism would uphold the principal advantage of investor-state dispute settlement: the review of investment awards, in particular those outside the ICSID system, *i.e.* under UNCITRAL and the ICSID Additional Facility Rules, would be confined to neutral and qualified tribunals which would operate on the basis of international standards and procedures instead of taking place in domestic courts which may have a local bias or be subject to governmental influences.

- Effective enforcement

  Under the current system, for ICSID awards there is a treaty obligation to recognise, which extends to the entire award[30] and an obligation to enforce,[31] which extends only to the pecuniary obligations imposed by the award. The enforcement provision is a distinctive feature of the ICSID Convention. Most other instruments governing international adjudication do not cover enforcement but leave the issue to domestic laws or applicable treaties.[32] Therefore, non-ICSID awards are enforceable under the normal rules governing the recognition and enforcement of arbitral awards established by national law, the New York Convention and other relevant treaties, which give the principal role to domestic courts. Under the New York Convention, the national court could refuse to honour an award.[33]

  In the discussions on creating an appellate mechanism, it was suggested that this might enhance the expeditious and effective enforcement of awards if a respondent that appealed were required to post a bond in the amount of the award and if appeal decisions were excluded from domestic court review.

ii) Disadvantages. The main disadvantages discussed were that an appeal would go against the principle of finality, would bring additional delays, costs and caseload and lead to the politicisation of the system.

- Against the principle of finality

  The finality of arbitration proceedings, *i.e.*, that an arbitration award is binding and not open to appeal on the merits, has generally been seen as one of the major advantages of arbitration over judicial settlement. The "final" award puts an end to the parties' conflict and related dispute settlement expenses in a limited period of time.

  To the extent the appeal mechanism expands the grounds currently available for annulment or set aside of an award, it would compromise the finality of arbitration. However, there was a view that investment arbitration involves issues of public interest which make the acceptance of the risk of flawed or erroneous decisions less justifiable in the name of finality than it may be in traditional commercial arbitration.

- Additional delays and costs

  The existence of an appeal mechanism could result in additional costs and delays in the resolution process. With respect to delays, however, there was a view that there are already considerable delays in the set aside proceedings under the national court systems which given the existence of different layers of appeal (first instance, appeal court, supreme courts), could take years before a final decision is rendered.

  It was also proposed that this potential problem could be limited by setting specific time limits in the appellate process.

  Another aspect affecting the potential delay and cost of an appeal mechanism was the scope of the review. It was the clear consensus of nearly all the experts that an appeal limited to pure questions of law and excluding review for even serious error of fact would be less potentially costly and time consuming.

- Additional caseload

  By including additional grounds to the ones under the current annulment and review procedures, an appeal in investment disputes could result in a greater number of challenges to arbitral awards. There was a concern that there would be a tendency to appeal in every case, which would result in decreasing confidence in the main body of decisions and the authority of the "first instance" arbitrators.

  On this point, it was argued that it might be possible to negotiate a balance of disincentives to appeal such as the requirement of the deposit of a bond to secure the award or the costs of the proceedings which would discourage routine resort to appeal.

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- Politicisation of the system

  There was a concern that the de-politicisation of investment disputes, considered one of the main achievements of investor-to-state arbitration, could be undermined. There was a view that governments, to please to their constituencies, are likely to appeal on every case they lose in the first instance and they would be the main beneficiaries of the system. In addition, it was argued that if the choice of appellate arbitrators is made by the states only, there is a risk of bias against investors.

  However, a number of arguments have been advanced about the benefits investors could draw from the creation of an appeals mechanism. First, statistically investors lose at least as often as governments, so they would have at least the same opportunity to appeal. Second, the posting of a bond would provide a security for the investor of the amount of the award rendered, which, as noted, can be of particular significance for non-ICSID arbitration. Finally, it was proposed that different solutions could be envisaged for the choice of arbitrators so to ensure neutrality of the system.

  The review of the advantages and disadvantages produced no consensus on the merits of adding an appeal to the investor-state dispute settlement system. Considering the ICSID proposal on this matter, its Administrative Council and most of those who offered comments, expressed the view that it would be premature to attempt to establish such an ICSID mechanism at this stage, particularly in view of the difficult technical and policy issues raised. The ICSID Secretariat, will continue however to study such issues to assist member countries when and if it is decided to proceed towards the establishment of an ICSID appeal mechanism.[34]

1.3. Scrutiny of awards

Under most rules for investment arbitration, there is no layer of quality control of the award until the final award has been issued and may then be subject to the review procedure – either set aside by national courts or the ICSID Annulment procedure. In the context of international commercial arbitration, the ICC International Court of Arbitration Rules provide for a unique feature of quality control named "scrutiny of awards by the Court". In the investor-state dispute settlement context, a somewhat similar procedure was introduced by the United States in its model BIT and in the investment chapters of its recent FTAs.

1.3.1. The ICC Court of Arbitration Procedure

This mechanism constitutes one of the essential features of ICC arbitration procedure and is appreciated by most ICC arbitration users, including arbitrators.[35]

Article 27 of the Rules reads:

"Scrutiny of the Award by the Court:

Before signing any Award, the Arbitral Tribunal shall submit it in draft form to the Court. The Court may lay down modifications as to the form of the Award and, without affecting the Arbitral Tribunal's liberty of decision, may also draw its attention to points of substance. No Award shall be rendered by the Arbitral Tribunal until it has been approved by the Court as to its form."

Article 6 of Appendix II to the Rules reads:

"Scrutiny of Arbitral Awards:

When the Court scrutinises draft Awards in accordance with Article 27 of the Rules, it considers, to the extent practicable, the requirements of mandatory law at the place of arbitration."

The procedure. The purpose of the scrutiny is to avoid the risk of an ICC award containing a serious formal defect. The Court checks whether the draft award rules on all the claims, includes an operative part, and gives all the reasons for the arbitral tribunal's decisions.[36]

The first step is submission by the Tribunal of a draft award to the Counsel in charge of supervising the arbitration within the Secretariat of the Court.[37] After studying the proposed draft the Counsel discusses some of the points with the president of the arbitral tribunal, who decides whether any changes should be made before the draft award is submitted to the Court. The Counsel then prepares a written report describing the arbitration in general terms and noting any obvious mistakes. The Court designates a Reporter from amongst its members who is charged with preparing a separate report. This report is submitted, along with the Counsel's report and the draft Award, to one of the Court's weekly Committee Sessions or, when the Awards involve large amounts in dispute, particularly complex or novel legal issues, state parties or dissenting opinions, to the Court's monthly Plenary Sessions. The Court, after discussion, either accepts the award as submitted or decides to return it to the arbitral tribunal requiring modification as to the form and/or drawing the Tribunal's attention to points of substance without affecting the latter's freedom of decision.

Modification as to the form means that the award is approved only after the arbitral tribunal has made the required modifications. No award may be notified to the parties until the arbitral tribunal has made the formal modification laid down by the Court.

The Court does not have the power to require the arbitral tribunal to make changes to the substance of the draft award[38] but it may draw the tribunal's attention to "points of substance". For instance, it may draw its attention to the fact that an award contains reasons which contradict each other and could make it partly incomprehensible. The Court could also point out that the tribunal has ruled "*ultra petita*" *i.e.*, it has decided on a point that did not form part of the claims or awarded amounts above those requested. It may further draw the arbitral tribunal's attention to compulsory statutes of limitation in a given country which may affect the enforcement of the award. The arbitral tribunal is free to ignore the Court's comments and the Court may not refuse to approve the draft award on this basis.

The scrutiny process is designed to take approximately two weeks from the date the Secretariat receives the draft award. This time can vary depending on whether the draft award needs to be translated, whether it is to be submitted to a Committee or to Plenary Session, the condition of the draft and the responsiveness of the arbitral tribunal in making any requested changes.

Its application to investment arbitration. Although the International Court of Arbitration sees some investor-state disputes, these do not constitute the majority of its load. The question is whether it would be desirable to try to apply this system of scrutiny to a greater number of investment arbitration cases which fall mainly under ICSID and to a lesser extent to other arbitration institutions. It will not apply to *ad hoc* arbitration since scrutiny needs an institution.

As practiced in ICC, scrutiny requires an experienced and well-trained Secretariat and an independent, permanent judicial body – to mirror the Court of Arbitration. ICSID has an experienced Secretariat but lacks the judicial body to carry the scrutiny process forward. Any establishment of such a body would likely require the amendment of a set of ICSID Rules (Arbitration or Administrative Rules) and subsequently approval by the Administrative Council.

Although there is value in this procedure in the context of the ICC arbitration, applying scrutiny to investment arbitration would require an important systemic change which was neither feasible nor justified under the circumstances.

1.3.2. The review of/ or comments by the disputing parties on draft awards

The 2004 US Model BIT[39] and the US FTAs with Central America-Dominican Republic,[40] Chile[41] and Morocco,[42] under the heading "conduct of arbitration", provide for a procedure of review/comment of the award by the disputing parties before it becomes final. According to this provision:

"*In any arbitration conducted under this section, at the request of a disputing party, a tribunal shall, before issuing a decision or award on liability, transmit its proposed decision or award to the disputing parties and to the non-disputing Party. Within 60 days after the tribunal transmits its proposed decision or award,* *the disputing parties may submit written comments to the tribunal concerning any aspect of its proposed decision or award. The tribunal shall consider any such comments and issue its decision or award not later than 45 days after the expiration of the 60-day comment period.*"

2. Multiple and parallel proceedings

As a result of the larger number of BITs currently in place, and the increasing globalisation of production and investment, investors seeking to pursue claims for damages often have a choice of fora, *i.e.* either of different arbitration regimes or of arbitration or a national court. Corporations are reported to begin structuring their transactions in such a way as to be able to benefit from the provisions of different BITs. The "Czech cases" (*CME/Lauder v. the Czech Republic*), and the approximately 40 cases currently pending against Argentina and arising from the same events demonstrate the increasing complexity of fora decisions.

Investors are sometimes able to claim breaches of different BITs and to seek relief through different arbitration proceedings under each of the invoked treaties in respect of a single investment and regarding the same facts, which could lead to parallel proceedings and potentially conflicting awards. This result is due to the fact that many, if not most BITS, protect not only investments made by nationals, individual and corporations of one state directly into the other state, but also investments made indirectly through a company established in one party but controlled by an investor in a non-party. Investors who are minority shareholders may be able to bring claims, too. A particular company may have minority shareholders of various nationalities. Hence, the host state may face multiple arbitrations under different BITs in relation to essentially the same set of facts. This section looks at issues related to forum shopping and multiple and parallel proceedings and at the consolidation of claims as a proposed avenue for the avoidance of possible inconsistent and conflicting awards emanating from the multiplicity of proceedings.

2.1. Multiple proceedings

The most striking example of multiple proceedings emanating from the same single set of events by one government is the number of cases brought to ICSID against Argentina. There are approximately 40 ICSID proceedings today against Argentina. The vast majority were initiated in the months following the December 2001 devaluation of the Argentine peso. At that time, by a set of laws and decrees related to what Argentina has described as a public economic emergency and by amendment of the exchange rate system, Argentina ended the regime of convertibility and parity of the Argentine peso with the US dollar which had been in effect since 1991. The majority of the proceedings concern

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utilities and related service sectors (*e.g.* water, gas and energy distribution, telephone companies) and extractive industries sector (oil concessions). In the first award rendered *CMS Gas Transmission Company v. The Argentine Republic* (May 12, 2005),[43] the Tribunal dismissed CMS's expropriation claim but upheld CMS's claim for violations of fair and equitable treatment under Article II(2) of the Treaty and awarded compensation in the amount of $133 million, plus interest. On 8 September 2005, Argentina filed for Annulment pursuant to Article 52 of the ICSID Convention based on two grounds: that the Tribunal manifestly exceeded its powers [Article 52(1)(b)] and that the Awards failed to state the reasons on which it was based [Article 52(1)(e)].[44]

All the ICISD proceedings involving Argentina have been initiated on the basis of BITs concluded in the 1990s mainly with G7 countries but also with countries in Latin America, Eastern Europe, Africa and Asia. There is a legitimate concern that multiple cases brought against a single country based on a single measure could be a major source of inconsistent awards.

In recent arbitration cases a broad notion has been emerging of what constitutes an "investor" and "investment". Foreign corporations frequently establish local ventures as indirect subsidiaries, incorporated in the Host state and held in a multi-tier arrangement. The tribunal in *CMS v. Argentina*[45] was the first to recognise that non-controlling minority shareholdings constitute an "investment" for purposes of the ICSID Convention and most BITs. Given the great number of non-controlling minority shareholders in each company, the risk of multiple proceedings over the same claim based on the same measures, is real.

In the *CMS v. Argentina* case, the CMS Gas Transition Company ("CMS") purchased shares of an Argentine company, Transportadora de Gas del Norte ("TGN"), pursuant to Argentina's privatization program in 1995. Argentina argued that CMS lacked standing to file its claim because it was merely a minority non-controlling shareholder and thus did not have standing to claim damages suffered by TGN.[46] The Tribunal ruled that the Convention did not require control over a locally-incorporated company in order to qualify under the Convention. It also ruled that the Convention does not bar a claim brought by a minority non-controlling shareholder such as CMS, observing that previous ICSID tribunals in also finding jurisdiction had "*not been concerned with the question of majority [ownership] or control but rather whether shareholders can claim independently from the corporate entity*". The Tribunal answered this question in the affirmative.

In *Lanco v. Argentina*,[47] 18.3% shareholding was sufficient to find jurisdiction as an investment. The Tribunal noted that there was nothing in the Treaty that required an investor in the capital stock to have either control over the administration of a company, or a majority share, in order to qualify as an investor for the purposes of the Treaty.[48] The Tribunal further noted *inter alia* that *Lanco* was liable for all contractual obligations "*to the extent of its equity share*" and concluded that *Lanco* was a party to the Agreement "*in its own name and right*".[49]

In Azurix v. Argentina,[50] the Tribunal found that "given the wide meaning of investment in the definition of Article.., the provisions of the BIT [US-Argentina] protect indirect claims". It cited the CMS Tribunals saying that "jurisdiction can be established under the terms of the specific provision of the BIT. Whether the protected investor is in addition a party to a concession agreement or license agreement with the host state is immaterial for the purpose of finding jurisdiction under those treaty provisions since there is a direct right of action of shareholder".

In *Sempra v. Argentina*,[51] the Tribunal made findings in line with those cited above. Based on the definition of investment and investor in the US-Argentina BIT, it held that "*there is no question that this is a broad definition, as its intent is to extend comprehensive protection to investors*".[52] It then referred to previous tribunals acting under both ICSID and UNCITRAL rules [the *Goetz*, *Enron*, *CMS* and *Enron (Additional Claim)* Tribunals] which have concluded that "*in the light of the very terms of the provision, it [the definition] encompasses not only the majority shareholders but also the minority ones, whether they control the company or not*".[53] It finally concluded that "*if the purpose of the Treaty and the terms of its provisions have the scope the parties negotiated and accepted, they could not now, as has been noted, be ignored by the Tribunal since that would devoid the Treaty of all useful effect*".[54]

In *Gas Natural SDG S.A. v. Argentina*,[55] Argentina also maintained that the claimant could not qualify as an investor under the BIT as it was only an indirect shareholder of the Argentine company. The Tribunal found that the claimant qualified within the definition of investment clearly stating that "*assertion that a claimant under a Bilateral Investment Treaty lacked standing because it was only an indirect investor in the enterprise that had a contract with or a franchise from the state* party *to the BIT, has been made numerous times, never, so far as the Tribunal has been made aware, with success*". The Tribunal made clear that for example the *CMS v. Argentina* tribunal's analysis "*was very close to the analysis of the present Tribunal*".

2.2. Forum shopping and parallel proceedings

The process throughout which one of the parties to a dispute attempts to bring a claim before the forum most advantageous to him or her is referred to as "*forum shopping*".[56] Forum shopping has long been a familiar concept in international private law and in many domestic law systems. A particular type of forum shopping can be found in international commercial disputes where parties can choose to pursue litigation before one out of several available jurisdictions.[57, 58]

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In the case of investment arbitration, "forum shopping" has a different meaning and application. On the one hand, the foreign investor is directed by the investment treaty to a specific arbitration option or set of options, *i.e.* local courts, ICISD arbitration or *ad hoc* arbitration. This creates an opportunity for forum shopping very different from the traditional private international law one: a forum shopping facility offered intentionally in favour of the investor.[59] On the other hand, a foreign investor and related parties may engage in forum shopping in combination with treaty shopping, to enlarge the choice of forum beyond the options provided by the specific BIT, or even to bring the same facts into parallel or multiple proceedings.[60]

The most graphic examples of this phenomenon are the *CME/Lauder v. the Czech Republic* cases.[61] In these cases,[62] the Czech Republic was subject to two different UNCITRAL proceedings concerning certain governmental measures with regard to a local company that owned a TV license. The claims were brought almost simultaneously by the ultimate controlling shareholder, a US investor, Lauder, under the US-Czech Republic BIT in London and by a Dutch company, the CME Czech Republic, that hold shares in the local company under the Netherlands-Czech Republic BIT in Stockholm. The Czech Republic prevailed against Lauder, but was ordered to pay a substantial compensation to CME.

The Lauder Tribunal acknowledged the potential problem of conflicting awards, noting "*that damages [could] be concurrently granted by more than one court or arbitral tribunal…*" Nevertheless, it reasoned that "*the second deciding court or arbitral tribunal could take this fact into consideration when assessing the final damage*".[63] The CME Tribunal addressed the ramifications of the parties' parallel proceedings but found no bar to adjudicating the same dispute:[64]

> "*The Czech Republic did not agree to consolidate the Treaty proceedings, a request raised by the Claimant (again) during these arbitration proceedings. The Czech government asserted the right to have each action determined independently and promptly. This has the consequence that there will be two awards on the same subject which may be consistent with each other or may differ. Should two different Treaties grant remedies to the respective claimants deriving from the same facts and circumstance, this does not deprive one of the claimants of jurisdiction, if jurisdiction is granted under the respective Treaty. A possible abuse by Mr. Lauder in pursuing his claim under the US Treaty as alleged by the Respondents does not affect jurisdiction in these arbitration proceedings.*"[65]

2.3. Consolidation of claims

Consolidation of claims has often been applied in commercial arbitration, subject to the parties' consent.[66] The need for consolidation arises when there are multiple arbitration proceedings filed with common questions of law or fact which raise the possibility of inconsistent or even conflicting awards. The

Lauder/CME v. the Czech Republic cases might have reached a different result if they had been consolidated; in this case however one of the parties was unwilling to agree to consolidate the claims.[67]

A comprehensive study on consolidation can be found in the next chapter of the present publication. It looks in particular in the way this procedural device has been used in commercial arbitration, at its application to investment arbitration, and finally, drawing from both experiences it highlights the advantages and disadvantages of such an application and proposes a set of action.

3. Other challenges of jurisdictional nature: treaty/contract claims

BITs establish a legal framework for the treatment and protection of foreign investment and investors and any claims arising from the treaty are treaty claims. Foreign investment also involves contracts between the investor and the host state or entities of the host state, for example in the form of concession contracts. Although the rights of the investor under each instrument are different, sometimes they may overlap. When a State-owned company breaches a contract concluded with a foreign investor – or when the host state breaches the contractual commitments assumed with a company in which a foreign investor has a stake, investors may have both contract and treaty claims against the host state. This has an impact on determinations of jurisdiction.

