5
Investment

Rule 22: The legal materialisation of an investment is the acquisition of a bundle of rights in property that has the characteristics of one or more of the categories of an investment defined by the applicable investment treaty where such property is situated in the territory of the host state or is recognised by the rules of the host state's private international law to be situated in the host state or is created by the municipal law of the host state.

Rule 23: The economic materialisation of an investment requires the commitment of resources to the economy of the host state by the claimant entailing the assumption of risk in expectation of a commercial return.

Rule 24: Where the claimant relies upon a contract to establish an investment pursuant to Rule 22 and Rule 23, the tribunal should differentiate between rights *in personam* as between the contracting parties and rights *in rem* that are memorialised by the contract. The rights *in personam* do not generally qualify as an investment independently of the rights *in rem*.

A. INTRODUCTION TO THE CONCEPT OF AN INVESTMENT

(i) The quid pro quo *of investment treaty arbitration*

335. The notion of a *quid pro quo* between a foreign investor and the host state is the cornerstone for the system of investment treaty arbitration. In exchange for contributing to the flow of capital into the economy of the host contracting state, the nationals of the other contracting state (or states in the case of a multilateral investment treaty) are given the right to bring international arbitration proceedings against the host contracting state and to invoke the international minimum standards of treatment contained in the applicable investment treaty. The conferral of this right reduces the sovereign risk attaching to the investment in the host state and hence investment treaties in this way can positively influence the

decision making process for investments. This *quid pro quo* is implicit in the preamble of most investment treaties; the USA Model BIT (2004) is representative in this respect:

> *Desiring* to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party;
>
> *Recognizing* that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties […][1]

336. The *quid pro quo* moves from an abstract expression in the preamble of investment treaties to a specific prerequisite for the national's reliance upon the substantive obligations of investment protection and the possibility of recourse to the dispute resolution mechanism against the host state. Such a requirement is normally expressed within the definition of the types of disputes that may be submitted to international arbitration in accordance with the investor/state dispute resolution mechanism. Quite simply, the contracting state parties consent to the arbitration of '*investment* disputes' or 'disputes arising out of an *investment*' or 'an *investment* agreement' or 'an *investment* authorisation'. Hence the existence of a covered investment is fundamental to the procedural right of recourse conferred upon nationals (individuals and legal entities) by the investment treaty. This is perhaps a trite observation but its significance is apparent in any consideration of the other jurisdictional requirements. Given that the stated objective of investment treaties is to stimulate flows of private capital into the economies of the contracting states, the claimant must have contributed to this objective in order to attain the rights created by the investment treaty. This contribution must be clearly ascertained by the tribunal if its existence is challenged by the host state; for otherwise the procedural privilege conferred by the investment treaty might be utilised by a claimant who has not fulfilled its side of the bargain.

337. So long as the existence of a covered investment is established, the national identity of the investor is less important to the objective of stimulating inward flows of private capital to the economy of one of the contracting states. The national contracting state of the claimant has only a marginal interest in the investor/state arbitration proceedings: whilst some economic activity might have been generated by expatriated profits (and the taxation thereof), the claimant's national contracting state has not benefited directly from the investment in the same way as the host contracting state, and, save for some rare exceptions,[2] the national contracting state has no procedural right to participate in the arbitration proceedings. Hence a purposive interpretation of the nationality

[1] See Appendix 11.
[2] E.g. NAFTA, Art. 1128. See Appendix 3.

requirements in investment treaties would not operate to disqualify a claimant from investment treaty protection on the basis of the quality of its links with its national contracting state, if the investment treaty is silent on the matter, so long as the claimant has contributed resources to the economy of the host state (see Rule 23).

338. So unlike human rights that are vested and enjoyed simply by virtue of one's being born into the human race, the vesting and enjoyment of investment treaty rights is contingent upon the putative investor taking certain positive steps. These positive steps are codified in Rule 23 and their fulfilment is a *sine qua non* for establishing the tribunal's jurisdiction.[3]

339. There are a small number of investment treaties that offer limited protection to qualified 'investors' with respect to the acquisition and establishment of investments and thus could be said to operate, at least to some to some extent, *in personam* (i.e. in relation to 'investors' rather than 'investments'). The most notable examples of such pre-investment protection are NAFTA and the USA Model BIT (2004), which accord most-favoured-nation and national treatment to putative investors in relation to the acquisition and establishment of their investments. This exception to Rule 21 and Rule 23 is dealt with in Chapter 4.

(ii) The legal and economic materialisation of an investment

340. A central thesis of this chapter is that an investment, in order to qualify for investment treaty protection, must incorporate certain legal and economic characteristics. The economic characteristics derive from the common economic conception of foreign direct investment.[4] In Rule 23 they are codified as the transfer of resources into the economy of the host state and the assumption of risk in expectation of a commercial return. The legal characteristics derive from the non-exhaustive examples of an 'asset' that constitute 'investments' in investment treaties, and this forms the basis of Rule 22, which generalises the requirement as the acquisition of property rights in the host state. It is essential that an investment have *both* the requisite legal and economic characteristics. If, by way of illustration, the legal characteristics of an investment were to be considered in isolation from the common sense economic meaning of that term, then, pursuant to some investment treaty definitions of an investment, a metro ticket might qualify as a 'claim to money or to any performance under contract, having a financial value' and thus as an investment.