BITs define the parameters for the activities of tribunals in investor-state arbitration. Jurisdiction may be subject to certain procedural requirements: for instance, the competence of arbitral tribunals may depend on proceedings in the host state's domestic courts. The subject-matter jurisdiction of tribunals also varies, and may be described narrowly or more broadly: it may be limited to claims alleging a violation of BITs or it may include all investment disputes arising out of contracts.

In recent disputes, contract claims have been submitted to investment arbitration, through a BIT, even in the absence of a contractual clause providing for ICSID jurisdiction. This raises a number of questions: to what extent may an investor rely on treaty based protections under a BIT, but arising from contracts containing exclusive jurisdiction clauses in favour of a national court? Can the breach of a contractual provision amount to a breach of international law rights? How should tribunals apply the so-called "umbrella clauses" contained in some BITs, in which States promise to comply with all commitments and undertakings? These issues have been considered by a number of ICSID tribunals in recent times but without much uniformity in their approach.

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3.1. Treaty jurisdiction despite the existence of a jurisdiction clause in a contractual agreement

The most direct precedents for allowing the investor to refer a contract dispute to an arbitral tribunal on the basis of a treaty despite the existence of a separate dispute settlement clause in the contract are the decisions on *Lanco v. Argentina, Salini v. Morocco and Vivendi v. Argentina*. More recent cases which drew from these are *Sempra Energy International v. Argentina*, *AES Corporation v. Argentina* and *Eureko B.V. v. Republic of Poland*.

In *Lanco v. Argentina*,[68] the tribunal held that the exclusive jurisdiction clause in favour of national courts did not prevent the submission of disputes to ICSID on two main grounds. The reasons were that, first, the wording of Article 26 of the Washington Convention is such that consent to ICSID arbitration is "to the exclusion of any other remedy" and second, since administrative jurisdiction cannot be selected by mutual agreement, the weight to be accorded to the contractual choice which the parties had made ought to be diminished.

In *Salini v. Morocco*,[69] despite the existence of a jurisdiction clause in favour of the courts of Morocco, the Tribunal concluded that the investor-state dispute resolution provision in the relevant BIT overrode the contractual jurisdiction clause and "*obliges the State to respect the offer of jurisdiction in relation to violations of the BIT and any breach of a contract that binds the State directly*". Negotiated by the Home state with the Host state, this solution renders this option a real substantive element of the protection offered to the foreign investor.[70]

The complexities of treaty/contract claims are very well illustrated in the *Vivendi* arbitration.[71, 72] The choice of forum was also examined in an indirect way by the ICSID *Ad hoc* Committee in *Vivendi v. Argentina* (Annulment procedure).[73] The Committee faced with an exclusive jurisdiction clause and a BIT, distinguished between claims based on a breach of contract and claims based on a breach of a treaty. It concluded that BITs "*set an independent standard*" from that contained in contracts and a State could breach a treaty without breaching a contract and *vice versa*. Where the "*essential basis*" of a claim was contractual, then the exclusive jurisdiction clause would apply; when the claim were based on the breach of a treaty standard, then the jurisdictional provisions of the BIT could be invoked:[74]

> "… *it is not open to an ICSID tribunal having jurisdiction under a BIT in respect of a claim based upon a substantive provision of that BIT, to dismiss the claim on the ground that it could or should have been dealt with by a national court…*"

> "… *A state cannot rely on an exclusive jurisdiction clause in a contract to avoid the characterisation of its conduct as internationally unlawful under a treaty.*"

> "*The claim was not simply reducible to so many civil or administrative law claims concerning so many individual acts alleged to violate the Concession Contract or the administrative law of Argentina. It was open to Claimants to claim, and they did claim, that these acts taken together, or some of them, amounted to a breach of Articles 3 and/or 5 of the BIT.*"[75]

In the *Sempra Energy International v. Argentina case*,[76] the Tribunal reviewed previous decisions which have dealt with this issue, in particular the one on annulment in Vivendi and concluded that it would not depart from the approach that "the claim is accordingly founded on both the contract and the Treaty, independently of the fact that purely contractual questions having no effect on the provisions of the Treaty can be subject to legal action available under the domestic law of the Argentine Republic".[77]

In *AES Corporation v. The Argentine Republic*[78] the Tribunal was confronted with the same argument raised by Argentina and concurred with the position discussed above, already adopted by previous tribunals. The Tribunal distinguished between "*two distinct legal orders: the international and the national one*". It held that exclusive jurisdiction of the national forum arose only within the Argentinean legal order and in relation to the execution of the contract but this did not preclude a claimant asserting its rights under two international treaties, the US-Argentina BIT and the ICSID Convention. To the extent that breaches of the concession contract also amounted to violations of Argentina's international obligations under the BIT, the Tribunal could assert jurisdiction over these claims.

In *Eureko B.V. v. Republic of Poland*,[79] Poland contended that Eureko's claims were inadmissible since they were predicated upon contractual claims. It relied on the terms of the Dutch-Poland BIT which provided that disputes concerning the BIT would be subject to the exclusive jurisdiction of a "Polish public court competent with respect to the Seller". Referring, *inter alia*, to the decision of the *ad hoc* Committee in the Vivendi annulment decision, Poland also submitted that international law requires that the extent of the State's contractual obligations must first be determined by the forum selected in the contract before a tribunal constituted pursuant to an investment treaty can consider whether the State breached its treaty obligations. The tribunal noted that the *Vivendi* annulment tribunal held that where "*the fundamental basis of the claim is the treaty laying down an independent standard by which the conduct of the parties may be judged, the existence of an exclusive jurisdiction clause in a contract between the claimant and the respondent state… cannot operate as a bar to the application of the treaty standard. At most, it might be relevant… in assessing whether there has been a breach of the treaty*".[80] The tribunal found that the principle underlying the decision of the *ad hoc* committee in Vivendi required it to consider whether the facts of this case constituted breaches of the BIT.

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Box 7.1. **Fork in the road**

BITs contain different provisions as for the relationship between international arbitration and domestic courts. Some BITs allow the investor to submit a dispute to arbitration after the dispute has been before the local courts or administrative tribunals for some fixed period of time, even if local courts have not concluded their proceedings.[1] Other BITs allow international arbitration provided no decision has been taken by domestic courts. The clear distinction between contract and treaty claims in order to determine the two types of litigation available for the same investment has an implication on the conditions of application of the "fork-in-the road" clause. These clauses aim at making irrevocable the choice of the investor who would have otherwise a generous choice of jurisdictions.[2] Not all investment agreements contain such a clause.

Investors are often involved in legal disputes which are of commercial or private law nature and may need to appear before a domestic court or an administrative tribunal. While these disputes may relate somehow to the investment, they are not "identical" to the investment dispute. This recourse to domestic courts does not necessarily reflect a choice which would preclude international arbitration. The emerging case law[3] related to the application of the "fork-in-the road" provision, is fairly consistent. This provision and the loss of access to international arbitration applies only if the same dispute between the same parties has been submitted to domestic courts or administrative tribunals of the host state before the resort to international arbitration.

Waiver: NAFTA does not include a "fork-in- the road" provision but a waiver. Its Article 1121 requires as "a condition precedent to submission of a claim to arbitration" that investors and, in certain circumstances enterprises owned or controlled by them: "*... waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach…except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party*".[4, 5] Similar language is included in the new model **US BIT,**[6] **US-Central America-Dominican Republic (CAFTA-DR) FTA**[7] **US-Chile FTA**[8] and the **US-Morocco FTA**.[9]

Interim or Injunctive Relief

An issue relating to "fork-in-the-road" concerns possible rights of recourse to interim or injunctive relief in order to prevent irreparable harm, *i.e.*, to preserve property from dispersal or destruction, during the course of the dispute settlement proceedings. Even in cases where an investor must choose between pursuing international arbitration and domestic legal proceedings, provision could be made to protect investors' rights to interim or injunctive relief. This exception to the "fork in the road" rule would allow the investor to seek interim or injunctive relief under domestic procedures without foreclosing his right to initiate international arbitration. ICSID (Article 47)[10] provides for the possibility of such relief as does the NAFTA (Article 1134),[11] many BITs and did the draft MAI.[12]

Box 7.1. **Fork in the road** *(cont.)*

1. See Romania-Sri Lanka BIT, Argentina-Spain BIT, Article x(3)(a); on this see Emilio Augustin Maffezini. The Kingdom of Spain, Decision on Jurisdiction, 25 January 2000, 16 ICSID Review – F.I.L.J. 203(2001).
2. See France-Argentina BIT (Article 8.2): If such dispute could not be solved within six months from the time it was stated by any of the parties concerned, it shall be submitted at the request of the investor: either to the national jurisdictions of the Contracting Party involved in the dispute; or to investment arbitration….Once an investor has submitted the dispute either to the jurisdictions of the Contracting Party involved or to international arbitration, the choice of one of the other of these procedures shall be final.
3. *Olguin v. Paraguay; Vivendi v. Argentina; Genin v. Estonia; Lauder v. the Czech Republic; Middle East Cement v. Egypt; CMS v. Argentina; Azurix v. Argentina and Enron v. Argentina*. For a more detailed and complete description of these cases and analysis of this provision see C. Schreuer "Travelling the BIT Route: of Waiting Periods, Umbrella Clauses and Forks in the Road"5*(2) J. World Inv. 231 (2004)*, pp. 231-256.
4. According to C. Brower and J Sharp, "Article 1121 appears to eliminate one element of the CME problem", in that it precludes an investor like Lauder from bringing a NAFTA claim against one of the NAFTA Parties while he (or an enterprise that he "owns or controls", such as CME) simultaneously brings another claim arising from the same governmental "measure" under a related contract or under a bilateral investment treaty. Of course, Article 1121 would not prevent a claimant from a non-NAFTA State Party from initiating an arbitration under a contract or bilateral investment treaty fro a claim arising from a governmental "measure" that also gives rise to a NAFTA claim by another claimant from Canada, Mexico or the United States. Or as the Tribunal in the Azinian case noted, jurisdiction in one forum does not "exclude recourse to other courts or arbitral tribunals… having jurisdiction on another foundation". See *op. cit*., No. 4.
5. In the context of NAFTA, this issue was considered in Waste Management Inc. v. United Mexican States, where the claimant argued that the waiver required by NAFTA did not apply to Mexican proceedings "involving allegations that [Mexico] has violated duties imposed by other sources of law, including the municipal law of Mexico". The arbitral Tribunal rejected this argument, reasoning that "when both legal actions have a legal basis derived from the same measures, they can no longer continue simultaneously in light of the imminent risk that the claimant may obtain the double benefit in its claim for damages. This is what NAFTA Article 1121 seeks to avoid". The Tribunal dismissed the claim for lack of jurisdiction with one dissenting opinion. The claim was submitted for a second time to a new Tribunal two years later. The second Tribunal in this case stated: "Chapter 11 of NAFTA does not contain any express provision requiring a claimant to elect between a domestic claim and a NAFTA claim in respect of the same dispute. Such 'fork in the road' provisions are not unusual in bilateral investment treaties, although their language varies… Chapter 11 of NAFTA adopts a middle course. A disputing investor is evidently entitled to initiate or continue proceedings with respect to the measure in question before any administrative tribunal or court of the respondent State in accordance with its law, without prejudice to eventual recourse to international arbitration. It is only when submitting a claim under Article 1120 that the requirement of waiver arises".
6. Article 26 (2), (3).
7. Article 10.18.
8. Article 10.17.
9. Article 10.17.
10. Provisional measures: "Except as the parties otherwise agree, the Tribunal may, if it considers that the circumstances so require, recommend any provisional measures which should be taken to preserve the respective rights of either party".
11. Interim measures of protection: "A Tribunal may order an interim measure of protection to preserve the rights of a disputing party, or to ensure that the Tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the Tribunal's jurisdiction. A Tribunal may not order attachment or enjoin the application of the measure alleged to constitute a breach referred to in Article 1116 and 1117. For purposes of this paragraph, an order includes a recommendation".
12. "An investor may seek interim relief, not involving the payment of damages, from the judicial or administrative tribunals of a Contracting Party, for the preservation of its rights and interests pending resolution of the dispute, without being deemed, thereby, to have submitted the dispute for resolution for purposes of subparagraph 4(b)". DAFFE/MAI/EG1(96)12 "Settlement of disputes between an investor and a contracting party".

3.2. The umbrella clause

The extent of jurisdiction *rationae materiae* (subject matter) is not uniform under BITs. Some BITS cover only disputes relating to an "obligation under this agreement", *i.e.* only for claims of BIT violations. Others extend the jurisdiction to "any dispute relating to investments". The latter clause[81] creates an international law obligation that a host state shall, for example, "observe any obligation it may have entered to"; "constantly guarantee the observance of the commitments it has entered into"; "observe any obligation it has assumed", and other formulations. These provisions are commonly called "*umbrella clauses*",[82] although other formulations have also been used: "mirror effect", "elevator", "parallel effect", "sanctity of contract" and "*pacta sunt servanda*". Clauses of this kind have been added to provide additional protection to investors and are directed at covering investment agreements (including contracts) that host countries frequently conclude with foreign investors. Until the recent jurisprudence on the interpretation of the umbrella clause in the two *SGS Société Générale de Surveillance SA* cases, there seemed to exist a settled opinion on its meaning and scope. For a better understanding of the clause, a brief overview of its history as well as its interpretation by scholars and arbitral tribunals is necessary.

3.2.1. History of the clause and investment agreements

The first occurrence of the "umbrella clause"[83] as a distinct investment protection clause can be traced to the ***1956-59 Abs Draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries*** (the Abs draft) (Article 4):[84]

> "*In so far as better treatment is promised to non-nationals than to nationals either under intergovernmental or other agreements or by administrative decrees of one of the High contracting Parties, including most-favoured nation clauses, such promises shall prevail.*"

This approach was reformulated in the 1959 Abs-Shawcross Draft Convention on Foreign Investment (Article II):[85]

> "*Each Party shall at all times ensure the observance of any undertakings which it may have given in relation to investments made by nationals of any other party.*"

The clause appeared right afterwards in the first ***BIT between Germany and Pakistan*** (Article 7):

> "*Either Party shall observe any other obligation it may have entered into with regard to investments by nationals or companies of the other party.*"

The clause was also one of the core substantive rules of the ***1967 OECD draft Convention on the Protection of Foreign Property*** (Article 2)[86] which provided that:

"*Each Party shall at all times ensure the observance of undertakings given by it in relation to property of nationals of any other Party.*"

The Notes and Commentaries accompanying the draft Convention describe this article as "an application of the general principle of *pacta sunt servanda* in favour of the property of nationals of another party, and their lawful successors in title unless the undertaking expressly excludes such succession". According to the Commentaries, "property" included but is not limited to investments which are defined in Article 9 as "all property, rights and interests whether held directly or indirectly, including the interest which a member of a company is deemed to have in the property of the company". Property is to be understood "in the widest sense".[87] However, the commentary limits the scope of Article 2 by insisting that undertakings "must relate to the property concerned; it is not sufficient if the link is incidental".[88]

Following the OECD draft Convention, this clause found its way in the 1983, 1984 and 1987 ***US Model BITs***:

"*Each Party shall observe any obligation it may have entered into with regard to investments*"[89]

and in many ***UK BITs*** as well, including its first with Egypt in 1975:

"*Each Contracting Party shall observe any obligation it may have entered into with regard to investments of nationals or companies of the other Contracting Party*."

The ***draft MAI*** text provided – in the Annex, listing negotiating proposals by two delegations, two formulations for a "respect clause":[90]

Respect Clause: "*Each Contracting Party shall observe any obligation it has entered into with regard to a specific investment of an investor of another Contracting Party and*",

Substantive approach to the respect clause:"*Each contacting Party shall observe any other obligation in writing, it has assumed with regard to investments in its territory by investors of another Contracting Party. Disputes arising from such obligations shall only be settled under the terms of the contracts underlying the obligations.*"

The ***Energy Charter Treaty***[91] in the final sentence of Article 10(1) requires that:

"*Each Contracting Party shall observe any obligations it has entered into with an Investor or an Investment of an Investor of any other Contracting Party.*"[92]

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3.2.2. Literature

The understanding of commentators and drafters on the umbrella clause provision in the draft OECD Convention was that while the clause probably did cover international obligations, its focus was contractual obligations accepted by the host state with regard to foreign property.[93]

Commenting on the same provision, ***Brower***,[94] raised the possibility that the article's scope *rationae materiae* may have been limited so as only "to apply specifically to large-scale investment and concession contracts – in the making of which the state is deliberately 'exercising its sovereignty' – and thus it might be argued that the ordinary commercial contracts is an implied exception to the general rule set forth in Article 2".[95]

Today, it seems that a more consistent view emerges among commentators on the scope of the umbrella clause. ***Prosper Weil*** presented in his Hague lecture the idea that an investment treaty would transform a mere contractual obligation between state and investor into an international law obligation, in particular if the treaty included a clause obliging the state to respect such contract.[96]

F. Mann also was of the view that the umbrella clause in the BITS protects the investor against a mere breach of contract: "this is a provision of particular importance in that it protects the investor against any interference with his contractual rights, whether it results from a mere breach of contract or a legislative or administrative act, and independently of the question whether or no such interference amounts to expropriation. The variation of the terms of a contract or license by legislative measures, the termination of the contract or the failure to perform any of its terms, for instance, by non-payment, the dissolution of the local company with which the investor may have contracted and the transfer of its assets (with or without the liabilities) – these and similar acts the treaties render wrongful".[97]

Dolzer and Stevens along the same lines state that: "these provisions seek to ensure that each Party to the treaty will respect specific undertakings towards nationals of the other Party. The provision is of particular importance because it protects the investor's contractual rights against any interference which might be caused by either a simple breach of contract or by administrative or legislative acts and because it is not entirely clear under general international law whether such measures constitute breaches of an international obligation".[98]

E. Gaillard notes that every time the State is engaged by a treaty to respect its contractual obligations towards foreign investors, the violation of the contract is also a violation of the treaty. These clauses could be qualified as "*clauses with a mirror effect*". The treaty has in effect as a result to reflect at the level of international law what is analysed at the level of applicable private law as simple contractual violation.[99]

UNCTAD's[100] analysis of the provision is less categorical. It notes that "the language of the provision is so broad that it could be interpreted to cover all kinds of obligations, explicit or implied, contractual or non-contractual, undertaken with respect to investment generally. A provision of this kind might possibly alter the legal regime and make the agreement subject to the rules of international law".

A middle approach is expressed by ***T. Wälde***. He believes that the principle of international law would only protect breaches and interference with contracts made with government or subject to government powers, if the government exercised it particular sovereign prerogatives to escape from its contractual commitments or to interfere in a substantial way with such commitments. This would apply as well to contracts concluded only with private parties in the host state if such contracts are destroyed by government powers. "… If the core or centre of gravity of a dispute is not about the exercise of governmental powers… but about 'normal' contract disputes, then the BIT and the umbrella clause has no role".[101]

A different view is expressed by ***P. Mayer***, who maintains that the nature of the *inter pares* relationship remains unchanged and is subject to the *lex contractus* and that only the interstate relationship is subject to international law.[102]

3.2.3. Jurisprudence

Although the umbrella clause has been a subject of scholarly discussion for some decades now, it has never been part of jurisprudence until very recently. The first ICSID case that addressed the umbrella clause arose in 1998: *Fedax NV v. Republic of Venezuela*[103] based on the BIT between the Netherlands and the Republic of Venezuela). In this case, the tribunal was unaware that there was an umbrella clause, and did not carry out any in-depth examination of the clause or its application. It simply applied its "plain meaning", that commitments should be observed under the BIT, to the promissory note contractual document. It found that Venezuela was under the obligation to "*honor precisely the terms and conditions governing such investment, laid down mainly in Article 3 of the Agreement, as well as to honor the specific payments established in the promissory notes issued*".[104] The merits of the case were partially settled by the parties.