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[3] *S.D. Myers v Canada* (Damages) 8 ICSID Rep 124, 148/102 ('The fact that an entity was treated in a manner contrary to Chapter 11 does not itself trigger a right to compensation. The existence of an investment is a threshold to maintaining a Chapter 11 claim').

[4] See e.g.: A. Adhar, Economic Development Institute of the World Bank, *Terms Used in Investment Decisionmaking: A Glossary* (1996) 46; J. Downes and J. Goodman, *Dictionary of Finance and Investment Terms* (6th edn, 2003) 350; F. Perry, *A Dictionary of Banking* (1983) 127; G. Bannock and W. Manser, *The Penguin International Dictionary of Finance* (3rd edn, 1999) 145.

341. In its attempt at a comprehensive review of investment treaty precedents on the definition of an investment, the tribunal in *Malaysian Salvors v Malaysia* distinguished between a 'typical characteristics approach' and a 'jurisdictional approach'.[5] For the purposes of this dichotomy, the former was said to reflect the characteristics of an investment articulated in *Salini v Morocco*,[6] whereas the latter reveals a strict adherence to the terms of the definition of an investment supplied by the investment treaty. This dichotomy may or may not accurately reflect the different interpretations of an investment adopted by investment treaty tribunals; but in any event it is likely to mislead if each approach is considered in a relationship of opposition. It is submitted that the proper definition of an investment, as reflected in Rule 22 and Rule 23, must incorporate *both* certain 'economic' characteristics and certain 'legal' characteristics.

(iii) The relationship between an 'investment' in Article 25 of the ICSID Convention and in an investment treaty

342. There is no definition of an 'investment' in the ICSID Convention and it was envisaged by the drafters that the parties would have a wide margin of discretion in settling upon a definition in each instrument recording their consent to ICSID arbitration.[7] The term 'investment', however, is a term of art: its ordinary meaning cannot be extended to bring any rights having an economic value within its scope, for otherwise violence would be done to that ordinary meaning, in contradiction to Article 31 of the Vienna Convention on the Law of Treaties. The right to performance embodied in a metro ticket cannot qualify as an investment.

343. Precisely the same considerations apply to the use of the term of art 'investment' in the first article of investment treaties. The standard formulation in investment treaties is to define an investment as 'any asset' and then provide a non-exhaustive list of assets that might qualify as an investment. The proprietary nature of the examples of assets or rights over assets listed in investment treaties serves as a means to distinguish, for example, the rights to performance arising out of a concession contract and rights to performance embodied in a metro ticket. Furthermore, the open-textured nature of the standard formulation in investment treaties preserves the ordinary meaning of the term 'investment' and therefore its consistency with the characteristics that must be attributed to the same term as employed in Article 25 of the ICSID Convention.

344. It is difficult to conceive of a hypothetical conflict between the conceptions of an investment in Article 25 of the ICSID Convention and an investment

5 *Malaysian Salvors v Malaysia* (Preliminary Objections) para. 70.
6 (Preliminary Objections) 6 ICSID Rep 400, 413/52.
7 C. Schreuer, *The ICSID Convention: A Commentary* (2001) 121–6.

treaty because the use of the term 'investment' in both instruments imports the same basic economic attributes of an investment derived from the ordinary meaning of that term, which are codified in Rule 23. But suppose an investment treaty defined an investment as an asset, and listed a metro ticket as an example of such an asset. In this case there would be a conflict between the definition of an investment in an investment treaty and Article 25 of the ICSID Convention because the state contracting parties in the former instance have transcended the frontier of the ordinary meaning of the term 'investment'. A bilateral act of this kind cannot produce effects in relation to a multilateral treaty (the ICSID Convention) and hence, if ICSID arbitration proceedings were to be commenced, the tribunal would be compelled to decline jurisdiction.

(iv) The significance of an investment for each phase of an investment treaty arbitration

345. Questions relating to the existence or scope of an investment are fundamental to each phase of an investment treaty dispute. The attribution of jurisdiction to the tribunal is contingent upon the claimant having made an investment in the host state, and thus satisfying the *quid pro quo* for the host state's consent to investment treaty arbitration.[8] The boundaries of the tribunal's *ratione materiae* jurisdiction are shaped by the nexus between the claims and the investment.[9] The tribunal's *ratione personae* jurisdiction extends to a claimant with control over the investment at the time of the alleged breach[10] and its *ratione temporis* jurisdiction depends upon the timing of the claimant's acquisition of the investment.[11] The tribunal's examination of the question of the host state's liability is intertwined with an assessment of whether the prejudice alleged by the claimant can be properly linked to the rights that comprise the investment. A host state cannot, for instance, expropriate something that the claimant does not have – whether it be leasehold rights over a hotel[12] or a right to the automatic renewal of a licence to process waste.[13] Finally, if the host state is found to be liable in damages, then the quantification of such damages will depend upon a careful assessment of the income generated by the whole or part of the investment that was subjected to unlawful interference.

346. Some of these interrelationships are illustrated in the following analysis of the awards in *Feldman v Mexico* and *TECMED v Mexico*.

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[8] See Chapter 5.
[9] See Chapter 6.
[10] See Chapter 7.
[11] See Chapter 8.
[12] A fundamental point that escaped the tribunal in: *Wena v Egypt* (Merits) 6 ICSID Rep 89.
[13] E.g. *Tecmed v Mexico* (Merits) 10 ICSID Rep 134.

346C(1). Marvin Feldman v Mexico[14]

A US national, Feldman, owned a Mexican exporting business 'CEMSA'.[15] A significant part of CEMSA's business consisted of the purchase of cigarettes in Mexico from bulk suppliers for resale in third countries. Mexico imposed a tax on the production and sale of cigarettes in the domestic market, but in some circumstances a zero tax rate was applied to cigarettes that were exported.[16] In 1991, Mexico passed new legislation to ensure that only the exports of producers of cigarettes in Mexico qualified for the zero tax rate, rather than the exports of resellers such as CEMSA.[17] This legislation was challenged as contravening the principle of 'equity of taxpayers',[18] and was then amended to apply the zero tax rate to all exporters of cigarettes.[19] The amended tax legislation remained unchanged between 1992 and 1997, which was the relevant period for the claims advanced by Feldman (the 'Tax Legislation').

The zero tax rate operated as a tax rebate to be claimed by the exporters of cigarettes. The 85% tax on production was initially paid by the cigarette producers, and this was passed on to the purchasers in the sales price for the cigarettes.[20] The Tax Legislation provided that, in order for exporters to claim the tax rebate, the tax on production on the cigarettes must be stated 'separately and expressly on their invoices'.[21] The effect of this invoice requirement, which was a feature of the Tax Legislation from its inception,[22] was to discriminate between the exports of cigarette producers and those resellers, despite the amendments to the legislation in 1992. Nevertheless, tax discrimination on this basis is consistent with international practice; and the tribunal noted that it was a 'rational tax policy and a reasonable legal requirement'[23] and thus could not constitute a violation of international law *per se*.[24]

Insofar as CEMSA purchased its cigarettes from volume retailers rather than producers, at a price that included the tax on production, the tax was not itemised separately on the invoice.[25] Therefore, in accordance with the tax regime prescribed by the Tax Legislation, CEMSA was not entitled to claim the tax rebate. Nevertheless, CEMSA was granted the tax rebates for a total of sixteen months between 1996 to 1997.[26]

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14 (Merits) 7 ICSID Rep 341.
15 The acronym for Corporación de Exportaciones Mexicanas, S.A. de C.V. *Ibid*. 342/1.
16 *Ibid*. 343/7.
17 *Ibid*. 344/10.
18 *Ibid*. 344/11.
19 *Ibid*. 344–5/12.
20 *Ibid*. 345/15.
21 *Ibid*.
22 And four years before Feldman established CEMSA in Mexico, *ibid*. 377/128.
23 *Ibid*. 377–8/129.
24 *Ibid*. 373/118.
25 *Ibid*. 345/15.
26 *Ibid*. 345–6/19.

Feldman claimed that Mexico's denial of tax rebates on cigarettes exported by CEMSA constituted an expropriation under Article 1110 of NAFTA. In its analysis of this claim, the tribunal reasoned that the Tax Legislation never afforded CEMSA a right to export cigarettes and neither customary international law nor NAFTA required Mexico to do so.[27] Furthermore, according to the tribunal, Feldman's investment, which consisted of the exporting business CEMSA, remained under the complete control of Feldman.[28] Finally, the tribunal noted that the profitability of Feldman's 'gray market' export business (CEMSA was not an authorised reseller of cigarettes in Mexico)[29] was wholly dependent upon obtaining the tax rebate, because otherwise the combined cost to CEMSA of the Mexican tax on production and the excise taxes imposed by the importing country would price CEMSA out of the market.[30] The claim for expropriation was dismissed by the tribunal.[31]

Feldman also advanced a claim based upon the national treatment obligation in Article 1102 of NAFTA by pleading that certain *Mexican* owned resellers of cigarettes had received the tax rebates from the Mexican authorities at various times when CEMSA was denied the rebate, despite the invoice requirements of the Tax Legislation, and that this constituted a failure by Mexico to accord CEMSA national treatment.[32]

The tribunal found that: (i) there was one Mexican-owned company in like circumstances to CEMSA for the purposes of the national treatment analysis (the 'Poblano Group');[33] (ii) the Poblano Group was granted the tax rebates during a period when CEMSA was denied them;[34] (iii) CEMSA had been audited by the Mexican tax authorities and ordered to repay the tax rebates that it had received, whereas there was no clear evidence about the status of a similar audit of the Poblano Group;[35] and (iv) this discrimination was the result of Feldman's US nationality.[36] The majority of the tribunal concluded that Mexico had violated Article 1102 of NAFTA.[37]

The main focus of the dissenting opinion rendered in *Marvin Feldman v Mexico*[38] was that the majority's finding of discrimination was unsupported by the evidence.[39] This controversy will be left aside. Instead the analysis that follows concentrates on a contradiction between the tribunal's findings

[27] *Ibid*. 370/111.
[28] *Ibid*.
[29] *Ibid*. 371–2/115.
[30] *Ibid*. 372–3/117.
[31] *Ibid*. 385/153.
[32] *Ibid*. 385–6/154.
[33] *Ibid*. 390–1/172.
[34] *Ibid*. 391/173.
[35] *Ibid*. 391/174.
[36] *Ibid*. 394–5/182.
[37] *Ibid*. 396–7/188.
[38] *Feldman v Mexico* (Merits: Dissenting Opinion) 7 ICSID Rep 407.
[39] *Ibid*. 409.

on the nature of the investment in its consideration of Feldman's expropriation claim and the majority's conclusion on national treatment.