The first time[105] an arbitral tribunal evaluated the scope of an umbrella clause was in the *SGS Société Générale de Surveillance, S.A. v. Pakistan* case[106] (2003), based on the Pakistan-Switzerland BIT. The Tribunal rejected SGS's contention that this clause elevated breaches of a contract to breaches of the treaty:

> "*The text itself of Article 11 does not purport to state that breaches of contract allege by an investor in relation to a contract it has concluded with a State (widely considered to be a matter of municipal rather than international law) are automatically 'elevated' to the level of breaches of international treaty law.*"[107]

The Tribunal added that the legal consequences were so far-reaching in scope and so burdensome in their potential impact on the State that clear and convincing evidence of such an intention of the parties would have to be proved. Such proof was not brought forward according to the Tribunal.[108] It also argued that the claimant's interpretation "would amount to incorporating by reference an unlimited number of state contracts" the violation of which "would be treated as a breach of the treaty".[109]

At the same time, SGS brought another case against the Philippines,[110] based on the Philippines-Switzerland BIT.[111] The Tribunal in this case examined the interpretation of the clause in the SGS v. Pakistan decision and although it recognized that the language of the clause was not the same, it found the decision unconvincing[112] and highly restrictive.[113] It concluded that:

> "*To summarise the Tribunal's conclusions on this point, Article X(2) makes it a breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments. But it does not convert the issue of the extent of content of such obligations into an issue of international law.*"[114]

However, while the Tribunal took a wider reading of the scope of the umbrella clause, than the SGS v. Pakistan Tribunal, it required at the end that if the contract vests exclusive jurisdiction over disputes arising under its terms to another tribunal (domestic court or a contractual arbitral tribunal) then this tribunal has the key jurisdiction. The Tribunal decided to suspend the proceedings indefinitely until the claimant got a judgment from the domestic courts and then return to it if he considered that such judgment was not satisfactory.[115]

In *Waste Management v. United Mexican States*[116] the NAFTA Tribunal, expressed its view on the "umbrella clause" although NAFTA Chapter 11 does not contain such a clause. It observed that "*NAFTA Chapter 11 – unlike many bilateral and regional investment treaties, does not provide jurisdiction in respect of breaches of investment contracts such as [the Concession Agreement]. Nor does it contain an 'umbrella clause' committing the host state to comply with its contractual commitments*".

Along the same lines, the Tribunal in *Consorzio Groupement L.E.S.I.-DIPENTA v. Republic of Algeria*,[117] although it held that the BIT between Italy and Algeria did not contain an umbrella clause, it stated that: "*the effect of such clauses is to transform the violations of the State's contractual commitments into violations of the treaty umbrella clause and by this to give jurisdiction to the Tribunal over the matter…*"[118] [translation by the Secretariat].

The Tribunal in Sempra Energy International v. Argentina[119] noted that the dispute arose from "how the violation of contractual commitments with the licensees [Sempra]… impacts the rights of the investor claims to have in the light of the provisions of the treaty and the guarantees on the basis of which it made the protected investment".[120] It recognised that these contractual claims were also treaty claims and was reinforced in its view by the fact that "the Treaty also includes the specific guarantee of a general 'umbrella clause', [such as that of Article II(2)(c)], involving the obligation to observe contractual commitments concerning the investment, creates an even closer link between the contract, the context of the investment and the Treaty".[121]

The Tribunal in *Joy Mining Machinery Limited v. The Arabic Republic of Egypt*[122] interpreted the "umbrella clause" as applying to violations of contract rights which by their magnitude are elevated into Treaty claims. It held that "*[i]n this context, it could not be held that an umbrella clause inserted in the treaty, and not very prominently, could have the effect of transforming all contract disputes into investment disputes under the Treaty, unless of course there would be a clear violation of Treaty rights and obligations or a violation of contract rights of such a magnitude as to trigger the Treaty protection, which is not the case. The connection between the Contract and the Treaty is the missing link that prevents any such effect. This might be perfectly different in other cases where that link is found to exist, but certainly it is not the case here*".[123]

The Partial Award in *Eureko B.V. v. Poland*[124] examined the question of the "umbrella clause" included in the Netherlands-Poland BIT in great detail. It interpreted this provision according with its ordinary meaning as stipulated in Article 31, paragraph 1 of the Vienna Convention. It stated that "*the plain meaning – the 'ordinary' meaning – of a provision prescribing that a State 'shall observe any obligations it may have entered into' with regard to certain foreign investments is not obscure. The phrase 'shall observe' is imperative and categorical. 'Any' obligations is capacious; it means not only obligations of a certain type, but 'any' – that is to say, all – obligations entered into with regards to investments of investors of the other Contracting Party*".[125] It therefore concluded that Eureko's contractual arrangements with the Government of Poland were subject to the jurisdiction of the Tribunal.

One analytical point in dispute before the tribunal in *Noble Ventures, Inc. v. Romania*[126] was the question of whether contractual obligations also amounted to international obligations by virtue of the "umbrella clause" in the US-Romania BIT. The tribunal, in a thorough discussion on this clause found that, Article II(2)(c) of the BIT intended to create obligations and "*obviously obligations beyond those specified in other provisions of the BIT itself*" and by doing so it referred clearly to investment contracts. It also noted that such an interpretation was also supported by the object and the purpose rule; "any other interpretation would deprive *Article II(2)(c) of practical content, reference has necessarily to be made to the principle of effectiveness*…". On this point, it stated that "*a clause that is readily capable of being interpreted in this way and which would otherwise be deprived of practical applicability is naturally to be understood as protecting investors also with regard to contracts with the host State*

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generally in so far as the contract was entered into with regard to an investment". It then added that by the negotiation of a bilateral investment treaty, two States may create an exception to the rules deriving from the autonomy of municipal law and "*in the interest of achieving the objects and goals of the treaty, the host state may incur international responsibility by reason of a breach of its contractual obligation… the breach of contract being thus 'internationalised',* i.e. *assimilated to a breach of a treaty*". The "umbrella clause" introduces this exception.

Although the decisions above do not all reach the same conclusion on the interpretation of the "umbrella clause" – owing in part to the different language included in the treaties under examination – it seems that there is a growing consistency on the interpretation of its meaning to include "all obligations" by the State, both treaty and contractual (in particular covering investment contracts).

Notes

1. See Chapter 1 of *International Investment Law – A Changing Landscape*, a companion volume to *International Investment Perspectives*, OECD 2005.
2. For a detailed analysis see C. Schreuer "The ICSID Convention: A Commentary", Cambridge University Press, ICSID, 2001.
3. For a comprehensive analysis on annulment procedures and cases see, *IAI Arbitration Series No. 1*, "*Annulment of ICSID Awards*", (E. Gaillard and Y. Banifatemi eds., 2004).
4. The *ad hoc Committee* annulled the Award on the grounds that the Tribunal had failed in its duty to state the reasons for the award. The dispute was retransmitted to a second Tribunal which rendered a new Award; both Parties asked for its annulment but the second *ad hoc* Committee rejected the requests for annulment. *Klöckner v. Cameroon*, Award, 21 October 1983, 2 ICSID Reports 9. *Klöckner v. Cameroon*, Decisions on Annulment, 3 May 1985, 2 ICSID Reports 95. The second award and the decision of the *ad hoc* committee were unpublished. See C. Schreuer *op. cit.*, No. 2, pp. 897-98.
5. The *ad hoc committee* annulled the award on the basis of the Tribunal's failure to apply the proper law – which was beyond its jurisdiction *rationae materiae*. *Amco v. Indonesia*, decision on Annulment, 16 May 1986, 1 ICSID Reports 509. The case was retransmitted to a new Tribunal which decided first on Jurisdiction (10 May 1988, 1 ICSID reports 543) and then on the merits (Award, 5 June 1990, 1 ICSID reports 569). Both Parties requested annulment of the second Award which was rejected by a second *ad hoc* committee (unpublished decision). See C. Schreuer *op. cit.*, No. 2, p. 900.
6. The *ad hoc* Committee annulled the damages section of the Award because the Tribunal had failed to deal with questions raised by Guinea and this failure might have affected the damages awarded. *MINE v. Guinea*, decision on Annulment, 22 December 1989, 4 ICSID reports 79. After MINE retransmitted the damages question for decision by a new tribunal, the parties reached a settlement by agreement. See C. Schreuer *op. cit.*, No. 2, p. 901.
7. This case was settled before the *ad hoc* Committee rendered its decision.

8. The *ad hoc* Committee rejected all three bases for annulment advanced by Egypt: manifest excess of powers, serious departure from a fundamental rule of procedure and the award failed to state the reasons on which it is based. See 41 ILM 933 (2002) and E. Gaillard, *op. cit.*, No. 3.
9. The *ad hoc* Committee annulled the tribunal's award on the basis of manifest excess of powers. See E. Gaillard, "Vivendi and Bilateral Investment Treaty Arbitration", *New York law Journal*, 6 February 2003.
10. *Patrick Mitchell v. Democratic Republic of the Congo* (Case No. ARB/99/7), *Consortium R.F.C.C. v. Kingdom of Morocco* (Case No. ARB/00/6), *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Chile* (Case No. ARB/01/7), *Repsol YPF Ecuador S.A. v. Empresa Estatal Petroleos del Ecuador (Petroecuador)* (Case No. ARB/01/10), *Hussein Nuaman Soufraki v. United Arab Emirates* (Case No. ARB/02/7), *CDC Group plc v. Republic of the Seychelles* (Case No. ARB/02/14), *Joy Mining Machinery Limited v. Arab Republic of Egypt* (Case No. ARB/03/11) and *CMS Gas Transmission Company v. the Argentine Republic* (Case No. ARB/01/8).
11. See Caron D.D., "Reputation and Reality in the ICSID Annulment Process: Understanding the Distinction between Annulment and Appeal", 7 ICSID Review-FILJ 21 (1992).
12. See N. Rubins "Judicial Review of Investment Arbitration Awards"*NAFTA Investment Law and Arbitration*, Todd Weiler (ed.), p. 363. Rubins states that "... non-arbitrability of the subject matter and procedural irregularity are grounds for challenge that have yet to appear prominently in cases related to investment arbitration awards but which could find increasing currency should challenges become more common".
13. For example, the Swiss international arbitration law provides: "where none of the parties has its domicile, its habitual residence or a business establishment in Switzerland, they may, by an express statement in the arbitration agreement or by a subsequent agreement in writing, exclude all setting aside proceedings, or they may limit such proceedings to one or several of the grounds listed…", *Swiss Private International Law Act*, Article 192(1) (December 18, 1987).
14. For instance, France does not consider set aside abroad when deciding to grant or refuse recognition and enforcement of a foreign arbitral award; this approach emphasises the parties' agreement by focusing on the arbitration award; *Article 1502 of the New Code of Civil Procedure*. An illustration of this is the case *Hilmarton Limited v. Omnium de Traitement et de Valorisation*, Decision No. 484, French Cour de cassation, First Civil Chamber (1994). A similar approach was taken by the US District Court for the District of Columbia in the case *Chromalloy Aeroservices Inc v. Arab Republic of Egypt*, 939 F., Supp. 907 (D.D.C.) 1996.
15. Some attorneys who have represented claimants in investment arbitration have suggested that in cases where public policy issues and pressure can be great, national courts may be more inclined to overturn the arbitrators' substantive decisions. See Rubins *op. cit.*, No. 12, p. 361.
16. Idea proposed by Jan Paulsson, head of the public international law group and the international arbitration group of the Law offices of *Freshfields, Bruckhaus, Deringer*, in the Investment Committee's consultation with BIAC, TUAC and NGOs in December 2004.
17. See E. Lauterpacht, "Aspects of the Administration of International Justice" 1991. S. Schwebel "The Creation and Operation of an International Court of Arbitral Awards", in *The Internationalisation of International Arbitration*, Hunter, M., Mariott, A., Veeder, V.V. (eds.), 115 (1995).

18. At a High Level Meeting in February 1998, one delegation proposed the establishment of an appeal mechanism in the MAI for both State-State and investor-State dispute settlement. In informal consultations, delegations broadly agreed with the objectives of ensuring the development of a coherent jurisprudence and permitting an appeal where there may have been an error in law – particularly concerning the interpretation of MAI obligations. However, concerns were expressed about the delays and costs that might be engendered by adding an appeal and departing for investor-State arbitration from the traditional philosophy of fast, inexpensive and final one step arbitration. As an alternative, it was proposed and accepted that the MAI dispute settlement mechanism would initially remain drafted as final and binding, but it would be made subject to review of practical experience in five years from signature of the MAI. If, as a result of that review, the Contracting Parties considered it advisable to introduce an appeals body, this could be done by amending the Agreement. "*Selected Issues on Dispute Settlement*" (Note by the Chairman) DAFFE/MAI(98)12, 13 March 1998.
19. "Possible Improvements of the Framework for ICSID Arbitration", ICSID, 22 October 2004.
20. "This trade authority, formerly known as 'fast-track', allows the Executive Branch to present trade agreements to Congress for approval by a yes-or no vote by a simple majority". See B. Legum, "The Introduction of an Appellate Mechanism: the US Trade Act of 2002", In *Annulment of ICSID Awards*, see *op. cit.*, No. 3, pp. 289-313.
21. 19 USC, paragraph 3802(b)(3).
22. See B. Legum *op. cit.*, No. 20; 19 USC, paragraph 3802(b)(3)(G)(iv).
23. Annex 10-H. The US-Chile Free Trade Agreement was signed on June 6, 2003.
24. Letter exchange, US Trade Representative R. Zoellick to Singapore Minister of Trade and Industry, G. Yeo on May 6, 2003. The US-Singapore Free Trade Agreement was concluded on January 15, 2003.
25. Annex 10-D. The US-Morocco Free Trade agreement was signed on June 15, 2004.
26. Annex D. For the text of the 2004 US Model BIT, see *www.state.gov/documents/organisation/38710.pdf*, Annex D.
27. Annex 10-F. The Dominican Republic – Central America – United States Free Trade Agreement was signed on August 5, 2004, but is not yet in force. The Central American countries are: Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua.
28. *CME Czech Republic B.V. v. Czech Republic*, Partial Award (September 13, 2001), available at *http://mfcr.cz/Arbitraz/en/PartialAward.doc*.
29. *Lauder v. Czech Republic* (Final Award) (September 3, 2002), available at *www.mfcr.cz/scripts/hpe/default.asp*>.
30. It does not extend to any other obligation under the award, such as restitution or other forms of specific performance or an injunction to desist from a certain course of action. According to Schreuer, "it is conceivable, although not likely, that a non-pecuniary obligation imposed by an ICSID award may be enforced on a different legal basis – under the New York Convention, for instance". Christoph H. Shreuer, "The ICSID Convention: A Commentary", see *op. cit.*, No. 2, pp. 1124, 1126.

31. According to Article 54(1) of the ICSID Convention: "Each Contracting State shall recognise an award rendered pursuant to this Convention as binding and shall enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgement of a court in that State…"

32. NAFTA Article 1136(3)(b) expressly provides for the possibility of actions in national courts to "revise, set aside or annul" awards, requiring the winning party to refrain from enforcement until the losing side has had the opportunity to pursue such relief.

33. The New York Convention requires contracting states to "recognise arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon". Article V sets out limited grounds on which recognition and enforcement of the award may be refused. See *op. cit.*, paragraphs 12-17.

34. See "Suggested changes to the ICSID Rules and Regulations", p. 4, *Working Paper of the ICSID Secretariat*, May 12, 2005, *www.worldbank.org/icsid/052405-sgmanual.pdf*.

35. It is worth mentioning that the French Courts of Appeal, which are faced with a considerable number of set aside awards, consider the ICC awards of a very high quality because of the scrutiny procedure.

36. Schäfer/Verbist/Imhoos, "ICC Arbitration in Practice", Chapter 3, The Rules, pp. 123-125, *ICC Paris 2004*.

37. For a complete description of the scrutiny procedure see D.T. McGovern "Scrutiny of the Award by the ICC Court", *The ICC International Court of Arbitration Bulletin*, Vol. 5/No. 1, May 1994, pp. 46-47.

38. Article 27 of the Rules.

39. See *op. cit.*, No. 26.

40. See *op. cit.*, No. 27.

41. See *op. cit.*, No. 23.

42. See *op. cit.*, No. 25.

43. *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/08, Award, 12 May 2005.

44. *CMS Gas Transmission Company v. The Republic of Argentina*, Application for Annulment and Request for Stay of Enforcement of Arbitral Award, September 8, 2005.

45. *CMS Gas Transmission Company v. The Republic of Argentina* ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction , in 42 ILM 788 (2003), *www.asil.org/ilib/cms-argentina.pdf*.

46. The only claim that it could make, argued Argentina, was one regarding direct damages to its shares in TGN (infringement of voting rights) not for its proportionate share of TGN's damages. Because the ICSID Convention does not provide a definition of the term "investment", the Tribunal analysed both the pre-Convention commentary on ownership of shares and a line of cases dealing with the issue of majority ownership of control. The Tribunal ruled that the Convention did not require control over a locally-incorporated company in order to qualify under the Convention.

47. *Lanco Int'l Inc. v. Argentina Republic*, Preliminary decision on jurisdiction, 40 I.L.M.457, 463 (2001).

48. *Ibid*. Section 10.

49. *Ibid*. Sections 12, 14.

50. *Azurix Corp. v. Argentina*, ICSID Case No. ARB/01/12, decision on Jurisdiction, December 8, 2003.

51. *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Decision on Objections to Jurisdiction, May 11, 2005. Sempra, participated in Argentina's privatization of the gas sector, a program beginning in 1989. It owns 43.09% share capital of Sodigas Sur S.A. ("Sodigas Sur") and Sodigas Pampeana S.A. ("Sodigas Pampeana"), Argentine companies that are licenses granted by Argentina to supply and distribute natural gas in several Argentine provinces. It maintained that the suspension of licensee companies' tariff increases that were based on the US producer index and the subsequent pesification of these tariffs pursuant to Law No. 25561, gave rise to a breach of investment protections afforded under the BIT.

52. *Ibid*., paragraph 93.

53. *Idem*.

54. *Ibid*., paragraph 94.

55. *Gas Natural SDG S.A. v. Argentina*, Decision of the Tribunal on Preliminary Questions on Jurisdiction Case No. ARB/03/10, June 17, 2005. Gas Natural is a corporation organized under Spanish law and has its principal place of business in Spain. In 1992, the claimant took part in a tender offer by the Argentine government as part of the privatization of its gas sector. It then participated in a consortium that purchased 70% of the shares of an Argentine corporation and formed an Argentine company. According to the claimant, it invested in Argentina in reliance on Law No. 23, 928 and Decree 2/28 of 1991, which established the parity and convertibility of the Argentine peso with the US dollar. The claimant alleged that the measures taken by the Argentine government pursuant to the emergency law breached the guarantees set forth in the BIT.

56. For the discussion on forum shopping in general see Yuval Shany "The Competing Jurisdictions of International Courts and Tribunals", *Oxford University Press, International Court and Tribunal Series, 2003*; Andrew S. Bell, "Forum Shopping and Venue in Transnational Litigation", *Oxford Private International Law Series*, 2003 and William Park "International Forum Selection", *Kluwer Law International*, 1995.