In relation to Feldman's investment, the tribunal held:

> [T]he only significant asset of the investment, the enterprise known as CEMSA, is its alleged right to receive … tax rebates upon exportation of cigarettes, and to profit from that business.[40]

However, the tribunal found:

> [T]he Claimant never really possessed a 'right' to obtain tax rebates upon exportation of cigarettes.[41]

Hence the right to obtain tax rebates upon the exportation of cigarettes did not feature among the bundle of rights that made up Feldman's investment in CEMSA in accordance with Mexican law. As Mexico could not expropriate something that never belonged to the investor, the tribunal correctly dismissed Feldman's Article 1110 claim. The tribunal's analysis of the nature of Feldman's investment should not, however, have been discarded by the majority when it came to deal with national treatment under Article 1102. The essence of Feldman's complaint was that its *investment*, CEMSA, had been accorded less favourable treatment than that which Mexico accorded to investments of its own investors.[42]

If Feldman's investment in CEMSA did not include the right to a tax rebate, and yet the receipt of the rebate was essential to the commercial viability of CEMSA's cigarette export activities (and indeed the sole alleged 'asset' of CEMSA), it is difficult to fathom how Mexico's sporadic conferral of tax rebates on a Mexican-owned cigarette reseller constituted discrimination with respect to Feldman's *investment*.

Another cause for concern is the majority's assessment of the damages flowing from its finding of discrimination. The majority held that Feldman through CEMSA was entitled to certain tax rebates that it had been denied.[43] If this finding were to be generalised, the resulting proposition would be that where a tax authority has improperly assessed the tax liability of X, with the effect that a benefit is conferred upon X, then Y, a competitor of X, is able to claim damages based on non-receipt of the same benefit to itself. The effect of the majority's decision is thus to compel Mexico to breach its own legislation (legislation held by the tribunal to be unimpeachable) and confer an unlawful benefit upon a foreign investor.

If Feldman did have an investment in Mexico (i.e. a business whose viability did not rest upon the misapplication of Mexican legislation) and Mexico

[40] (Merits) 7 ICSID Rep 341, 394/181.
[41] *Ibid*. 373/118.
[42] *Ibid*. 386/155.
[43] *Ibid*. 400–1/202-5.

were found to have derogated from its own legislation in favour of Feldman's Mexican competitors in like circumstances, then damages should have been assessed on the basis of the harm caused to Feldman's business by such derogation. This might, for instance, include damages representing a loss of market share due to the competitive advantage obtained by Feldman's competitors.

346C(2). Técnicas Medioambientales Tecmed SA v United Mexican States[44]

The claimant, Técnicas Medioambientales Tecmed SA, was the Spanish parent company of the Mexican company 'Tecmed', which in turn owned another Mexican company 'Cytrar'.[45] At an auction of public utilities by the Mexican municipal agency 'Promotora',[46] Tecmed purchased rights to a landfill for hazardous industrial waste.[47] These rights were later transferred from Tecmed to Cytrar with the consent of the relevant Mexican authority 'INE'.[48] When a new operating licence for the landfill was issued by INE in Cytrar's name, it was expressed to be valid only for a year and renewable thereafter on an annual basis.[49] This was in contrast with the operating licence that was originally granted to Tecmed for an unlimited duration. Cytrar's licence was renewed after the first year. INE refused to grant any further renewals thereafter.[50]

The claimant's principal claim was that the failure to renew Cytrar's operating licence amounted to an expropriation of its investment under the Spain/Mexico BIT as it brought Cytrar's exploitation of the landfill facility to an end.[51]

If the claimant (through Tecmed and Cytrar) had acquired its investment fully cognisant of a Mexican law to the effect that operating licences are issued for one year and may be terminated by the Mexican authorities at will thereafter, it is difficult to conceive how Mexico's exercise of its regulatory authority could amount to an expropriation.[52] If, however, the claimant had acquired, along with the tangible property interest in the landfill, certain intangible property rights including the right to the requisite

[44] (Merits) 10 ICSID Rep 134.
[45] *Ibid*. 135–6/4.
[46] Promotora Inmobiliaria del Ayuntamiento de Hermosillo, a decentralised municipal agency of the Municipality of Hermosillo located in the State of Sonora, Mexico (*ibid*. 139/35).
[47] *Ibid*.
[48] *Ibid*. 140/38. 'INE' is an acronym for the Hazardous Materials, Waste and Activities Division of the National Ecology Institute of Mexico, an agency of the Federal Government of the United Mexican States within the Ministry of the Environment (*ibid*. 139-40/36).
[49] *Ibid*. 140/38.
[50] *Ibid*. 140/39.
[51] *Ibid*. 141/41.
[52] A claimant was denied a remedy under Article 1 of Protocol 1 of the European Convention on Human Rights on this basis: *Gudmunsson v Iceland* 21 EHRR CD 89.

licences to operate the landfill, the subsequent interference with the claimant's intangible rights might also be protected. The claimant advanced its case on this basis and the tribunal decided to consider the 'price and scope of the acquisition by Cytrar and Tecmed of assets relating to the Las Víboras landfill' as a 'preliminary matter'.[53] What then followed was a meticulous examination by the tribunal of all the transactional documents relating to the acquisition of the landfill to ascertain whether part of the consideration provided by Tecmed was for intangible property rights of the type alleged. This question was ultimately decided in the affirmative,[54] and the tribunal went on to rule in a separate section of the award dealing with the merits that Mexico had used its regulatory power to revoke Cytrar's licence (thereby depriving Cytrar of its right thereto) in a manner inconsistent with its obligations under the investment treaty.[55]

The tribunal was, therefore, clearly cognisant of the importance of ascertaining the scope of the rights comprising the investment before considering the acts of the host state alleged to have caused prejudice to that investment.