57. There have been different reactions to the phenomenon. Many civil law countries have opted for a restrictive definition of their courts' jurisdiction, accepting it only if they have substantial links to the dispute – and the same requirement can be found under the 1968 Brussels Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters (the Brussels Convention). Certain jurisdictions provide that even when the court has jurisdiction to hear a dispute, it may decline jurisdiction if it considers that the authorities of another country are in a better position to decide (*forum non conveniens* doctrine). The international *lis pendens* rule also provides that a court may stay its ruling if another action between the same parties, based on the same facts and having the same object, is pending before a foreign authority.

58. According to B. Cremades and D. Cairns, "it seems likely that investor-State arbitral tribunals will have to develop doctrine similar to *lis pendens* and *forum non conveniens* to confront the issue [of duplication of claims and double recovery by investors] in the near future". "The Brave New World of Global Arbitration", *3 J, World Investment 173 (2003)*.

59. E. Gaillard calls this "*forum shopping in favorem*", in "L'Arbitrage sur le fondement des traités de protection des investissements", *Revue de l'Arbitrage 2003*, No. 3, pp. 853-875.

60. The MAI Negotiating Group in its consideration of issues arising from the relationship between the MAI and other international agreements, including the WTO agreements, was focused on the avoidance of forum shopping, multiple procedures and contradictory awards. MAI negotiators expressed the view that it would be desirable to minimise forum shopping. The draft articles of the MAI reflected some initial judgements on how to address the issues of choice of forum. A provision was to preserve the MAI Party's right to take to state-to-state arbitration a dispute which was subject to an investor-state proceeding. The text proposed to accept the possibility that a MAI Party might win a state-to-state award finding its measure was not a treaty violation, while it might lose on that point in an investor-state panel and be held to pay damages to the investor. MAI negotiators had treated this as acceptable and had insisted that the state-to-state award did not affect the validity of the investor to state award.

61. G. Sacerdoti notes that these cases represent the first instance of a major investment dispute arising under BITs being resolved in UNCITRAL arbitration (synonymous to international commercial arbitration). These arbitrations have evidenced a number of specific questions, if not problems, that may arise from the combination of BIT clauses of arbitration with recourse to standard international commercial arbitration. "Investment Arbitration under ICSID and UNCITRAL Rules: Prerequisites, Applicable Law, Review of Awards" in *19 ICSID Review – Foreign Investment Law Journal 1(2004)*.

62. *CME (Netherlands) v. Czech Republic* (Partial Award) and *Lauder (US) v. Czech Republic* (Final Award) see *op. cit.*, No. 28-29.

63. Paragraph 172 of the Award.

64. The CME Tribunal likewise rejected the Czech Republic's argument that Mr. Lauder had impermissibly "treaty shopped": "*The argument of abusive treaty shopping is not convincing. A party may seek its legal protection under any scheme provided by the laws of the host country. The Treaty, as well as the US Treaty, is part of the laws of the Czech Republic and neither of the treaties supersedes the other. Any overlapping of the results of parallel process must be dealt with on the level of loss and quantum but not on the level of breach of treaty*". Paragraph 419 of the Award.

65. Paragraph 412.

66. E. Gaillard: "Consolidation of Arbitral Proceedings and Court Proceedings" in *Complex Arbitrations: Perspectives on their Procedural Implications, Special Supplement – ICC International Court of Arbitration Bulletin, December 2003 pp.* 35-42.

67. The CME v. Czech Republic Tribunal, in its Final Award ordering the Czech Republic to pay damages, reiterated the respondent's repeated rejection of CME's offer to structure the two cases so as to avoid potentially conflicting arbitral awards: "*At the hearing the Respondent declined anew to accept any of the Claimant's alternative proposals…* i) *to have the two arbitrations consolidated into a single proceeding,* ii) *to have the same three arbitrators appointed for both proceedings,* iii) *to accept the Claimant's nomination in this*

proceeding of the same arbitrator that Mr. Lauder nominated in the London proceeding, iv) *to agree that the parties to this arbitration are bound by the London Tribunal's determination as to whether there has been a Treaty breach,* v) *that after the submission of the parties' respective reply memorials and witness statements in this arbitration, the hearing be postponed until after the issuance of an award in they London Arbitration*".

68. See *op. cit.*, No. 47.

69. See *op. cit.*, No. 78.

70. E. Gaillard, "La jurisprudence de CIRDI", p. 901, Pedone 2004. See also the analysis of all ICSID cases.

71. *Compania de Aguas des Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3 Award of 21 November 2000, in 40 ILM 426 (2001).

72. The case arose out of a long-term concession for the provision of water and sewage services in the Argentine Province of Tucumán. The concession services were provided by Compania de Aguas des Alconquija S.A. (CAA), an Argentine affiliate of Compagnie Générale des Eaux (predecessor to Vivendi). CAA and Vivendi alleged breaches of the 1991 Argentine-France BIT, committed both by the Tucumán authorities and by the Argentina federal authorities themselves. The Tribunal, at the jurisdictional phase, found that the dispute resolution provision of the Concession contract did not divest the Tribunal of jurisdiction "*if only because* ex hypothesi*, those claims are not based on the Concession Contract but allege a course of action under the BIT*". On this, the Tribunal relied directly on the Preliminary Decision on jurisdiction in the *Lanco* case in which the ICSID Tribunal upheld the investor's option to choose ICSID arbitration despite the existence of a contractual forum selection clause. However, even though the Tribunal found jurisdiction over all of Vivendi's claims it decided not to reach the merits of those claims. Instead, it reasoned that the BIT claims were so interlinked with contract claims and questions of Argentine law that the case should be decided by the Tucumán courts. Vivendi requested an annulment of the case. The *ad hoc* Committee upheld the Tribunal's award on jurisdiction but annulled the award with respect to the claims of "wrongdoing" by the province of Tucumán on the basis that the Tribunal had manifestly exceeded its powers by failing to decide the "Tucumán claims" even though it had found that it had jurisdiction over them. For an analysis of the case, see: Stanimir Alexandrov "The *Vivendi* Annulment decision and the Lessons for Future ICSID Arbitrations – The Applicant's Perspective" in "*Annulment of ICSID Awards*" see *op. cit.*, No. 3, pp 83-104; also B. Cremades and D. Cairns in "Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes", in *Arbitrating Foreign Disputes, eds. Prof. N. Horn, Kluwer International (2004)*.

73. *Compania de Aguas des Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment of 3 July 2002, 41 ILM 1135, p. 1156, paragraphs 102, 103.

74. The same reasoning was adopted by the Tribunal in the first ASEAN Investment Arbitral Award case, *Yaung Chi Oo Trading Pte. Ltd. v. Government of the Union of Myanmar*, which, though it did not retain jurisdiction, reiterated the previous findings establishing that, without prejudice to any forum-selection clause in the contract that refers purely contractual disputes to the courts of the host state, an arbitration may be initiated by an investor under an investment treaty regarding the international responsibility of the host state under the treaty. [ASEAN Case No. ARB/01/1, March 31, 2003, 42 ILM (May 2003), as commented by E. Gaillard in "The First Association of Southeast Asian Nations Agreement Award", in *New York Law Journal*, 7 August, 2003]. Finally, in a recent case *PSEG*

Global Inc, The North American Coal Corporation, and Konya Ilgin Elektrik Uterim ve Ticaret Limited Sirketi v. Republic of Turkey, the Tribunal referring to the previous cases and in particular to Vivendi II, rejected the argument that the Claimants had not resorted to previously agreed dispute settlement proceedings and pointed out that if the dispute was contract-based the choice of forum established in the contact would apply but if the dispute was treaty-based, a contractual dispute settlement procedure provision would not impede application of the treaty standard. However, if the dispute was both contract and treaty-based, then the dispute would be qualified as treaty-based (*PSEG Global Inc., The North American Coal Corporation, and Konya Ilgin Elektric Yterim ve Ticaret Limited Sirketi v. Republic of Turkey*, ICSID Case No. ARB/02/5 Decision on Jurisdiction of 4 June, 2004).

75. E. Gaillard in his comment on the Lanco, Salini and Vivendi cases notes that: "*Although both awards [Lanco and Salini] held that all disputes relating to a violation of the international obligations of a state should be referred to the tribunal selected by the international treaty's jurisdiction clause, both focused in part on the fact that the jurisdiction clauses contained in the litigious contractual agreements granted jurisdiction to local administrative courts which cannot ordinarily be selected or waived and thus seemed to imply that their selection in a jurisdiction clause could not constitute a real choice by the parties. The commitment in Vivendi eliminates this ambiguity its rationale being based solely on the distinction between the separate causes of action based on the contract, taken in isolation, and on the treaty, even where it encapsulates in turn a violation based on the contract. Thus the Annulment Committee's decision rightly maintains that the same factual circumstances may constitute the basis of one claim relating to a contractual violation and of another relating to the international obligations of a state*". "Vivendi and Bilateral Investment Treaty Arbitrations"*New York Law Journal*, 6 February, 2003 also in "La jurisprudence de CIRDI", see *op. cit.*, No. 95.

76. See *op. cit.*, No. 51.

77. *Idem*, paragraph 101.

78. *AES Corporation v. The Argentine Republic*, ICSID Case No. ARB/02/17, Decision on Jurisdiction 26 April 2005, paragraphs 90-99.

79. *Eureko B.V. Poland*, Partial Award of an *ad hoc* Tribunal, 19 August 2005. Powszechny Zaklad Ubezpieczen ("PZU") was a wholly state-owned, Polish insurance company. In 1999, the State Treasury of the Republic of Poland published an invitation for an international tender to sell 30% of the share capital of PZU. After negotiations, the State Treasury of the Republic of Poland selected Eureko B.V. ("Eureko"), a company incorporated in the Kingdom of the Netherlands, along with another buyer and entered into a share purchase agreement ("SPA"). Eureko claimed that within a few months following the execution of the SPA, there were several acts of political interference with the privatization that continued from 2000-02, resulting in delays of the initial public offering. Eureko contended that as a result of its investment in PZU, it acquired rights that were entitled to protection by the Republic of Poland pursuant to the BIT, and such rights were frustrated by measures attributable to the Republic of Poland.

80. *Idem*, paragraph 101.

81. The clause often appears in BITs concluded by Germany, the Netherlands, Switzerland, the United Kingdom and the US (based on previous models). *Source UNCTAD*"Bilateral Investment Treaties in the Mid-1990s", 1998, p. 56.

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82. According to C. Schreuer, "they are often referred to as 'umbrella clauses' because they put contractual commitments under the BIT's protective umbrella", in "Travelling the BIT Route: of Waiting Periods, Umbrella clauses and Forks in The Road", J. World Inv (2004), pp. 231-256.

83. For a complete history of the umbrella clause see A.C. Sinclair: "The Origins of the Umbrella Clause in the International Law of Investment Protection", *Arbitration International 2004*, Vol. 20, No. 4, pp. 411-434. Sinclair's research suggests that the origins can be traced to the advice provided by Sir Elihu Lauterpracht in 1953-54 to the Anglo-Iranian Oil Company in connection with the settlement of the Iranian oil nationalisation dispute. The so-called "umbrella" or "parallel protection" treaty was again proposed in Lauterpracht's advice given in 1956-57 to a group of oil companies contemplating a trunk pipeline from Iraq in the Persian Gulf through Syria and Turkey to the Eastern Mediterranean.

84. See H.J. Abs, "Proposals for Improving the Protection of Private Foreign Investments", in *Institut International d'Études Bancaires, Rotterdam, 1958*, as cited by A. Sinclair *op. cit.*, No. 108.

85. The text of the Abs-Shawcross Draft is reprinted in UNCTAD "International Investment Instruments: A Compendium in *United Nations*", New York, 2000, Vol. V, p. 395.

86. "Draft Convention on the protection of foreign property and Resolution of the Council of the OECD on the Draft Convention", OECD Publication No. 23081, November 1967.

87. For a detailed analysis of this provision and the Notes and Commentaries as well as related reactions by scholars, see A. Sinclair *op. cit.*, No. 108, pp. 427-433.

88. Notes and Comments to Article 2, paragraph 3(a), see *op. cit.*, No. 111.

89. US-Senegal BIT, US-Panama, US-Zaire BITs. See R.S. Gudgeon, "United States Bilateral Investment Treaties: Comments on their Origin, Purposes, and General Treatment Standards", in *11 Int'l Tax and Bus. L.*, 105 at 111 (1986).

90. The MAI Drafting Group considered the question of provisions which might be included in the MAI on investor rights arising from other agreements. Three broad conceptual approaches emerged. These were, in ascending order of ambition: *i)* a "zero" option, *i.e.*, no special provision in the MAI on rights under investor-state agreements; *ii)* a procedural provision, *i.e.*, a dispute settlement clause; or *iii)* a substantive and procedural provision, *i.e.*, a "respect clause". The third approach was considered the most ambitious. It would make respect for such investor-state agreements into a MAI obligation, giving them substantive protection of the international law rule, *pacta sunt servanda*. Arguably, this could affect the defences of or damages owed by a government asserting rights to cancel or modify a contract for sovereign reasons or to change laws affecting an investment. It also has the following essential procedural effect: violations of the investor-state agreement would be subject to the full range of MAI dispute settlement mechanisms, including state-state consultations and arbitration. In such settlement, the issues would be considered in a broad context including both domestic and international law. The MAI Drafting Group considered that: "the second and third approaches would, in effect, amend investor-state agreements. They could introduce uncertainties about the law and remedies to be applied in case of dispute. They raise the questions of whether and how to draw a line between the kinds of agreements for which the additional protection might be appropriate and those for which it might not, such as purely commercial bargains, or agreements settling tax or other administrative claims". There was no consensus in the Group on the basic choice of approach.

That choice may also be affected by outcome on a provision stating that the more favourable of the MAI or those investor-state agreements prevailed. If a decision is taken to pursue either the second (procedural) or third (substantive and procedural) approach, there would be subsidiary questions, the most important being scope of coverage. Should the provision apply broadly to all investor rights under investor-state agreements? If not, should it be limited by, for example, distinguishing between rights arising under essentially commercial agreements (presumably excluded) and those under which a state is acting as a sovereign (presumably covered) – a distinction which may be difficult to make in practice; or enumerating or defining categories of covered rights, such as those arising out of investment agreements and authorisations on which an investor has relied. The Group examined the strategic choices and issues thoroughly, in the time available, and clarified their implications. Given the range of views, the Group did not elaborate draft provisions for inclusion in the MAI. However, it agreed to provide the above mentioned provisions to aid in understanding the basic choices. These texts were not examined by the Group and did not represent specific recommendations. See "*Report of The Drafting Group Concerning the Protection of Investor Rights Arising from Other Agreements*", DAFFE/MAI/DG1(96)REV1, 18 March 1996, in *www1.oecd.org/daf/mai/pdf/dg1/dg1961r1e.pdf*.

91. The Energy Charter Treaty was signed on 17 December 1994, available at *www.encharter.org*.

92. The accompanying Secretariat document defines the scope of the provision as follows: "*Article 10(1) has the important effect that a breach of an individual investment contract by the host state country becomes a violation of the ECT. As a result, a foreign investor and its home country may invoke the dispute settlement mechanism of the Treaty*", The Energy Charter Treaty: A Reader's Guide, June 2002, p. 26.

93. See Sinclair, *op. cit.*, No. 108.

94. C.N. Brower, "The Future of Foreign Investment – Recent Developments in the International Law of Expropriation and Compensation", in V.S. Cameron (eds.), *Private Investors Abroad – Problems and Solutions in International Business in 1975* (Southwestern Legal Foundation Symposium Series, Private Investors Abroad, Matthew Bender, New York, 1976), pp. 93, 105, No. 27 as cited by A. Sinclair *op. cit.*, No. 108.

95. Wälde notes that contracts related to investment – at this time seen in a much more narrow way as "foreign direct investment" than today – did by their very nature always involve a governmental dimension. Treaties at this time also only provided for state-to-state arbitration which was a screening mechanism against exorbitant and gratuitous use of treaties by private commercial operators. "The 'Umbrella' (or Sanctity of Contract/*Pacta Sunt Servanda*) Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases", *Transnational Dispute Management*, Vol. 1, Issue #04, October 2004 (forthcoming 2005, *Arbitration International*).

96. "Il y a en effet, pas de difficultés particulières (en ce qui concerne la mise en jeu de la responsabilité contractuelle de l'État) lorsqu'il existe entre l'État contractant et l'État national du cocontractant un traité de 'couverture' qui fait de l'obligation d'exécuter le contrat une obligation internationale à la charge de l'État contractant envers l'État national du cocontractant. L'intervention du traité de couverture transforme les obligations contractuelles en obligations internationales et assure ainsi, comme on l'a dit, 'l'intangibilité du contrat sous peine de violer le traité'; toute inexécution du contrat, serait-elle même régulière au regard du droit interne de l'État contractant, engage dès lors la responsabilité internationale de ce dernier envers l'État national du cocontractant", *Recueil des Cours III*, 1969, pp. 132 and seq.

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97. F.A. Mann, "British Treaties for the Promotion and Protection of Investments", *52 British Yearbook of International Law 241* (1981), at p. 246.

98. R. Dolzer and M. Stevens, "Bilateral Investment Treaties", *Kluwer Law*, 1995, pp. 81-82.

99. "L'arbitrage sur le fondement des traités de protection des investissements", Revue de l'Arbitrage, p. 868, note 43.

100. "Bilateral Investment Treaties in the mid-1990s", United Nations, 1998, p. 56.

101. T. Wälde *op. cit*., No. 120.

102. "La neutralisation du pouvoir normatif de l'État en matière de contrats d'État", *JDI*, 1986, pp. 36-37.

103. *Fedax NV v. Republic of Venezuela*, Award 9 March 1998, 37 ILM 1391 (1998).

104. *Idem*, paragraphs 25, 29 (2002), 5 ICSID report 186 pp.

105. The first Energy Charter Treaty tribunal in *Nycomb v. Latvia* could have rendered its judgment on the basis of the ECT umbrella clause as was proposed by the claimant, but preferred to rest its decision on national treatment. By doing so, it avoided having to decide whether, in this case, the contract's jurisdictional clause in favour of domestic courts should be overridden by the ECT's arbitral jurisdiction. The existence and the potential scope of the clause was also addressed *in Salini Construttori S.P.A. and Italstarde S.P.A. v. The Hashemite Kingdom of Jordan* under the Italy-Jordan BIT. The Tribunal considered the decisions of the SGS Tribunals on the umbrella clause but ultimately found that the language of the Italy-Jordan BIT did not include such a clause.

106. *SGS Société Générale de Surveillance, S.A. v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdcition, 6 August 2003, 18 ICSID Rev. F.I.L.J. 307 (2003).

107. *Ibid*., paragraph 166.

108. *Ibid*., paragraphs 167 and 173.

109. *Ibid*. at paragraph 168.

110. *SGS Société Générale de Surveillance, S.A. v. the Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, 29 January 2004, available at *www.worldbank.org/icsid/cases/SGSvPhil-final.pdf*.

111. On both cases see the analysis by E. Gaillard *op. cit*., No. 95, C. Schreuer *op. cit*., No. 107, T. Wälde *op. cit*., No. 120.

112. *Ibid*. at paragraph 125.

113. *Ibid*. at paragraphs 119 and 120.

114. *Ibid*., paragraph 128.