Rule 22. The legal materialisation of an investment is the acquisition of a bundle of rights in property that has the characteristics of one or more of the categories of an investment defined by the applicable investment treaty where such property is situated in the territory of the host state[56] or is recognised by the rules of the host state's private international law to be situated in the host state or is created by the municipal law of the host state.[57]

A. APPLICABLE LAWS

347. The first article of the vast majority of investment treaties supplies a definition of an investment, usually in the form of a non-exclusive list of paradigmatic examples of investments, such as shares in a company and real property. The list of examples is invariably introduced by a formulation of the type: '"investment" of a national or company means every kind of investment owned or controlled directly or indirectly by that national or company'. This standard formulation is infected

[53] (Merits) 10 ICSID Rep 134, 145/52.
[54] *Ibid*. 164–5/91.
[55] *Ibid*. 191–2/151.
[56] *UPS v Canada* (Preliminary Objections) 7 ICSID Rep 288, 314/121; *Ethyl v Canada* (Preliminary Objections) 7 ICSID Rep 12, 35–6/70,72; *SGS v Philippines* (Preliminary Objections) 8 ICSID Rep 518, 547/105; *Zhinvali v Georgia* (Preliminary Objections) 10 ICSID Rep 3, 90/381; *Mitchell v Congo* (Annulment) paras. 42, 46; *Mytilineos v Serbia* (Preliminary Objections) para. 131; *Canadian Cattlemen v USA* (Preliminary Objections) para. 112.
[57] *EnCana v Ecuador* (Merits) 12 ICSID 427, 476/184.

by a tautology – 'an "investment" is an investment' – that is perhaps responsible for a great deal of confusion about the object of investment treaty protection.

348. An investment treaty does not establish a legal regime for the creation, possession, use or disposal of investments by foreign nationals. This is hardly surprising: municipal laws governing these acts or rights with respect to real property, for instance, are necessarily voluminous and intricate and cannot be swept away by the stroke of a drafter's pen for the benefit of a certain class of investors. The municipal law of the host state continues to apply to questions pertaining to the creation, possession, and disposal of investments by foreign nationals who qualify for treaty protection (Rule 4) but it is the treaty that determines whether the investment qualifies for international protection (Rule 5).

B. THE TERRITORIAL CONNECTION WITH THE HOST STATE

349. The importance of the territorial connection with the host state is recognised in Rule 22. There must be a territorial connection to the respondent host state so that the investment is within the domestic jurisdiction of the host state. This cardinal feature of the investment treaty regime has consequences for the economic materialisation of an investment in Rule 23 as well, and the investment treaty jurisprudence concerned with the territorial requirement is examined in that context.

(i) Tangible property

350. If the investment consists of rights over tangible property then, in order to satisfy the territorial requirement, it is obvious that the *situs* of the property in question must be the host state. The *situs* of tangible property, for these purposes, is a straightforward question of fact as it is for the municipal courts in the context of applying the ubiquitous *lex situs* choice of law rule in private international law.[58]

(ii) Intangible property

351. Localising something that is intangible is a more complex problem. Resort must be had to the rules of private international law of the host state which, in respect of some forms of intangible property, may supply a fictitious *situs*. A debt may have its *situs* at the place of domicile of the debtor;[59] shares – at the

[58] *Dicey, Morris & Collins on the Conflict of Laws* (2006, 14th edn by L. Collins *et al.*) 1116.
[59] *Ibid*., 1116–30; E. Rabel, *The Conflict of Laws: A Comparative Study* (Vol. III, 1958) 3–8, 14–16; *Cheshire and North's Private International Law* (1999, 13th edn by P. North and J. Fawcett) 955–6.

place where the company's share register is maintained.[60] In each case, if the host state's rules of private international law locate the intangible property rights in the host state, then the territorial requirement is satisfied with respect to a putative investment in that form of intangible property.

352. In relation to other forms of intangible property for which private international law does not confer a fictitious *situs*, such as intellectual property rights, the solution is to inquire of the host state's substantive law directly as to whether such rights have a basis under that law. An investment treaty does not compel the recognition of new forms of intangible property by the contracting state parties, hence a *renvoi* to the host state's substantive law is the proper foundation for establishing the necessary territorial link to the host state. The test for such recognition in the temporal sense is the time at which the investment was made. Subsequent changes to the law of the host state cannot affect the characterisation of intangible property rights as an investment, for this would give the host state a simple device for avoiding the substantive obligations of investment protection in the investment treaty.[61]

C. 'A BUNDLE OF RIGHTS IN PROPERTY'

(i) Introduction

353. Rule 22 identifies rights in property as the common denominator of all the categories of 'investments' enumerated in investment treaties. The OECD Draft Convention on the Protection of Foreign Property of 1967, which is the inspiration for the modern investment treaty, made reference to 'foreign property' rather than 'investments', which was defined 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'.[62] The introduction of the concept of 'investment' in the evolution of investment treaties has not diminished the importance of identifying a proprietary foundation for the investor's commercial interests in the host state. The attributes of property are essential to the functioning of the investment protection mechanism encapsulated in the treaty, for the reasons elaborated in the discussion of Rule 24.