115. *Ibid*., paragraphs 136-155 and 170-76. One of the three members of the Tribunal, Professor A. Crivellaro, dissented.

116. *Waste Management Inc. v. United Mexican States*, ICSID Case No. ARB (AF)/00/3, Award, 30 April 2004, paragraph 73, in *www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Waste_2_management/laudo/laudo_ingles.pdf*.

117. *Consorzio Groupement L.E.S.I.-DIPENTA c. République algérienne démocratique et populaire*, ICSID Case No. ARB/03/08, Award, 10 January 2005, in *www.worldbank.org/icsid/cases/lesi-sentence-fr.pdf*.

118. *Idem*, paragraph 25(ii), "… Cette interprétation est confirmée *a contrario* par la rédaction qu l'on trouve dans d'autres traités. Certains traités contiennent en effet ce qu'il est convenu d'appeler des clauses de respect des engagements ou '*umbrella clauses*'. Ces clauses ont pour effet de transformer les violations des engagements contractuels de l'État en violations de cette disposition du traité et, par là même, de donner compétence au tribunal arbitral mis en place en application du traité pour en connaître…".

119. See *op. cit.*, No. 51.

120. *Idem*, paragraph 100.

121. *Idem*, paragraph 101.

122. *Joy Mining Machinery Limited v. The Arabic Republic of Egypt*, Award on Jurisdiction, ICSID Case No. ARB/03/11, August 6, 2004. Joy Mining, a company incorporated under the laws of the United Kingdom initiated an ICSID arbitration pursuant to the UK-Egypt BIT. The dispute concerned a "Contract for the Provision of Longwall Mining Systems and Supporting Equipment for the Abu Tartur Phosphate Mining Project", executed in April 1998 between Joy Mining and the General Organization for Industrial Projects of the Arab Republic of Egypt. The parties' disagreement related to performance tests of the equipment and to the release of guarantees. The Tribunal addressed the issue of whether bank guarantees may be considered to be an investment under the BIT. Noting that bank guarantees are simply contingent liabilities, concluded that they could not constitute assets under the BIT and were not protected investments. In terms of the distinction between contractual disputes and investment disputes, the Tribunal held that "[i]n this context, it could not be held that an umbrella clause inserted in the treaty, and not very prominently, could have the effect of transforming".

123. *Idem*, paragraph 81.

124. *Eureko B.V. v. Poland*, Partial Award, 19 August 2005 can be found at *www.investmentclaims.com/decisions/Eureko-Poland-LiabilityAward.pdf*.

125. *Idem*, paragraph 246.

126. *Noble Ventures, Inc. v. Romania*, Award, October 12, 2005, ICSID Case No. ARB/ 01/11. The decision concerns a dispute between a US company, Noble Ventures, Inc. ("the claimant") and Romania arising out of a privatization agreement concerning the acquisition, management and operation of a Romanian steel mill, Combinatul Siderugic Resita ("CSR") and other associated assets. The privatization agreement was entered into between the claimant and the Romanian State Ownership Fund ("SOF"). Noble Ventures paid SOF the initial instalment of the purchase price and SOF transferred to Noble Ventures its shares of CSR, comprising almost all of CSR's equity share capital. Noble Ventures alleged, *inter alia*, that Romania failed to honour the terms of several agreements related to the control of CSR, that Romania misrepresented CSR's assets in the tender book prepared for the privatization, that Romania failed to carry out its obligation to negotiate debt rescheduling with state budgetary creditors in good faith, that Romania failed to provide full protection and security to its investment during a period of labour unrest in 2001, and that Romania's initiation of insolvency proceedings were in bad faith, in violation of fair and equitable treatment, and tantamount to expropriation.

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ISBN 92-64-02689-4
International Investment Perspectives
2006 Edition

PART II

Chapter 8

Consolidation of Claims: A Promising Avenue for Investment Arbitration?*

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Introduction

The multiplication of investment agreements with investor-state dispute settlement provisions has raised the risk of multiple and conflicting awards, as the same dispute can lead to awards under different treaty regimes as well as under different contracts. Investors are sometimes able to claim breaches of different BITs and to seek relief through different arbitration proceedings under each of the invoked treaties in respect of a single investment and regarding the same facts. The two "Czech cases", (*CME/Lauder v. the Czech Republic*)[1] and the approximately 40 cases currently pending against Argentina and arising from the same events demonstrate the increasing complexity of such situations.

Hence, the host state may face multiple arbitrations under different BITs in relation to essentially the same set of facts. Although the experience up to now does not show major inconsistencies among arbitral awards, some decisions are considered inconsistent by certain parties.

In this evolving landscape of investment arbitration, consolidation of claims might be considered as an avenue for the avoidance of possible inconsistent and conflicting awards emanating from the multiplicity of proceedings, and agreed to review the issue further.

The present paper provides factual elements of information on the application of the consolidation of claims.. For a better understanding of the origin of this device, first it examines the way it has been used in commercial arbitration. Second, it looks at its application to investment arbitration, and third drawing from both experiences it highlights the advantages and disadvantages of such an application and proposes a set of action.

1. Consolidation of claims in commercial arbitration

Consolidation is a procedural device which denotes the process whereby two or more claims are united into one single procedure concerning all parties and all disputes. Although it is a recent concept in investment arbitration, it is not a new one in the commercial arbitration context where it is being used when multiple and parallel arbitral proceedings have been initiated.

Issues relating to consolidation of claims carry a particular concern to the business community as business relationships, and disputes which arise therein, can and do often involve a multiplicity of parties and contracts. When two or more disputes arise, it may prove beneficial to one or more parties to

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hear all disputes in one hearing. This can be contrasted with "*de facto* consolidation" where each individual arbitration is heard by the same panel of arbitrators or with a similar procedure[2] in which two or more arbitrations are heard simultaneously by the same panel of arbitrators but an award is rendered separately for each individual proceeding.

In the context of commercial arbitration, consolidation can involve the uniting of two or more court proceedings, consolidation of two or more arbitral proceedings or the consolidation of court and arbitral proceedings. Issues relating to consolidation of court proceedings will not be addressed in this paper as such a situation raises different issues or concerns and is often regulated under a different legal regime. In the latter two scenarios, however, consolidation raises much the same issues and thus will be treated in the same manner.

In situations where consolidation of claims may be relevant, it must be determined whether such a course of action is permissible under the relevant legal regime and if so, whether it is appropriate in the given circumstances. The questions which arise are: *i)* under what circumstances is consolidation of claims an appropriate measure; *ii)* what is the legal basis for such a consolidation. These issues or questions are not present where parties agree to consolidation; such an agreement falls within the doctrine of party autonomy and courts and tribunals will ordinarily respect any such agreement.[3] Thus, the questions that arise do so in connection with court ordered or tribunal ordered consolidation.

1.1. Under what circumstances is consolidation of claims an appropriate measure?

A number of different situations arise where consolidation of claims can be envisaged as pertinent. The most common such situations are: *i)* where a party raises claims against two or more parties, based on the same or a related fact pattern and where the claims are subjected to different arbitration agreements or arise under different contractual arrangements; *ii)* when several parties raise similar claims against the same defendant based on the same or a related fact pattern; *iii)* where a defendant or respondent to a claim itself has cross-claims which are subjected to a different dispute resolution arrangement; *iv)* where the defendant or respondent to a dispute itself has a claim against a third party based on the same factual pattern;[4] or; *v)* where two or more disputes arise out of the same fact pattern or raise the same or related questions of law or fact and such disputes are not linked by a common party.[5] In essence, consolidation of claims may arise between two parties where there is a multiplicity of contracts or claims, or between a multiplicity of parties based on a single claim or a multiplicity of claims[6] (Annex 8.A1).

1.2. Legal basis for consolidation

As the typical commercial arbitral process is premised upon notions of party autonomy, the power to order consolidation of claims in the absence of an agreement between the parties necessarily requires an appropriate legal basis. Three potential legal bases are suggested in the literature: *i)* the arbitration agreement itself; *ii)* rules of arbitral institutions; and *iii)* provisions of national arbitration laws.

1.2.1. The arbitration agreement

The contractual solution would only be plausible in a narrow set of circumstances. First, there would need to be symmetry between the relevant arbitration agreements as to seat of arbitration, applicable law, appointment mechanisms and procedural rules. Without such symmetry, it would necessarily need to be decided which agreement prevailed, an undertaking which has been described as "an impossible task".[7] Second, the relevant arbitration agreements must each empower a tribunal to assume jurisdiction over other disputes and other parties; the power to order consolidation thus derives from the will of the parties themselves. Where a two-party multi-dispute situation is consolidated in this manner, fewer problems arise than where a multipartite arbitration is envisaged as, from a theoretical point of view, it is arguable that no contractual relationship from which obligations arise exists between certain parties to the arbitration.[8]

1.2.2. Rules of arbitral institutions

Similar theoretical difficulties arise where the legal basis for consolidation is a set of institutional rules. Here again, the power to order consolidation arises from exercise of party autonomy through agreement on applicable procedure rules. As a necessary precondition, each relevant arbitration agreement would need to refer to the same institutional rules. Few institutional rules empower an arbitrator to order consolidation of proceedings; where such a power does exist, exercise of the arbitrators' discretion to order consolidation is generally tempered by a requirement that the disputes arise out the same set of facts or legal issues.[9] While many institutional rules contain provisions regulating the procedure to be used in multiparty arbitrations,[10] few contain provisions empowering a tribunal to coerce consolidation of proceedings (Annex 8.A2).

1.2.3. National arbitration laws

The most commonly used basis for consolidation of claims in commercial arbitration, is a provision in national arbitration law. Three variants in approach are discernible from a comparison of national arbitration laws: *i)* those that allow for court ordered or coerced consolidation even absent consent between the parties; *ii)* those that contain provisions on consolidation but precondition its application on consent of the parties; and *iii)* those that make no reference to consolidation (Annex 8.A3).

i) Court ordered consolidation

At present, only the **Netherlands**,[11] **Hong Kong**[12] and **Colombia** provide for court ordered consolidation of claims. Article 1046 of the **Netherlands** CCP makes no distinction between the legal regime applicable to domestic and international arbitrations although there exists two restrictions on court ordered consolidation. First, all relevant arbitrations must have their seat in the territory of the Netherlands. Second, parties may "opt out" of Article 1046. Exclusive jurisdiction over a request for consolidation is vested in the President of the District Court in Amsterdam.

By contrast, Section 6B of the **Hong Kong Ordinance** applies only to domestic arbitrations. However, parties to an international arbitration may "opt in" to the domestic arbitration regime, including the provision on consolidation.[13]

In the case of **Colombia**, the 1989 decree on arbitration renders invalid an arbitration agreement between two parties where a dispute may have effects on a third party that is not party to this agreement and refuses to be joined in the arbitration. In such a case, the arbitration proceedings are effectively consolidated with any related court proceedings despite the absence of all agreements of all parties in this respect.[14]

ii) Consolidation with the consent of the parties

Section 35 of the **English Arbitration Act** preconditions consolidation on consent of the parties. When reviewing arbitration law and procedure prior to adoption of the 1996 Act, the Departmental Advisory Committee ("DAC") considered the obstacles to consolidation insurmountable and thus no provision for consolidation of claims absent the agreement of the parties was introduced.[15] These obstacles were, in particular, concerns over protection of confidentiality and enforceability of an award rendered by a consolidated tribunal.

This approach can also be seen in the **British Columbia International Commercial Arbitration Act 1996**[16] which provides for court ordered consolidation on terms it considers "just and necessary" and where the parties have agreed to consolidation.[17] The **Australian International Commercial Arbitration Act 1989** also conditions application of the provision on consolidation on agreement of the parties insofar as parties must "opt in" to its application. In contrast to the approach taken in Canada, however, the decision to consolidate is taken by the arbitrators.[18]

iii) No reference to consolidation

The **Spanish Arbitration Law 2003** contains no reference to consolidation of claims.[19]

The legislative drafting history from both **Sweden** and **Germany** indicates provisions on consolidation of claims were purposefully omitted as the issue was considered too complex for resolution in their respective arbitration laws.[20]

The **Swiss Private International Law (PIL)** contains few provisions on regulation of the arbitral procedure and no specific provision on consolidation of claims.[21]

The **United States Federal Arbitration Act** (FAA) is also silent on the issue of consolidation of claims. Through statutory interpretation, certain District Courts had read into the FAA a power to coerce consolidation absent the agreement of the parties;[22] this interpretation has subsequently been overruled. As a result, court ordered consolidation of claims is presently not possible under the FAA.[23]

2. Consolidation of claims in investment arbitration

Consolidation of claims in investment arbitration is a more recent phenomenon. It is first seen in NAFTA and first applied in 2005. The need for consolidation arises when there are multiple arbitration proceedings filed with common questions of law or fact which raise the possibility of inconsistent or even conflicting awards. In this context, it is often raised when there are two or more claims arising from the same governmental measure. The *Lauder/CME v. the Czech Republic* cases might have reached a different result if the claims had been consolidated; in this case however, the respondent was unwilling to agree to consolidate the claims.[24]

2.1. State practice and international rules

The ***UNCITRAL Rules***,[25] the ***ICSID Convention***,[26] and the ***Additional Facility Rules***, do not have any provision allowing for consolidation of claims. The ***draft MAI***[27] had provided for consolidation of multiple proceedings in its Article 9 of the chapter of Investor-State Procedures. A provision worth mentioning under the draft MAI, which is not found in any agreement in force, gave the investor who objected to consolidation ordered by a consolidation tribunal, the right to withdraw the arbitration request but without prejudice to his non arbitration dispute settlement options, *e.g.* local courts.[28]

The first multilateral agreement in force which provided for consolidation of claims was ***NAFTA***. Its Article 1126 provides that where a Tribunal established under this Article is satisfied that claims submitted to arbitration *have a question of law or fact in common* the Tribunal may, in the interests of fair and efficient resolution of the claims, and after hearing the disputing parties, order that the Tribunal assume jurisdiction over and hear and determine together, all or part of the claims, the determination of which it believes would assist in the resolution of the others[29] (see Annex 8.A4). Since NAFTA, provisions of consolidation have been included in investment chapters of Free Trade Agreements of all three NAFTA Parties, such as in US FTAs with Chile,[30] Morocco,[31] Central America-Dominican Republic (CAFTA-DR)[32] and in the FTAs between Canada and Chile (Article G-27)[33] and between Mexico, Bolivia, Costa Rica[34] and Japan.

A novel element which appears in the ***Mexico-Japan FTA***,[35] is the possibility given to an investor who considers that his claim raises questions of fact and law common to those upon which the consolidation has been requested, but has not been named in the request of consolidation, to ask the Tribunal to consider the consolidation of its claim.

Consolidation provisions can be found for the first time in ***BITs*** in the new US Model BIT[36] as well as the new model Canada FIPA.[37] As is the case with NAFTA and the US FTAs, these new model agreements provide for consolidation upon request by a disputing party and concern multiple claims having a question of law or fact in common and arise out of the same events or circumstances , usually a state measure alleged to be in breach of the State's obligation.[38] The requested consolidation should be in the interest of fair and efficient resolution of claims. However, although they are very similar, one difference is noted. Under Canada's new model FIPA, only treaty claims and not claims based on an investment contract, may be referred to arbitration and possibly consolidated under the BIT provisions.

All the above agreements provide for consolidation in full or in part.[39] If consolidation in full is ordered, the Tribunals constituted to hear each of the claims cease to function. If partial consolidation is ordered, then these tribunals no longer have jurisdiction over the part over which the consolidation tribunal has assumed jurisdiction.[40]

2.2. Jurisprudence

2.2.1. Consolidation "stricto sensu"

The first application of the NAFTA provision on consolidation was the consideration of a request by Mexico for consolidation of three claims by a Tribunal constituted to this effect.[41] *Corn Products International, Archer Daniels Midland Company and Tate and Lyle Ingredients Americas, Inc.* ("The High Fructose Corn Syrup casesHFCS cases", HFCS thereafter), three US based companies, had submitted requests for institution of arbitration proceedings to ICSID against Mexico, for alleged breaches of NAFTA arising from the imposition of an excise tax on soft drinks containing high fructose corn syrup. A "Consolidation Tribunal" was constituted upon agreement of all the parties on both the membership and its mandate, to rule upon Mexico's request and decided against this consolidation in its Order of May 20th, 2005. It held that although there were some common questions of fact and law, there were several reasons to reject the claim: the direct and major competition between the claimants which would require complex confidentiality measures throughout the arbitration process and the numerous distinct issues of state responsibility and quantum.

On March 7, 2005, the United States filed a request[42] with ICSID pursuant to NAFTA Article 1126 to consolidate three claims: *Canfor Corp. v. United States of America, Terminal Forest Products Ltd. v. United States of America and Tembec Inc.* et al. *v. United States of America*, ("the Softwood lumber" cases, thereafter), related to losses allegedly suffered as a result of certain US antidumping, countervailing duty and material injury determinations on softwood lumber. The United States made this request "in the interest of a fair and efficient resolution of those claims and to avoid the possibility of conflicting determinations", claiming that relevant issues of fact and law in the three notices of arbitration are nearly identical. A Tribunal was constituted to this effect by the Secretary General of ICSID and held its hearing on June 16, 2005.[43] On 7 September 2005, the Tribunal issued its Order[44] agreeing to the request of consolidation after having found after having found that all four conditions of Article 1126(2) of the NAFTA were met. First, the claims in question had been submitted to arbitration under Article 1120; second, many questions of law and fact were common in the three Article 1120 arbitrations (including the similar jurisdictional objections raised by the United States); third, the interests of fair and efficient resolution of the claims merit the assumption of jurisdiction over all of the claims; and fourth, the parties to the proceedings had been heard. The interests of avoiding conflicting awards and enhancing "procedural economy" were also important factors in its decision. The Tribunal disagreed with the statements found in the "HFCS cases" related to the major competition among the claimants and the respect of confidentiality as the main impediments for such a consolidation. After the Tribunal issued its decision, Tembec has voluntarily withdrawn its claim from the consolidation tribunal and is seeking to set aside the consolidation award in the US courts.

*2.2.2. "*De facto*" consolidation*

In order to avoid inconsistencies in the findings of different tribunals, parties could also appoint the same arbitrators. There have been some recent cases filed at ICSID in which the parties agreed to have their claims against a particular state consolidated *de facto*, when two or three claims were brought by different investors against the same host State for similar actions taken by that State.[45] For instance, the ICSID Secretariat recommended such an action in the cases *Salini Construttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*[46] and *Consortium R.F.C.C. v. Kingdom of Morocco*[47] based both on the same BIT between Italy and Morocco and on similar factual and legal backgrounds. Although the two procedures were conducted separately, the identical tribunal was named to hear both and, naturally avoided issuing inconsistent decisions.[48]

In the context of the ICSID claims pending against Argentina a single Tribunal has been appointed to hear two independent claims. In March 2004 Sempra Energy International and Camuzzi International agreed to set up a single Tribunal to hear their claims registered within a three month time period and raised under two different BITs (US-Argentina for Sempra and Belgo-Luxembourg Economic Unit-Argentina for Camuzzi). The *Sempra Energy International v. Argentina*[49] and *Camuzzi International A.A. v. Argentina*[50] cases were heard by one Tribunal.[51] One set of arbitrators has also been appointed to hear two disputes against Argentina involving electricity distribution companies in *Electricidad Argentina, S.A., and EDF International S.A. v. Argentina*[52] and *EDF International S.A., SAUR International S.A. and Léon Participations Argentinas S.A. v. Argentina*.[53] The same Tribunal was also constituted in three cases involving water services concessions: *Aguas Provinciales de Santa Fe, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A. and Interagua Servicios Integrales de Agua, S.A. v. Argentine Republic*,[54] *Aguas Cordobesas, S.A., Suez, and Sociedad General de Aguas de Barcelona, S.A. v. Argentine Republic*[55] and *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A.* and *Vivendi Universal, S.A. v. Argentine Republic*.[56]

3. Rationale for the Consolidation of Claims

In situations where a consolidation of claims is possible, it remains to be determined whether such a course of action is appropriate in the circumstances of the case at hand. To make this determination, a balancing of the advantages and disadvantages of consolidation of claims as compared to separate proceedings is undertaken. The only arbitral tribunal which decided in favour of such a consolidation thereafter the "Softwood lumber tribunal", Mexico and the United States, which have argued in their submissions in favour of consolidation, as well as several commentators, generally identify two main benefits to consolidation of claims: *i)* increase in the efficiency of arbitration; and *ii)* avoidance of conflicting or contradictory awards.[57] On the other hand, the arguments against consolidation made by objecting parties and some commentators focus on: *i)* lack of the parties' consent; *ii)* non-participation in the appointment of the arbitral tribunal; *iii)* potential infringements of a party's substantive rights; and *iv)* apportionment of arbitral fees and other costs.

3.1. Arguments in favour of consolidation

3.1.1. Efficiency

Efficiency considerations concern legal efforts, time and cost. When claims arise from the same measures, it is likely that they would present common issues of treaty breach and treaty interpretation and require common grounds of defence. Time and financial expenditures can be reduced through having a unified process; repetition or duplication of the same evidentiary materials is avoided as is litigation or arbitration related costs such as expert witness fees. A second source of costs-savings relates to the single payment of arbitrators fees, an expenditure which often constitutes a significant portion of the cost of arbitration.[58] Here the necessity of balancing the "overall" efficiencies becomes apparent.[59] On the whole, it seems reasonable to conclude that the consolidation of closely related disputes, where essentially the same evidence will be presented, will result in significant savings of both time and money.[60]

However, it is possible that an individual arbitration may be more efficient for an individual disputing investor.[61] The investor may have small or indirect claims, the determination of which is likely to take longer and be more expensive in a consolidated arbitration than in a purely bilateral resolution of the dispute. In contrast, consolidated proceedings may be more efficient for a respondent State Party.[62]

Article 1126 of NAFTA provides for consolidation "*in the interests of fair and efficient resolution of claims*". The "Softwood lumber" consolidation tribunal in making the determination of efficiency also considered what is "fair". It noted that "*the interests of all parties involved should be balanced in determining what is the procedural economy in the given situation…it includes the consideration that all parties shall continue to receive the fundamental right of due process…*". It found as a guiding test for measuring efficiency the comparison with the existing situation, if no consolidation were ordered.

3.1.2. Avoidance of inconsistent or contradictory awards

The second and often cited as the most important, justification for consolidation is the avoidance of inconsistent or contradictory awards.[63] In the context of investment arbitration, the concern over inconsistent or contradictory awards gains a heightened importance because of the public interest issues raised and insofar the grounds for review of arbitral awards are narrow and do not allow for re-examination of questions of law or fact. The grounds for such review under the ICSID Convention are limited to annulment procedures on limited grounds and for non-ICSID awards through challenge procedures or through resisting recognition and enforcement of an award based on the Article V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (The New York Convention)

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pertaining primarily to breaches of due process and a few other narrow exceptions.[64] As a consequence, inconsistent or contradictory awards risk not being reconciled or set aside by annulment committees or judicial authorities.

The consolidation tribunal in the "Softwood lumber" cases acknowledged that inconsistent results do occur, making reference to the Czech cases. It added that although arbitral awards do not constitute binding precedent, they do constitute persuasive precedent and the effective administration of justice requires the avoidance of conflicting results. Consolidation, both full and partial, would work in favour of avoiding conflicting results: "… *if a total consolidation occurs, no conflicting decisions can arise. But if a partial consolidation under that provision occurs, no conflicting decisions can arise either since a decision by an Article 1126 Tribunal must be deemed to be binding to the Article 1120 Tribunals to the extent of the questions chosen for determination in the partial consolidation.*"[65]

Some argue that the risk of inconsistent awards is easily over-emphasized from a theoretical point of view whereas arbitral practice shows this risk has rarely materialised and thus does not pose a substantial problem.[66] Others have argued that the risk of inconsistent or contradictory awards in and of itself detracts from or diminishes the confidence of the international community in arbitration as an effective means of dispute resolution as it may result in an unjust or inequitable solution, in particular where issues of public interest are at stake.[67]

3.2. Arguments against consolidation of claims

Arguments against the consolidation of claims relate to: *i)* the intention and consent of the parties to submit their claims to arbitration; *ii)* non-participation in the appointment of the arbitral tribunal; *iii)* potential infringements of a party's substantive rights; *iv)* apportionment of arbitral fees and other costs.[68]

3.2.1. Parties' consent

In the context of commercial arbitration, it is argued that when the parties to a dispute have not expressly provided for consolidation, to impose such a course of action runs counter to the intent and consent of the parties as expressed in the dispute resolution mechanism provided for in each individual arbitration agreement.[69] Critics of consolidation consider the nature of arbitration as a consensual process as paramount and thus as outweighing all suggestions that a court or tribunal may revise an arbitration agreement to provide for or allow consolidation.[70]

The situation might be different in investment arbitration. One argument raised in the NAFTA Softwood lumber consolidation case against unifying claims into a single procedure was that it would be against the consensual nature of arbitration (or the principle of party autonomy). Although this might be true for commercial disputes where the parties' consent is the guiding force for such a consolidation, it might not necessarily be the same on investment arbitration where the guiding consolidation principles are the unity of the economic transaction affected by the same State measure. As the Softwood Lumber consolidation tribunal noted on this point, by submitting their dispute to arbitration under NAFTA Chapter 11, the investors accept the conditions set by the three NAFTA States who negotiated the treaty. Therefore, "*party autonomy is not relevant for considering a consolidation request under Article 1126*". It supported this point by citing H. Alvarez:

> "*Although mandatory consolidation is not widely accepted in private commercial arbitration, it makes good sense in the case of Chapter 11 of NAFTA, which is not the usual private, consensual context of international commercial arbitration. Rather, Chapter 11 creates a broad range of claimants who have mandatory access to a binding arbitration process without the requirement of an arbitration agreement in the conventional sense, nor even the need for a contract between the disputing parties. In view of this, some compromise of the principles of private arbitration may be justified.*"[71]

A different view was held by the Consolidation tribunal in the "HFCS cases". The Tribunal considered that the opposition of the claimants to consolidation was a factor weighing against it:

> "*It would appear to follow that since party autonomy at least for certain limited purposes, has been read into Article 1126 and accepted by three NAFTA treaty states as well as by the private parties in this consolidation proceeding… should be a relevant consideration to be taken into account in the interpretation and application of Article 1126; in this case… three of the four parties before it do not wish to have the claims consolidated… the Tribunal views those wishes as a relevant consideration in evaluating the fairness of the proposed consolidation.*"

3.2.2. Non-participation in the appointment of the Tribunal

It is often stated that one of the primary advantages of arbitration over judicial remedies is the ability of the parties to appoint the arbitrators. Arbitration agreements and investment treaties in the case of investment arbitration can expressly prescribe the method of appointment or do so by reference to institutional arbitration rules. These methods of appointment, however, may not be practicable or appropriate to a consolidated tribunal where there is to be a panel of arbitrators and the claim involves multiple parties. Where the tribunal is to be composed of three arbitrators, a typical arrangement is to provide for each party to nominate or appoint one arbitrator while the chair or neutral arbitrator is to be appointed by agreement of the party-appointed arbitrators.[72] Where claims are consolidated to the effect that the consolidated claim is raised against or by multiple parties, enabling each party to appoint an arbitrator may prove more difficult.

On the other hand, it has been suggested that non-participation in the appointment process may not necessarily prove fatal to consolidations, since what is important is equality of treatment between the parties.[73] This could, for instance, be effectuated through the appointment of all the arbitrators by an appointing authority, *e.g.* the Secretary General in the case of ICSID for instance.

3.2.3. Infringement of a party's substantive rights

Potential infringements of a party's substantive rights – in particular the investor's – include two separate considerations. First is whether consolidation is liable to increase the likelihood of arbitrator error; second is the issue of confidentiality.

As regards the question of arbitrator error, it has been suggested that the increased complexity of a consolidated proceedings may increase the likelihood of arbitrator error.[74] Against this proposition is the suggestion that errors of fact are less likely to occur in a consolidated procedure as the arbitrators are presented with a more complete set of facts or a wider perspective from which to draw their conclusions.[75]

Confidentiality is often advanced as a primary advantage of arbitration over court proceedings[76] although it has been strongly debated and increasingly bypassed in the context of investment arbitration. It is argued that consolidation proceedings may affect confidentiality with regard to additional parties to a dispute. A typical example where issues of confidentiality are pertinent is in the sphere of investors who are direct competitors where, for example, they may not wish to disclose to their sub-contractors, details as to the nature of their investments, business strategies, production costs, plant design or profit margins.[77] Some commentators, Mexico in the "HFCS cases " and the consolidation tribunal in the "Softwood lumber cases", argued that confidentiality concerns can be protected through other means such as protective orders, imposition of confidentiality undertakings, partially separate hearings *in camera*, classifying submissions, documents and testimony; appointment of a confidentiality advisor, arbitral orders restricting access, while ensuring that each party is afforded a full opportunity of presenting its case. As the tribunal in the Softwood lumber cases noted, "*in many international arbitrations, parties negotiate and execute an appropriate confidentiality agreement among themselves*".[78] It also noted that protecting confidentiality is a balancing act for the tribunal which is called to make its decision based on due process considerations for the parties:

> "*The exceptional cases where confidentiality would defeat efficiency of process or would infringe the principle of due process enunciated in Article 1115 of the NAFTA, if proceedings were consolidated, are not likely often to occur. Such a*

situation may be present in the event that clearly identified and significant confidentiality issues are bound to arise in the proceedings, if consolidated; that these issues overweight all three factors (time, cost and avoidance of conflicting results); and that these issues are such that, if the proceedings are consolidated, they are manifestly counterproductive to an effective administration of justice."[79]

Other commentators argue that confidentiality concerns should not prevent the consolidation of claims *ipso facto* but rather should operate to guide the discretion of the court or tribunal as to whether consolidation is appropriate in the specific case.[80]

3.2.4. Apportionment of the costs of arbitration

Another issue raised regarding consolidation of claims is the appropriate or correct apportionment of fees and costs of arbitration. Some rules require each party to pay its own arbitration costs. Others, however, may require the losing party to pay all costs or apportion costs between the parties.[81] As no generalised formula exists, equitable distribution of costs remains a discretionary function of the arbitral tribunal having regard to the particular circumstances of each individual case.[82]

4. Summing up

Consolidation of claims has its roots in commercial arbitration where it is based essentially on the party autonomy principle, *i.e.* the parties' consent, except in a few cases where national arbitration laws provide for court-ordered consolidation. In investment arbitration, NAFTA as well as a number of recent US, Canada and Mexico FTAs and the US model BIT and Canada model FIPA, provide for consolidation of claims when there are questions of law and fact in common. Two NAFTA consolidation tribunals issued their opinions on this issue which differ in their conclusions as to the fairness of consolidation in the circumstances. A number of arguments have been advanced to favour consolidation and counter arguments to dispute its legitimacy.

In the field of investment arbitration, where public interest issues are at stake, the risk of inconsistent decisions, although not often observed, remains a significant consideration. The result could be for a State to be exposed to two opposite decisions in regard to the same measure (one decision condemning it for having violated its international obligations, the other not finding any responsibility, see for instance the Czech cases). Consolidation of claims emanating from the same state measure and based on similar factual and legal elements could protect against such a risk. However, there is no consensus that the advantages of consolidation provisions in investment agreements exceed *versus* its disadvantages. The consent of the parties as a prerequisite for a request for consolidation and concerns about confidentiality still weigh strongly against the advantages of this measure.

Only few treaties presently provide for consolidation. In the absence of such provision, the disputing parties who wish to do so could take the initiative to ask for consolidation or "*de facto*" consolidation, and arbitral institutions such as ICSID could facilitate the process by appointing the same panel of arbitrators – which has already been done in some of the cases against Argentina.

Notes

1. *CME Czech Republic B.V. v. Czech Republic*, Partial Award (September 13, 2001), available at *http://mfcr.cz/Arbitraz/en/PartialAward.doc* and *Lauder v. Czech Republic* (Final Award) (3 September, 2001) available at *www.mfcr.cz/scripts/hpe/default.asp*>.
2. Available under the Australian International Commercial Arbitration Act 1989.
3. Leboulanger, "Multicontract Arbitration" (1996), *13:4 J. Int. Arb. 43*. See also Gaillard, "L'affaire Sofidif ou les difficultés de l'arbitrage multipartite" (1984), *3 Revue de l'arbitrage*, 274 at 284: "En l'état de la législation française, le seul moyen de consolider les procédures ou de rapprocher les clauses, est de découvrir dans l'intention de *toutes* les parties concernées le souci que la procédure arbitrale se déroule de cette manière. A défaut, l'une des parties serait fondée à soutenir que le tribunal arbitral s'est prononcé, à son égard, hors des termes du compromis."
4. See *e.g. The Vimeira* [1983] 2 Lloyd's Rep 424 (see Annex 1).
5. See the "Soya Bean Embargo" cases where a number of arbitrations were initiated in the wake of the 1973 US embargo on exports of soybeans, cited in Mustill, "Multipartite Arbitrations: An Agenda for Lawmakers" (1991), 7:4 Arb. Int. 393 at 393.
6. E. Gaillard, "Consolidation of Arbitral Proceedings and Court Proceedings", in *Complex Arbitrations: Perspectives on their Procedural Implications, Special Supplement – ICC International Court of Arbitration Bulletin*, December 2003, pp. 35-42.
7. Mustill, *supra* note 5 at p. 396.
8. For example, in consolidated proceedings between A and B and between B and C, from a theoretical standpoint there is no contractual relationship between A and C.
9. Arbitration Rules of the New York State Insurance Department (11 NYCRR 65); 2000 Arbitration Rules of the Chartered Institute of Arbitrators; 1997 Rules of the Belgian Centre for the Study and Practice of National and International Arbitration (CEPANI).
10. *E.g.* ICC Rules Article 10 on Multiple Parties: "Where there are multiple parties, whether as Claimant or as Respondent, and where the dispute is to be referred to three arbitrators, the multiple Claimants, jointly, and the multiple Respondents, jointly, shall nominate an arbitrator for confirmation pursuant to Article 9. In the absence of such a joint nomination and where all parties are unable to agree to a method for the constitution of the Arbitral Tribunal, the Court may appoint each member of the Arbitral Tribunal and shall designate one of them to act as chairman. In such case, the Court shall be at liberty to choose any person it regards as suitable to act as arbitrator, applying Article 9 when it considers this appropriate."
11. Article 1046 Netherlands Code of Civil Procedure 1986.
12. Section 6B Hong Kong Arbitration Ordinance 1997.

13. Four alternatives are available under Section 6B; the Court may order consolidation, or the arbitrations to be heard together, are to be heard immediately one after another or may order a stay of arbitration pending the resolution of the other arbitration. In the majority of cases, measures that fall short of full consolidation are ordered. Kaplan and Morgan, *International Handbook on Commercial Arbitration*, supp. 29, December 1999.

14. See F. Mantilla Serrano, "La nouvelle législation colombienne sur l'arbitrage", *Revue de l'arbitrage*, 1992, p. 54 as referred to by E. Gaillard see *op. cit.*, No. 6.

15. Appendix C to the DAC's Second Report: Consolidation, 1991 (1991), 7:4 Arb. Int. 389; see also South African Law Commission Project 94, Report of July 1998, "Arbitration: An International Arbitration Act for South Africa", which rejected a proposal to include a provision on consolidation of claims on the basis of difficulties in enforcement and confidentiality of proceedings.

16. *E.g.* Article 27 British Columbia International Commercial Arbitration Act 1996.

17. The Canadian International Commercial Arbitration Laws of the common law provinces and territories contain largely similar provisions.

18. While no problems arise where the arbitrations are being heard by the same panel of arbitrators, Section 24(5) provides a mechanism for consultation and joint deliberation between panels of arbitrators where the arbitrations are being heard by different panels. In such a case, consolidation can only proceed where the arbitrators reach consensus. Subsection (6)(c) provides an appointment mechanism for the appointment of the consolidated tribunal. Subsection (1) empowers the tribunal(s) to order consolidation, to hear the proceedings simultaneously or in a specified sequence, or to stay proceedings pending resolution of a specified claim.
    A similar approach is taken in Florida Stat. s.684.12.

19. The Spanish Arbitration Law creates one regime for both domestic and international commercial arbitration.

20. Cited in Weigand, "The UNCITRAL Model Law: New Draft Arbitration Acts in Germany and Sweden" (1995), 11:4 Arb. Int. 397.

21. Article 182 details the regulatory regime for determining the applicable procedure. The choice of applicable procedure is primarily submitted to party autonomy. In the absence of a determination by the parties, the arbitral tribunal is accorded the power to so determine. The lack of procedural rules results from an intention on the part of the legislator to accord the greatest degree of flexibility to the parties and arbitrators so as to tailor the arbitral process to their specific needs. Blessing, "The New International Arbitration Law in Switzerland: A Significant Step Towards Liberalism" (1988), 5:2 J. Int. Arb. 9.

22. See *e.g. Compañia Española de Petrolleos S.A v. Nereus Shpiing, S.A.*, 527 F. 2d 966 (2d Cir. 1979).

23. *UK v. Boeing* 998 F. 2d 68, 72 (2d Cir. 1993).

24. *The CME v. Czech Republic* Tribunal, in its Final Award ordering the Czech Republic to pay damages, reiterated the respondent's repeated rejection of CME's offer to structure the two cases so as to avoid potentially conflicting arbitral awards:
    "*At the hearing the Respondent declined anew to accept any of the Claimant's alternative proposals…* i) *to have the two arbitrations consolidated into a single proceeding;* ii) *to have the same three arbitrators appointed for both proceedings;* iii) *to accept the Claimant's nomination in this proceeding of the same arbitrator that Mr. Lauder nominated in the London proceeding;*

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iv) *to agree that the parties to this arbitration are bound by the London Tribunal's determination as to whether there has been a Treaty breach;* v) *that after the submission of the parties' respective reply memorials and witness statements in this arbitration, the hearing be postponed until after the issuance of an award in they London Arbitration*."

25. When reviewing possible improvements to the 1985 UNCITRAL Model Law, the Secretariat proposed work on a provision on consolidation of claims. The Working Party, however, could not reach agreement on the importance to attach to this issue nor whether this issue was capable of resolution at that time. Ultimately, the UNCITRAL Model Law 2002 contained no reference to consolidation of claims.

26. A. Crivellaro suggests that "Article 26 of the ICSID Convention" which stipulates that "consent of the parties to arbitration under this Convention… be deemed consent to arbitration to the exclusion of any other remedy… *is an important reference point as a policy of consolidation since it excludes the parallel referral of the dispute to domestic courts and serves to avoid duplication of proceedings*". See "Consolidation of Arbitration and Court Proceedings in Investment Disputes", presentation at the *ICC Institute of World Business Law*, 24th Annual Meeting, Paris, 15 November 2004. Professor Schreuer also suggests that the function of Article 26 is to create a "*rule of priority* vis-à-vis *other systems of adjudication in order to avoid contradictory decisions and to preserve the principle of 'ne bis in idem'*" in "The ICSID Convention: A Commentary", Cambridge University Press 2001, p. 359.