354. In the next section, the standard categories of investments will be analysed in some detail by reference to two model BITs and Chapter 11 of NAFTA. The USA Model BIT (2004) is a substantial revision of the previous USA Model BIT (1994) and is likely to influence the drafting of the next generation of BITs. Many of the new provisions of the USA Model BIT (2004) were designed to eliminate

60 *Cheshire and North's Private International Law*, 969–73.
61 See the commentary to Rule 5 above.
62 Available at: www.oecd.org/dataoecd/35/4/39286571.pdf.

certain ambiguities common to most of the existing BITs and reflect the interpretive practice of investment treaty tribunals in the past decade. The second is the Germany Model BIT (2005), which, as the revised model of the first BIT concluded with Pakistan in 1959, is representative of the majority of BITs in force today. It will also be instructive to compare and contrast these model BITs from the two major legal traditions and determine whether common law or civilian conceptions of property are reflected in the treaty texts.

355. In order to enhance the clarity of the analysis that follows, the definitions of investments in each of the BITs and Chapter 11 of NAFTA will now be set out in full.

USA Model BIT (2004)

'investment' means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:
(a) an enterprise;
(b) shares, stock, and other forms of equity participation in an enterprise;
(c) bonds, debentures, other debt instruments, and loans;
(d) futures, options, and other derivatives;
(e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts;
(f) intellectual property rights;
(g) licenses, authorizations, permits, and similar rights conferred pursuant to domestic law; and
(h) other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges.

Germany Model BIT (2005)

[T]he term 'investments' comprises every kind of asset which is directly or indirectly invested by investors of one Contracting State in the territory of the other Contracting State. The investments include, in particular:
(a) movable and immovable property as well as any other rights in rem, such as mortgages, liens and pledges;
(b) shares of companies and other kinds of interest in companies;
(c) claims to money which has been used to create an economic value or claims to any performance having an economic value;
(d) intellectual property rights, in particular copyrights and related rights, patents, utility-model patents, industrial designs, trademarks, plant variety rights;
(e) trade-names, trade and business secrets, technical processes, know-how, and good-will;
(f) business concessions under public law, including concessions to search for, extract or exploit natural resources […].

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investment means:
(a) an enterprise;
(b) an equity security of an enterprise;
(c) a debt security of an enterprise
 (i) where the enterprise is an affiliate of the investor, or
 (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;
(d) a loan to an enterprise
 (i) where the enterprise is an affiliate of the investor, or
 (ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;
(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
(f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);
(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and
(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
 (i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or
 (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,
(i) claims to money that arise solely from
 (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
 (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
(j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h)[.]

356. Both the provisions in the model BITs provide a non-exhaustive list of various categories of investments and hence it is within the prerogative of treaty tribunals to recognise other types of investments as warranting treaty protection if they meet the criteria examined hereinafter. In contradistinction, the definition of an investment in Chapter 11 of NAFTA is drafted as an exclusive list of covered investments.

357. The USA Model BIT (1994) contained a hopeless tautology, viz. ‘an “investment” is an investment’.[63] The USA Model BIT (2004) is not much of an improvement in this respect: ‘[an] “investment”… that has the characteristics of an investment’. Nevertheless, the use of the word ‘asset’,[64] like in the German Model BIT, does clarify the proprietary foundation of investments covered by the treaty.[65] Furthermore, the reference to *ownership* and *control* with respect to the relationship between the investor and the investment in the USA Model BIT confirms the necessary proprietary nature of the investor’s interest in an investment.

D. THE CATEGORIES OF INVESTMENTS

(i) Tangible property

358. Both model BITs employ, in the same breath, the two different notions of property as either things or rights over things – the reified entity or the bundle of rights in that entity.[66] ‘Movable or immovable property’ designates a *thing*, whereas ‘related property rights’ or ‘rights *in rem*’ denotes *rights* over things. A mortgage, for example, is not a ‘related property right’ to movable or immovable property because movable or immovable property are not rights but things. A mortgage is instead a right *in rem* over movable or immovable property.

359. The USA Model BIT (2004) is a significant improvement over its predecessor in its use of property concepts and classifications. Article I(d)(iv) of the USA Model BIT (1994) had included within the definition of an investment:

> Tangible property, including real property; and intangible property, including rights, such as leases, mortgages, liens and pledges.[67]

360. The inference here is that ‘rights, such as leases, mortgages, liens and pledges’ falls within the category of ‘intangible property’, which is manifestly incorrect. Leases, mortgages, liens and pledges are rights *in rem* over tangible property; they

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[63] UNCTAD Compendium (Vol. VI, 2002) 502.

[64] See, e.g., the definition of an ‘asset’ in *Black’s Law Dictionary* (1999, 7th edn) 112: ‘1. An item that is owned and has value. 2. The entries on a balance sheet showing the items of property owned, including cash, inventory, equipment, real estate, accounts receivable, and goodwill. 3. All the property of a person (esp. a bankrupt or deceased person) available for paying debts.’ See also: *Deardorff’s Glossary of International Economics*, available at: www-personal.umich.edu/~alandear/glossary/ (‘An item of property, such as land, capital, money, a share in ownership, or a claim on others for future payment, such as a bond or a bank deposit’).

[65] *Petrobart v Kyrgyz Republic* (Merits) para. 71.

[66] The perceived confusion from this dual usage provoked the ire of no less than Jeremy Bentham: ‘It is to be observed, that in common speech, in the phrase *the object of a man’s property*, the words *the object of* are commonly left out; and by an ellipsis, which, violent as it is, is now become more familiar than the phrase at length, they have made that part of it which consists of the words *a man’s property* perform the office of the whole.’ J. Bentham, *An Introduction to the Principles of Morals and Legislation* (J. Burns and H. Hart, eds. 1970) 211 at note 12.