27. DAFFE/MAI(98)7REV1, *www1.oecd.org/daf/mai/pdf/ng/ng987r1e.pdf*.

28. Article 9e of the draft MAI: "*An investor may withdraw the dispute from arbitration under this paragraph 9 and such dispute may not be resubmitted to arbitration under paragraph 2c. If it does so no later than 15 days after receipt of notice of consolidation, its earlier submission of the dispute to that arbitration shall be without prejudice to the investor's recourse to dispute settlement other than under paragraph 2c.*"

29. *www.dfait-maeci.gc.ca/nafta-alena/chap11-en.asp?#article_1125*.

30. US-Chile Free Trade Agreement (Article 10.24) signed on 1 March 2004.

31. US-Morocco Free Trade Agreement (Article 10.24) signed on 15 June 2004.

32. US-CAFTA-DR (Article 10.25) signed on 5 August 2004.

33. *www.dfait-maeci.gc.ca/tna-nac/cda-chile/chap-g26-en.asp#II*.

34. *www.sice.oas.org/cp_bits/english/fta7c2e.asp*.

35. Article 83 of the Japan-Mexico Free Trade Agreement in *www.mofa.go.jp/region/latin/mexico/agreement/agreement.pdf*.

36. Article 33 in *www.state.gov/documents/ organisation/38710.pdf*.

37. Article 32 in *www.dfait-maeci.gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf*.

38. Usually, the same fact is a State measure which is allegedly in breach of the State's obligation. "This concept is a more precise criterion for consolidation than the 'same dispute' requirement under the traditional *lis pendens/res judicata* theories". See A. Crivellaro, *op. cit*., No. 26.

39. NAFTA Article 1126(2)(b), Article 33(6)(b) of the US Model BIT and 32(2)(b) of the Model FIPA.

40. Partial consolidation further raises the question whether, and if so, to what extent, the individual claim tribunals should adjourn the proceedings before them, pending resolution by the consolidation tribunal. The consolidation tribunal in the softwood lumber cases (see below) has raised but not examined the question. See

Canfor Corp. v. United States of America, Terminal Forest Products Ltd. v. United States of America and Tembec Inc. et al. *v. United States of America*, Order of the Consolidation Tribunal, 7 September 2007, paragraph 158, at *http://naftaclaims.com/Disputes/USA/Softwood/Softwood-ConOrder.pdf*.

41. *Corn Products International, Inc. v. United Mexican States* and *Archer Daniels Midland Company and Tate and Lyle Ingredients Americas, Inc. v. United Mexican States*, Order of the Consolidation Tribunal, May 20, 2005.

42. Request on consolidation by the United States, 7 March 2005, *www.state.gov/documents/organisation/43492.pdf*.

43. See transcript of the consolidation hearing, *www.state.gov/documents/ organisation/48508.pdf*.

44. *Canfor Corp. v. United States of America, Terminal Forest Products Ltd. v. United States of America and Tembec Inc.* et al. *v. United States of America*, Order of the Consolidation Tribunal, 7 September 2007, at *http://naftaclaims.com/Disputes/USA/Softwood/Softwood-ConOrder.pdf*.

45. E. Obadia, "ICSID, Investment Treaties and Arbitration: Current and Emerging Issues", in *Investment Treaties and Arbitration*, ASA Swiss Arbitration Association Conference on 25 January 2002, pp. 67-77.

46. *Salini Construttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4 in 42 ILM 609 (2003).

47. *Consortium R.F.C.C. v. Kingdom of Morocco*, ICSID Case No. ARB/00/6 in *www.worldbank.org/icsid/cases/rfcc-decision.pdf*.

48. See Antonio Crivellaro, *op. cit*., No. 26.

49. *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Decision on Objection to Jurisdiction, 11 May, 2005.

50. *Camuzzi International S.A. v. Argentina*, ICSID Case No. ARB/03/2, Decision on Objection to Jurisdiction, 11 May, 2005. Camuzzi has also raised a second claim in relation to its electricity distribution and transportation enterprise, *Camuzzi International S.A. v. Argentina*, ICSID Case No. ARB/03/7; this claim is being heard by a different Tribunal, separately and independently of its other claim.

51. One arbitrator was appointed jointly by Sempra and Camuzzi, Argentina appointed the second arbitrator and the president of the tribunal was appointed by the Secretary General of ICSID. Other procedural matters also appear to have been agreed by the parties, including the time-table for submissions and, where appropriate, submission of consolidated pleadings (Decision, paragraphs 9-14).

52. *Electricidad Argentina, S.A., and EDF International S.A. v. Argentina*, ICSID Case No. ARB/03/22.

53. *EDF International S.A., SAUR International S.A. and Léon Participations Argentinas S.A. v. Argentina*, ICSID Case No. ARB/03/23. No procedural history of these two cases is available, thus the degree of integration and the procedures adopted, are, at present, unclear.

54. *Aguas Provinciales de Santa Fe, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A. and Interagua Servicios Integrales de Agua, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/17.

55. *Aguas Cordobesas, S.A., Suez, and Sociedad General de Aguas de Barcelona, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/18.

56. *Aguas Argentinas, S.A., Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19.

57. For a detailed discussion on the advantages and disadvantages to consolidation in the context of commercial arbitration see Chiu, "Consolidation of Arbitral Proceeding and International Arbitration", (1990), 7:2 J. Int. Arb 53.

58. On the other hand, it is similarly possible that a party's costs may actually increase through consolidation of claims; this may arise, for example, where the increased complexity of the case results in a longer procedure than would have occurred had a party been required to be present only at a single unconsolidated arbitration. See Gaillard, *op. cit.*, No. 6 at 35; Born, "International Commercial Arbitration" (2nd ed. 2001), at p. 674; Chiu, *op. cit.*, No. 57.

59. Platte, "When Should an Arbitrator Join Cases?" (2002), 18:1 Arb. Int. 67.

60. Chiu, *op. cit.*, No. 57.

61. An issue for reflection is whether in the case the treaty contains an umbrella clause, consolidation should extend to claims and counterclaims under covered contracts, *e.g.*, for additional costs, delay, or unpaid invoices. Would it be possible or desirable to permit the consolidation of proceedings under a BIT (in which an investor is pursuing contractual claims through an umbrella clause) with proceedings under a contract (where a State is pursuing contractual claims or counterclaims against the same investor), provided of course that all claims arise out of the same contractual relationship?

62. See Order of the Consolidation Tribunal in the Softwood lumber cases, Antonio Crivellaro *op. cit.*, No. 26.

63. E. Gaillard as President to the Canfor Tribunal said that "*… a consolidation tribunal established pursuant to NAFTA Article 1126 could dispose of these issues for the sake of consistency and for the sake of fair and efficient resolution of the claims…*" "*… consolidating similar claims is a very important issue for the integrity of NAFTA, for the integrity of the process, for the sake of consistency, and the way the whole treaty works*". *Canfor Corporation v. United States of America*, HEARING ON JURISDICTION, Hrg. Tr. ("Canfor Hrg. Tr."), Vol. 1 at 15:20-21 (December. 7, 2004). *Idem* at 16:4-8.

64. See *e.g.* UNCITRAL Model Law on International Commercial Arbitration 1985 (UNCITRAL Model Law) Articles 34 and 36; Article V New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958; Netherlands Code of Civil Procedure 1986 Articles 1062 to 1068; French Code of Civil Procedure 1981 Articles 1502 and 1504 ; English Arbitration Act 1996 s.68, 69 and 103.

65. Order of the Consolidation Tribunal in the Softwood lumber cases, paragraph 131.

66. Platte, *op. cit.*, No. 59; Position of Tembec in Order of the Consolidation Tribunal: *Canfor Corp. v. United States of America, Terminal Forest Products Ltd. v. United States of America and Tembec Inc.* et al. *v. United States of America*, paragraph 42.

67. Leboulanger *op. cit.*, No. 3 at p. 62.

68. Another argument advanced against the consolidation of claims in particular in the context of commercial arbitration is the difficulty in ensuring enforceability of the award. Doubts have been raised over the enforceability of an award rendered by a consolidated tribunal where consolidation was not agreed upon by the parties. Relevant literature suggests the following grounds upon which recognition and enforcement of an award rendered by a consolidated tribunal could be resisted under Article V of the New York Convention: *i)* absence of an agreement in writing; and *ii)* irregular composition of the arbitral tribunal. For a detailed discussion on this

issue, see Chiu *op. cit.*, No. 56; Van den Berg, "*Consolidated Arbitration and the 1958 New York Arbitration Convention (1986)*", 2:4 Arb. Int. 367; Jarvin, *Consolidated Arbitration and the 1958 New York Arbitration Convention – A Critique of Dr. Van den Berg* (1987), 3:3 Arb. Int. 254; Van den Berg, Consolidated *Arbitration and the 1958 New York Arbitration Convention – A Replique to Mr. Jarvin* (1987), 3:3 Arb. Int. 257.

69. A number of authors, however, suggest that the absence of a consolidation clause is not of itself indicative of intent on the part of the contracting parties to exclude consolidation. Rather, they posit this omission may merely reflect that such a possibility had not been considered during their negotiations. Further, drafting a consolidation clause before a dispute arises may prove difficult or impossible where the issues and parties are not yet known. Consequently, these authors argue the absence of an arbitration agreement does not necessarily suggest intent to preclude consolidation of claims. As regards judicial modification of the arbitration agreement, Chiu argues this is not precluded by application of the doctrine of sanctity of contracts. See *op. cit.*, No. 57.

70. Hascher describes consolidation as reflecting the will of the courts rather than of the disputing parties, "Consolidation of Arbitration by American Courts: Fostering or Hampering International Commercial Arbitration?" (1984), 1 J. Int. Arb. at pp. 133-134.

71. Order of the Consolidation Tribunal, at paragraph 78 citing Henri Alvarez, "Arbitration under the North American Free Trade Agreement", 16 ARB'N INT'L 393, 414 (2000).

72. See *e.g.* UNCITRAL Model Law Article 11(3)(a).

73. Gaillard *op. cit.*, No. 6; see also Platte, *op. cit.*, No. 59, "… the right to nominate an arbitrator need not be treated as sacrosanct".

74. Hascher, *op. cit.*, No. 70 at p. 135: "… Matters are enormously complicated by the incorporation of separate disputes in a single arbitration proceeding. Each party assumes the additional burden of hearing claims, giving evidence and discussing testimonies with all the other parties involved. There is a higher probability of delays. Risks of omission and error are multiplied".

75. See Chiu *op. cit.*, No. 57.

76. See Platte *op. cit.*, No. 59.

77. *Corn Products v. United Mexican States*, Order of the Consolidation Tribunal, paragraph 7.

78. In the context of commercial arbitration, notwithstanding these arguments, and the few legislative acts which provide for consolidation, many jurisdictions have found this consideration insurmountable. Concerns over confidentiality formed a determinative factor in the English legislature's rejection of a provision providing for court ordered consolidation.

79. Order of consolidation, paragraph 147.

80. Diamond, "Multi-Party Arbitrations: A Plea for a Pragmatic Piecemeal Solution", (1991) 7:4 Arb. Int. 403.

81. See *e.g.* Articles 40 and 41 Stockholm Chamber of Commerce Arbitration Rules 1999; Article 31(3) ICC Arbitration Rules 1998.

82. Leboulanger *op. cit.*, No. 3 at p. 67.

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ANNEX 8.A1

Jurisprudence in Commercial Arbitration

Karaha Bodas company, L.L.C. (Cayman Island) v. Perushahaan Pertambangan Minyak Dan Gas Bumi Negara[1]

The dispute related to a contractual relation between a state-owned oil and gas exploration company and a private company as the sole contractor for the exploration and development of geothermal energy. The question raised here was whether an award rendered by a consolidated tribunal, where consolidation of claims arose under separate contracts (two-party multi-contract situation), could be refused recognition and enforcement under Article V of the New York Convention. As a preliminary point, the Court referred to previous case law in which it had been held that because of the clear "pro-enforcement" bias of the New York Convention, an objection to enforcement could only be sustained where two hurdles were met: *i)* it must be shown that there was a violation of the arbitration agreement; and *ii)* that such violation caused "substantial prejudice" to the parties seeking to avoid enforcement of the award.

Two grounds relevant to the present discussion were raised as potential barriers to enforcement. First, it was argued under Article V(1)(d) that the procedure was not in accordance with the agreement of the parties due to consolidation. The district court upheld the Tribunal's conclusion that the two independent contracts formed part of a single transaction and that consolidation was "appropriate due to the integration of the two contracts and the fact that the Presidential Decree, the consequences of which are at the origin of the dispute, affected both of them, the initiation of two separate arbitrations would be artificial and would generate the risk of contradictory decisions. Moreover, it would increase the costs of all the parties involved, an element of special weight in the light of difficulties faced by the Indonesian economy, to which counsel for the Respondents legitimately drew the Arbitral Tribunal's attention". The Tribunal concluded the unity of contract was of such a nature as to enable it to conclude that the parties had contemplated arbitration in a single proceeding. This unity of contract was found to exist on the basis of several factors, including that both contracts had been concluded on the same day; that one of the contracts referred to the other contract as an "integral part of this contract and… shall be deemed to be incorporated into this contract for all purposes". The district court therefore concluded that the consolidation of claims did not violate the agreement of the parties, nor did they consider that the claimant had satisfied its burden of proof in establishing substantial prejudice.

A second ground upon which recognition and enforcement was sought to be resisted was that the constitution of the Tribunal was not in conformity with the agreement of the parties. Both contracts contained appointment procedures which differed slightly however, the Tribunal reconciled the two clauses on the basis of identical default provisions in the event one party failed to fulfil its obligation to appoint an arbitrator, as was the case here. The Court considered this as a question of contract interpretation which fell to be arbitrable by the Tribunal, nor did they find any reason to reject the analysis of the Tribunal. Further, pointing to the unanimous finding and awards rendered by the consolidated Tribunal, the Court did not consider that the party resisting enforcement of the award had discharged its burden of proof in establishing substantial prejudice suffered.

This decision was upheld by the Fifth Circuit Court of Appeal. Furthermore, the reasoning of the Arbitral Tribunal was endorsed by both the Alberta Court of Queen's Bench[2] and the High Court of the Hong Kong Special Administration Region in enforcement proceedings.[3]

Siemens AG (Germany) and BKMI Industrienlagen GmbH (Germany) v. Dutco Construction Company (Dubai)

The three parties in this case had entered into a consortium agreement for the construction of a cement plant in Oman. The agreement provided for arbitration under the ICC Rules and appointment of three arbitrators in accordance with the provisions of the ICC Rules. Dutco filed a claim against the other two parties to the agreement in respect of separate claims. Under the provisions providing for multiparty arbitration, Dutco appointed one arbitrator while the two respondents jointly and under protest and reservation, appointed a single arbitrator. On appeal, it was held the agreement unambiguously expressed the intent of the parties to resolve any dispute that might arise between them by arbitration and that if followed from the multiparty nature of the agreement itself that the parties had accepted the possibility of a multiparty arbitration. The Cour de Cassation, however, concluded that as a matter of public policy each party enjoyed equality in the appointment of the Tribunal and that this right could not be renounced in an

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arbitration agreement before a dispute arose.[4] Accordingly, it appears that under French doctrine two or more parties may not be required to jointly appoint an arbitrator while the opposing party has the opportunity to appoint an arbitrator.

It has been argued that the Dutco decision is not as wide reaching as it may first appear to be.[5] The respondents in this case were two autonomous and independent entities with separate and potentially conflicting interests. This can be contrasted to a situation where two or more entities form part of a single business structure or share a common interest. On the basis of these facts Schwartz argues the principle of equality in appointment of the arbitrators will not ipso fact be violated where there is a degree of commonality between the parties. As an extension to this argument, Schwartz even suggests where two or more parties share a common interest, were these parties entitled each to appoint an arbitrator the principle of equal treatment in respect of the individual party may in fact be violated as the representation of the joint parties' interests would be greater than the individual party's.

"The Vimeira"

The disputes in this case arose out of damage suffered by the vessel *The Vimeira* and have been presented as a situation where consolidation of claims would have proved beneficial. Upon discovery of damage to The Vimeira the owners of the vessel raised a claim against the Time Charterers to whom they had chartered the vessel (the head arbitration.) The Time Charterers had sub-chartered the vessel to another party, the Voyage Charterers; when the claim by the owners was raised against the Time Charterers in turn raised a separate claim against the Voyage Charterers under the terms of the sub-charter (the sub-arbitration.) While the facts and legal issues raised in both arbitrations were identical or substantially similar, English law does not provide for court ordered or tribunal ordered consolidation of claims in related proceedings. Furthermore, the sub-arbitration had not been instituted until three months after the head-arbitration and thus was at a different stage of proceedings. Accordingly the two proceedings were to be heard and decided separately. The head arbitration was to be heard by a panel of three arbitrators; the sub-arbitration was to be heard by the same arbitrators but under the English Umpire system. Despite being heard by the same arbitrators, the awards, although consistent in terms of result, were based on different conclusions of fact.

In the sub-arbitration, the factual conclusions reached in the head arbitration as to the cause of the damage were rejected in favour of an alternate theory. Through application of English rules of procedure, the award in the head arbitration had been published prior to conclusion of the sub-arbitration; this enabled the respondents in the sub-arbitration to focus their arguments according to the reasons adduced in the head arbitration. Separate legal proceedings were raised in respect of both these awards on the ground that both losing respondents argued the findings of fact had not been raised in the arbitral proceedings against them; both awards were remanded back to the Tribunals for further consideration and to allow the respondents to argue their defence against these findings. The owners were thus in the position that the basis of the decision in their favour had been rejected in the sub-arbitration, as such they attempted to introduce new evidence and argue a new point in support of their claim. This, and subsequent claims were rejected by the English courts as not satisfying the high requirements needed to introduce new evidence at a late stage of the procedure. Ironically, the Time Charterers had opposed this application but made a similar application in respect of its arbitration with the Voyage Charterers; the court consolidated these two proceedings. Upon rejection of the application, the Court ordered the Owner's to bear the legal costs of the proceedings, including those incurred in respect of the application relating to the sub-arbitration. This order had the effect of requiring the Owners' to bear the costs in respect of a party with which they had no dispute and no contractual relationship. Further, the inability of the Owners' to adduce fresh evidence meant that after five years of litigation and arbitration, they were left with no arguments capable of supporting their claim. The facts of *The Vimeira* bring into sharp relief the advantages of consolidation of claims over separate proceedings where the disputes are based on the same set of facts.[6]

The Shui On Cases

Two separate requests for consolidation have arisen under Section 6B of the Hong Kong Arbitration Ordinance involving a common party to both requests. The reasons of the court for arriving at divergent results provide a good basis for analysis of the difficulties in enforcing consolidation and the conditions for exercise of this power even where domestic law permits the courts to enforce consolidation of claims in the absence of an agreement between the parties. The first *Shui On case*[7] involved a string dispute; the court considered consolidation impossible as there could be no single claimant or defendant, although the court did use an alternative tool found in Section 6B and ordered the disputes be "heard together".