[67] USA Model BIT (1994), Art. I(d)(iv), UNCTAD Compendium (Vol. III, 1996) 196.

do not constitute 'intangible property'. An example of intangible property that generally falls within the definition of an investment is intellectual property.

361. A precise formulation of this investment category would recognise that both an investor's ownership of tangible property such as land (including permanent fixtures thereupon) and goods (personal chattels) constitutes an investment, together with other rights *in rem* over such tangible property, such as mortgages, liens, pledges and leases.

362. The distinction between movable and immovable property found in both model BITs is a civil law concept that is similar to, but not identical with,[68] the common law distinction between real and personal property.[69] It is thus interesting that it features in the USA Model BIT (1994,[70] 2004)[71] and UK Model BIT (1991).[72] The further distinction employed by the USA Model BIT in clause (h) between tangible and intangible property (and in clause (g) of Chapter 11 of NAFTA) is used by the common law but sits uneasily alongside the distinction between movable and immovable property. Tangible property can be either movable or immovable property, whereas that distinction is obviously meaningless for intangible property. Save for the ubiquitous reference to movable and immovable property in investment treaties, and the reference to 'real estate or other [tangible] property' in Chapter 11 of NAFTA, all the other categories of investments relate to intangible property.

363. Many BITs, but in particular those based upon a model BIT from a common law jurisdiction, contain a reference to leases as one of the rights *in rem* that qualify as an investment. There is a divergence in the treatment of leases in common law and civil law jurisdictions. The former recognise a proprietary foundation for the leasehold so that the lessee has a better right to possession of the leased property than anyone else excepting the owner. The lease in civil law jurisdictions does not generally confer a right *in rem* upon the lessee over the property in question because a leasehold does not feature in the closed list of proprietary rights (the principle of *numerus clausus*) in the civil code. Hence in civil jurisdictions it is more akin to a contractual right but which attracts special legislative protection so that, in substance, a lessee has a right to possession akin to the right *in rem* in common law jurisdictions.[73]

[68] B. Rudden, 'Things as Things and Things as Wealth' (1994) 14 *Oxford J of Legal Studies* 81.

[69] 'Real property' means interests in land except leases; 'personal property' means everything else. Tangible personal property is called a 'chattel'.

[70] UNCTAD Compendium (Vol. VI, 2002) 502.

[71] See Appendix 11.

[72] UNCTAD Compendium (Vol. III, 1996) 185. The same is true for the UK Model BIT (2005). See Appendix 10.

[73] See: § 571 BGB (German Civil Code); § 1599 C.c. (Italian Civil Code). In Germany, the right of a tenant to live in a rented apartment, for instance, has been classified as 'property' for the purposes of the constitutional protection afforded to property in Art. 14(1) of the Constitution. In particular, a tenant is protected against the termination of a rental contract that is not founded upon a legitimate interest of the landlord and specified in the contract itself. D. Kommers, *The*

364. The USA Model BIT (2004) refers to a lease in clause (h) in the context of 'other property rights'. In contrast, the Germany Model BIT (2005) makes no mention of leases as one of the 'any other rights *in rem*' in clause (a). Hence the dichotomy in the treatment of leases is preserved by the two model BITs under consideration from each of the two major legal traditions.

365. An inevitable problem will arise if, by way of example, the USA concludes a BIT based upon its own model BIT with a civil law country because there will be a lack of symmetry in the categories of qualified investments in the two contracting states.

366. In *Wena v Egypt*,[74] Wena, an English company, had an investment in the form of two lease agreements with the public sector corporation 'Egyptian Hotels Company' with respect to separate hotels. In terms substantially identical to the Germany Model BIT (2005) under consideration, the UK/Egypt BIT defines an investment to include 'movable and immovable property and any other property rights such as mortgages, liens and pledges'. The tribunal ruled that the lease agreements qualified as an investment pursuant to the aforementioned clause.[75] As leases are not specifically mentioned by the clause, the tribunal must have relied upon the words 'other property rights'. This is problematic because Egypt is a civil law jurisdiction and the civilian conception of a leasehold does not embody a property right.[76] In would appear that neither party raised this point in the jurisdictional phase of the proceedings.[77]

(ii) Security interests

367. Security interests in property, such as mortgages, liens and pledges, are generally included in the definition of an investment. The USA Model BIT (2004)[78] and the Germany Model BIT (2005)[79] are no exception. Chapter 11 of NAFTA does not make express reference to security interests in this sense, but

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Constitutional Jurisprudence of the Federal Republic of Germany (1997, 2nd edn) 255. A lease was described as an 'interest in real estate' by an international tribunal in: *Rio Grande Irrigation & Land Company Ltd* (*UK v USA*) 6 RIAA 131, 136–7 (1923). The European Court of Human Rights has also considered the proprietary nature of leases in the context of Art. 1 of Protocol 1 of the European Convention on Human Rights: *Pentidis v Greece* (Case 23238/94) Comm. Rep. 27.2.96; *Panikian v Bulguria* (Case 29583/96, 10 July 1997); *JLS v Spain* (Case 41917/98, 27 April 1999); *Blečić v Croatia* (Case 59532/00, 29 July 2004).

[74] (Preliminary Objections) 6 ICSID Rep 74.