In the Second *Shui On* case[8] the Hong Kong Court ordered consolidation of claims in relation to two disputes in which Shui On was the claimant in each arbitration. Having satisfied itself that the jurisdictional hurdles of Section 6B(1) were satisfied in that both arbitrations raised "common questions of law and fact" as per Section 6B(1)(a) the Court went on to consider whether consolidation would be appropriate. The most significant hurdle to

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consolidation was that the two arbitrations were at substantially different stages, the second arbitration having been initiated nearly three years after the first. Shui On's application for consolidation had requested the second arbitration be subjected to the timetable of the first arbitration however, the court considered this unrealistic and stated in its decision that it would not have ordered consolidation had the timetable not been altered so that the hearings were to take place at a much later date than originally envisaged. Consolidation was then ordered on the ground that the powers of the sole arbitrator would be increased and the issues in dispute would be better resolved. Importantly, both Shui On cases show restraint in applying Section 6B and a reluctance on the part of the judiciary to interfere with the powers of the arbitrators.

Notes

1. US 482, United States Court of Appeal, Fifth Circuit, 2004.
2. Alberta Court of Queen's Bench, 8 September 2004.
3. Hong Kong 17. High Court of the Hong Kong Special Administrative Region, Court of First Instance, Construction and Arbitration Proceedings No. 28 of 2002.
4. Le principe de l'égalité des parties dans la désignation des arbitres est d'ordre public ; on ne peut y renoncer qu'après la naissance du litige – at p. 471, Revue de l'arbitrage, 1992, No. 3, p. 470.
5. Schwartz, "Multiparty Arbitration and the ICC in the Wake of Dutco", (1993) 10:3 J. Int. Arb. 5.
6. The Vimeira [1983] 2 Lloyd's Rep 424 and Veeder QC, Multiparty Disputes: consolidation under English law, The Vimeira- a Sad Forensic *Fable* (1986), 2:4 Arb. Int. 310.
7. *Re Shui On Construction Co Ltd. And Schindler Lifts (HK) Ltd.* (1986) HKLR 1177.
8. Veeder, "Consolidation: More News from the Front-Line- The Second Shui On Case" (1987), 3:3 Arb. Int. 262.

ANNEX 8.A2

Institutional Rules

New York State Insurance Department Arbitration Rules (11 NYCRR 65)

Article 65-4.4 – Insurance Department Arbitration (IDA) forum procedure

(b) Consolidation. The IDA may consolidate disputes if the claims arose out of the same accident and involve common issues of fact.

Article 65-4.5 – No Fault Arbitration Procedure

(c) Consolidation. The designated organisation shall, except where impracticable, consolidate disputes for which a request for arbitration has been received, if the claims involved arose out of the same accident and involve common issues of fact.

Chartered Institute of Arbitrators, Arbitration Rules 2000

Article 7 – Powers of the Arbitrator

7.3. Where the same arbitrator is appointed under these Rules in two or more arbitrations which appear to raise common issues of fact or law, whether or not involving the same parties, the arbitrator may direct that such two or more arbitrations or any specific claims or issues arising therein be consolidated or heard concurrently.

7.4. Where an arbitrator has ordered consolidation of proceedings or concurrent hearings he may give such further directions as are necessary or appropriate for the purposes of such consolidated proceedings or concurrent hearings and may exercise any powers given to him by these Rules or by the Act either separately or jointly in relation thereto.

7.5. Where proceedings are consolidated the arbitrator will, unless the parties otherwise agree, deliver a consolidated award or awards in those proceedings which will be binding on all the parties thereto.

7.6. Where the arbitrator orders concurrent hearings the arbitrator will, unless the parties otherwise agree, deliver separate awards in each arbitration.

7.7. Where an arbitrator has ordered consolidation or concurrent hearings he may at any time revoke any orders so made and give such further orders or directions as may be appropriate for the separate hearing and determination of each arbitration.

Belgian Centre for the Study and Practice of National and International Arbitration (CEPANI) Rules 1997

Article 20 – Multiparty Arbitration

When several contracts containing the Cepani arbitration clause give rise to disputes that are closely related or indivisible, the Chairman of Cepani is empowered to order the consolidation of the arbitration proceedings.

This decision shall be taken, either at the request of the arbitrator or arbitrators, or, prior to any other measure, at the request of the parties or the earliest petitioner, or even *ex officio*.

If the request is granted, the Appointments Committee or the Chairman of Cepani shall appoint the arbitrator or arbitrator to rule on the dispute arising from the consolidation decision. If necessary, the said Committee or said Chairman shall increase the number of arbitrators to a maximum of five.

The Appointments Committee or the Chairman of Cepani shall reach a decision after having summoned the parties, and, if need be, the arbitrators already appointed, by registered letter.

The said Committee or the Chairman may not order the consolidation of disputes for which a decision prior to the ruling, a decision on admissibility or a decision on the substance of the request has already been taken.

ANNEX 8.A3

National Arbitration Laws

Hong Kong Arbitration Ordinance 1997

Section 6B – Consolidation of Arbitration

(1) Where in relation to two or more arbitration proceedings it appear to the Court –

1. that some common question of law or fact arises in both or all of them, or
2. that the rights to relief claimed therein are in respect of or arise out of the same transaction or series of transactions, or
3. that for some other reason it is desirable to make an order under this section, the Court may order those arbitration proceedings to be consolidated on such terms as it thinks just or may order them to be heard at the same time, or one immediately after another, or may order any other them to be stayed until after the determination of any other of them.

(2) Where the Court orders arbitration proceedings to be consolidated under Subsection (1) and all parties to the consolidated arbitration proceedings are in agreement as to the choice of arbitrator or umpire for those proceedings the same shall be appointed by the Court but if all parties cannot agree the Court shall have power to appoint an arbitrator or umpire for those proceedings.

(3) Where the Court makes an appointment under Subsection (2) of an arbitrator or umpire consolidated arbitration proceedings, any appointment of any other arbitrator or umpire that has been made for any of the arbitration proceedings forming part of the consolidation shall for all purposes cease to have effect on and from the appointment under Subsection (2).

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Netherlands Code of Civil Procedure, Book Four: Arbitration (1986)

Article 1046 – Consolidation of arbitral proceedings

1. If arbitral proceedings have been commenced before an arbitral tribunal in the Netherlands concerning a subject matter which is connected with the subject matter of arbitral proceedings commenced before another arbitral tribunal in the Netherlands, any of the parties may, unless the parties have agreed otherwise, request the President of the District Court in Amsterdam to order a consolidation of the proceedings.

2. The President may wholly or partially grant or refuse the request, after he has given all parties and the arbitrators an opportunity to be heard. His decision shall be communicated in writing to all parties and the arbitral tribunals involved.

3. If the President orders consolidation in full, the parties shall in consultation with each other appoint one arbitrator or an uneven number of arbitrators and determine the procedural rules which shall apply to the consolidated proceedings. If, within the period of time prescribed by the President, the parties have not reached agreement on the above, the President shall, at the request of any of the parties, appoint the arbitrator or arbitrators and, if necessary, determine the procedural rules which shall apply to the consolidated proceedings. The President shall determine the remuneration for the work already carried out by the arbitrators whose mandate is terminated by reason of the full consolidation.

4. If the President orders partial consolidation, he shall decide which disputes shall be consolidated. The President shall, if the parties fail to agree within the period of time prescribed by him, at the request of any of the parties, appoint the arbitrator or arbitrators and determine which rules shall apply to the consolidated proceedings. In this event the arbitral tribunals before which arbitrations have already been commenced shall suspend those arbitrations. The award of the arbitral tribunal appointed for the consolidated arbitration shall be communicated in writing to the other arbitral tribunals involved. Upon receipt of this award, these arbitral tribunals shall continue the arbitrations commenced before them and decide in accordance with the award rendered in the consolidated proceedings.

5. The provisions of Article 1027(4) shall apply accordingly in the cases mentioned in paragraphs (3) and (4) above.

6. An award rendered under paragraphs (3) and (4) above shall be subject to appeal to a second arbitral tribunal if and to the extent that all parties involved in the consolidated proceedings have agreed upon such an appeal.

US Uniform Arbitration Act (2000)

Consolidation of Separate Arbitration Proceedings

Except as otherwise provided in Subsection (c), upon [motion] of a party to an agreement to arbitrate or to an arbitration proceeding, the court may order consolidation of separate arbitration proceedings as to all or some of the claims if:

- there are separate agreements to arbitrate or separate arbitration proceedings between the same persons or one of them is a party to a separate agreement to arbitrate or a separate arbitration proceeding with a third person;
- the claims subject to the agreements to arbitrate arise in substantial part from the same transaction or series of related transactions;
- the existence of a common issue of law or fact creates the possibility of conflicting decisions in the separate arbitration proceedings; and
- prejudice resulting from a failure to consolidate is not outweighed by the risk of undue delay or prejudice to the rights of or hardship to parties opposing consolidation.

The court may order consolidation of separate arbitration proceedings as to certain claims and allow other claims to be resolved in separate arbitration proceedings.

The court may not order consolidation of the claims of a party to an agreement to arbitrate which prohibits consolidation.

International Commercial Arbitration Act (RSBC 1996) Chapter 233

Article 27 Court Assistance in Taking Evidence and Consolidating Claims

(2) If the parties to 2 or more arbitration agreements have agreed, in their respective arbitration agreements or otherwise, to consolidate the arbitration arising out of those arbitration agreements, the Supreme Court may, on application by one party with the consent of all the other parties to those arbitration agreements, do one or more of the following:

(a) order the arbitrations to be consolidated on terms the court considers just and necessary;

(b) if all the parties cannot agree on an arbitral tribunal for the consolidated arbitration, appoint an arbitral tribunal in accordance with Section 11 (8);

(c) if all the parties cannot agree on any other matter necessary to conduct the consolidated arbitration, make any other order it considers necessary.

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(3) Nothing in this section is to be construed as preventing the parties to 2 or more arbitrations from agreeing to consolidate those arbitrations and taking any steps that are necessary to effect that consolidation.

Australia International Arbitration Act 1989

s.24 – Consolidation of arbitral proceedings

(1) A party to arbitral proceedings before an arbitral tribunal may apply to the tribunal for an order under this section in relation to those proceedings and other arbitral proceedings (whether before that tribunal or another tribunal or other tribunals) on the ground that:

(a) a common question of law or fact arises in all those proceedings;

(b) the rights to relief claimed in all those proceedings are in respect or, or arise out of, the same transaction or series of transactions; or

(c) for some other reason specified in the application, it is desirable that an order be made under this section.

(2) The following orders may be made under this section in relation to 2 or more arbitral proceedings:

(a) that the proceedings be consolidation on terms specified in the order;

(b) that the proceedings be heard at the same time or in a sequence specified in the order;

(c) that any of the proceedings be stayed pending the determination of any other of the proceedings

(3) Where an application has been made under Subsection (1) in relation to 2 or more arbitral proceedings (in this section called the "related proceedings"), the following provisions have effect.

(4) If all the related proceedings are being heard by the same tribunal, the tribunal may make such order under this section as it thinks fit in relation to those proceedings and, if such an order is made, the proceedings shall be dealt with in accordance with the order.

(5) If 2 of more arbitral tribunals are hearing the related proceedings:

(a) the tribunal that received the application shall communicate the substance of the application to the other tribunals concerned; and

(b) the tribunals shall, as soon as practicable, deliberate jointly on the application.

(6) Where the tribunals agree, after deliberation on the application, that a particular order under this section should be made in relation to the related proceedings:

(a) the tribunals shall jointly make the order;

(b) the related proceedings shall be dealt with in accordance with the order; and

(c) if the order is that the related proceedings be consolidated – the arbitrator or arbitrators for the purposes of the consolidated proceedings shall be appointed, in accordance with Articles 10 and 11 of the Model Law, from the members of the tribunals.

(7) If the tribunals are unable to make an order under Subsection (6), the related proceedings shall proceed as if no application has been made under Subsection (1).

(8) This section does not prevent the parties to related proceedings from agreeing to consolidate them and taking such steps as are necessary to effect that consolidation.

English Arbitration Act 1996

s.35 – Consolidation of Proceedings and Concurrent Hearings

(1) The parties are free to agree:

(a) that the arbitral proceedings shall be consolidated with other arbitral proceedings; or

(b) that concurrent hearings shall be held, on such terms as may be agreed.

(2) Unless the parties agree to confer such power on the tribunal, the tribunal has no power to order consolidation of proceedings or concurrent hearings.

Swiss Private International Law

Article 182

(1) The parties may, directly or by reference to rules of arbitration, determine the arbitral procedure; they may also submit the arbitral procedure to a procedural law of their choice.

(2) If the parties have not determined the procedure, the Arbitral Tribunal shall determine it to the extent necessary, either directly or by reference to a statute or to rules of arbitration.

(3) Regardless of the procedure chose, the Arbitral Tribunals hall ensure equal treatment of the parties and the right of both parties to be heard in adversarial proceedings.

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ANNEX 8.A4

Investor-state Arbitration

Draft MAI

9. Consolidation of Multiple Proceedings

a. In the event that two or more disputes submitted to arbitration with a Contracting Party under paragraph 2.c have a question of law or fact in common, the Contracting Party may submit to a separate arbitral tribunal, established under this paragraph, a request for the consolidated consideration of all or part of them. The request shall stipulate:

1. the names and addresses of the parties to the proceedings sought to be consolidated,
2. the scope of the consolidation sought, and
3. the grounds for the request.

The Contracting Party shall deliver the request to each investor party to the proceedings sought to be consolidated and a copy of the request to the Parties Group.

b. The request for consolidated consideration shall be submitted to arbitration under the rules chosen by agreement of the investor parties from the list contained in paragraph 2.c. The investor parties shall act as one side for the purpose of the formation of the tribunal.

c. If the investor parties have not agreed upon a means of arbitration and the nomination of an arbitrator within 30 days after the date of receipt of the request for consolidated consideration by the last investor to receive it:

1. the request shall be submitted to arbitration in accordance with this article under the UNCITRAL rules, and
2. the appointing authority shall appoint the entire arbitral tribunal, in accordance with paragraph 7.

d. The arbitral tribunal shall assume jurisdiction over all or part of the disputes and the other arbitral proceedings shall be stayed or adjourned, as appropriate if, after considering the views of the parties, it decides that to do so would best serve the interest of fair and efficient resolution of the disputes and that the disputes fall within the scope of this paragraph.

e. An investor may withdraw the dispute from arbitration under this paragraph 9 and such dispute may not be resubmitted to arbitration under paragraph 2.c. If it does so no later than 15 days after receipt of notice of consolidation, its earlier submission of the dispute to that arbitration shall be without prejudice to the investor's recourse to dispute settlement other than under paragraph 2.c.

f. At the request of the Contracting Party, the arbitral tribunal established under this paragraph may decide, on the same basis and with the same effect as under paragraph 9.d, whether to assume jurisdiction over all or part of a dispute falling with the scope of paragraph 9.a which is submitted to arbitration after the initiation of consolidation proceedings.

NAFTA

Article 1126 – Consolidation

1. A Tribunal established under this Article shall be established under the UNCITRAL Arbitration Rules, and shall conduct its proceedings in accordance with those Rules, except as modified by this Subchapter.

2. Where a Tribunal established under this Article is satisfied that claims have been submitted to arbitration under Article 1120 that have a question of law or fact in common, the Tribunal may, in the interests of fair and efficient resolution of the claims, and after hearing the disputing parties, order that the Tribunal:

(a) shall assume jurisdiction over, and hear and determine together, all or part of the claims; or

(b) shall assume jurisdiction over, and hear and determine one or more of the claims, the determination of which it believes would assist in the resolution of the others.

3. A disputing party that seeks an order under paragraph 2 shall request the Secretary-General of ICSID to establish a Tribunal and shall specify in the request:

(a) the name of the disputing Party or disputing parties against which the order is sought;

(b) the nature of the order sought; and

(c) the grounds on which the order is sought.

4. The disputing party shall give to the disputing Party or disputing parties against which the order is sought a copy of the request.

5. Within 60 days of receipt of the request, the Secretary-General of ICSID shall establish a Tribunal consisting of three arbitrators. The Secretary-

General shall appoint the presiding arbitrator from the roster described in paragraph 4 of Article 1124. In the event that no such presiding arbitrator is available to serve, the Secretary-General shall appoint a presiding arbitrator, who is not a national of any of the Parties, from the ICSID Panel of Arbitrators. The Secretary-General shall appoint the two other members from the roster described in paragraph 4 of Article 1124, and to the extent not available from that roster, from the ICSID Panel of Arbitrators, and to the extent not available from that panel, in the discretion of the Secretary-General. One member shall be a national of the disputing Party and one member shall be a national of the Party of the disputing investors.

6. Where a Tribunal has been established under this Article, a disputing party that has not been named in a request made under paragraph 3 may make a written request to the Tribunal that it be included in an order made under paragraph 2, and shall specify in the request:

(a) the party's name and address;

(b) the nature of the order sought; and

(c) the grounds on which the order is sought.

7. A disputing party described in paragraph 6 shall give a copy of its request to the parties named in a request made under paragraph 3.

8. A Tribunal established under Article 1120 shall not have jurisdiction to decide a claim, or a part of a claim, over which a Tribunal established under this Article has assumed jurisdiction.

9. A disputing Party shall give to the Secretariat of the Commission, within 15 days of receipt by the disputing Party, a copy of:

(a) a request for arbitration made under paragraph 1 of Article 36 of the ICSID Convention;

(b) a notice for arbitration made under Article 2 of the Additional Facility Rules; or

(c) a notice of arbitration given under the UNCITRAL Arbitration Rules.

10. A disputing Party shall give to the Secretariat of the Commission a copy of a request made under paragraph 3 of this Article:

(a) within 15 days of receipt of the request, in the case of a request made by a disputing investor;

(b) within 15 days of making the request, in the case of a request made by the disputing Party.

11. A disputing Party shall give to the Secretariat of the Commission a copy of a request made under paragraph 6 of this Article within 15 days of receipt of the request.

12. The Secretariat of the Commission shall maintain a public register consisting of the documents referred to in paragraphs 9, 10 and 11.

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(20 2006 06 1 P) ISBN 92-64-02689-4 – No. 55249 2006

International Investment Perspectives

The global environment for foreign direct investment (FDI) improved in 2005. Macroeconomic growth, traditionally one of the main drivers of direct investment, gained momentum in several OECD countries. In addition, corporate profitability was generally strong, interest rates were low and equity valuation in most countries was firm so ample liquidity was available to companies wanting to invest abroad. In this benign environment, overall FDI inflows to OECD countries grew by 27 per cent to reach USD 623 billion in 2005. At the same time, OECD economies remained strong net contributors of direct investment capital to the rest of the world. Estimated new outflows in 2005 were USD 95 billion.

The special focus of this *International Investment Perspectives* volume is on legal and policy issues arising from international investment agreements. The articles in this section, which were prepared for the OECD Investment Committee, investigate novel features of recent bilateral investment treaties; options for improving the system of investor-state dispute settlement; and the consolidation of claims as an avenue for improving investment arbitration.

This volume contains several more articles on topical investment issues. One takes stock of how new technologies are a force advancing the closer integration of national economies. Another reviews the challenges and opportunities for policy makers that arise from international investor participation in infrastructure. A third summarises recent evidence of source (or "home") country benefits of outward direct investment. The final article explains the role of the OECD peer review process in building investment policy capacity.

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OECD PUBLISHING

ISBN 92-64-02689-4
20 2006 06 1 P

9 789264 026896

2006