[75] *Ibid*. 85. There is precious little discussion of the nature or scope of Wena's investment in the tribunal's award, whereas the *ad hoc* committee's decision simply notes that: 'This Committee cannot ignore of course that there is a connection between the leases and the [BIT] since the former were designed to operate under the protection of the [BIT] as the materialization of the investment.' (Annulment) 6 ICSID Rep 129, 137/35.

[76] U. Mattei, *Basic Principles of Property Law: A Comparative Legal and Economic Introduction* (2000) 81.

[77] (Preliminary Objections) 6 ICSID Rep 74, 85.

[78] Clause (h) of the definition of 'investment'. See Appendix 11.

[79] Clause (a) of the definition of 'investment'. See Appendix 7.

clause (f) includes 'an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution' within the definition of an investment. A mortgage, lien or pledge over the property of an enterprise in the host state would thus satisfy this definition.

368. For a security interest to qualify as an investment it is clear that it must be a form of consensual security rather than a security interest arising by the operation of law. The latter would not address the requirements of an investment in Rule 22 because there would be no commitment of resources to the economy of the host state. A maritime lien over a ship and her cargo for damage caused by the ship would not, for example, constitute an investment.

369. A security interest should not be confused with investment securities such as shares and bonds. Investment securities also qualify as an investment but are treated separately below. A security interest in the present sense is often referred to as 'collateral' and is a contingent claim on an asset that permits the holder of the interest to take physical possession of the asset and sell it to a third party upon the non-payment of a debt. A security interest thus gives the secured creditor two basic rights *in rem*: (i) the right to follow its asset into the hands of any third party, and (ii) the right to satisfy its debt in priority to the claims of other creditors upon the bankruptcy of the debtor.[80] For security interests to meet the other requirements in Rule 23 for an investment, the funds transferred against the pledged asset must be employed for a commercial use in the economy of the host state and a rate of interest must be charged so as to entail a commercial return.

370. A pledge involves the creditor taking possession of the debtor's asset as security until payment of the debt. Assets that are capable of being physically pledged can therefore be the object of a pledge and thus include tangible assets (e.g. machinery) and also documentary intangibles (e.g. negotiable bills of exchange) but not pure intangibles (e.g. simple debts). The possession of the asset gives the pledgee the legal title to that asset.

371. A mortgage entails the transfer of ownership of an asset to the creditor as security but subject to the condition that the debtor shall regain ownership when the funds provided by the creditor against the secured asset have been paid. In most legal systems it is unnecessary for the creditor to take possession of the asset; indeed the major benefit of this form of security is that the debtor retains the ability to use the asset productively. Insofar as possession is not required, a mortgage can be taken over all classes of assets, whether tangible or intangible.

372. One can envisage how a creditor, in acquiring a security interest in the form of a pledge or a mortgage, might comply with the requirements for an investment in Rule 23: the property is situated or registered in the host state;

[80] R. Goode, *Commercial Law* (2004, 3rd edn) 623.

funds move from the creditor (a national of a contracting state) to the debtor (a national of another contracting state) to be employed for a commercial purpose; a commercial return is generated by the rate of interest; and the creditor assumes the risk that the debtor might default in its repayments. More difficult, however, is the case of a lien.

373. A lien is generally a right given to a creditor under a contract to detain goods of the debtor to secure payment or performance of some other obligation. Unlike a pledge, a lien does not import an implied power of sale upon the debtor's default. It is possible to conceive how a lien could be part of the investor's bundle of rights acquired over time as a result of its investment activities in the host state. For instance, an investment agreement with a public authority might grant the investor a lien in case of default of payment over minerals extracted and in the possession of the investor but in relation to which title had passed to the public authority under the agreement. If the host state later nationalises the investor's mining operation, then the right over the minerals covered by the lien would be one of the expropriated rights *in rem* that would attract compensation. But it is difficult to see how a lien in and of itself could constitute an investment at the time of entry and fulfil the requirements of Rule 23 independently.

374. The issue of whether a security interest has been acquired by the putative investor is governed by the municipal law of the host state. If the property is tangible property, then this is by virtue of the *lex situs* rule. If it is intangible property, then the rights in question (such as intellectual property rights) must be recognised (i.e. by registration) in accordance with the law of the host state. The conditions that need to be satisfied in order for a consensual security interest to attach to an asset are complex in any legal system and divergences are likely to exist. Nonetheless, the following conditions adapted from Goode's analysis of security interests from a common law perspective[81] do at least illustrate the types of questions that might arise for the tribunal to resolve if the existence of the security interest is contested by the host state:

(a) There must be an agreement for security conforming to the formalities prescribed by the municipal law of the host state. If the security agreement itself is to be relied upon as producing attachment, without the transfer of ownership or possession, then the agreement must be valid and enforceable as a contract in accordance with its governing law.
(b) The asset to be given in security must be identifiable as falling within the scope of the agreement.
(c) The debtor must have power to give the asset in security.
(d) There must be a current obligation of the debtor to the creditor which the asset is designed to secure. Money must be transferred from the creditor to the debtor.

[81] *Ibid*. 627–37.

(e) Any contractual conditions for the attachment must have been fulfilled.
(f) In the case of pledge, actual or constructive possession must be given to the creditor.

(iii) Investment securities

375. Investment securities are issued by corporations or governments and create property in debt or in equity. They fall within a broad category of intangible assets that are, at base, claims to money, as opposed to those intangible assets that are not, such as intellectual property rights.

376. Investment securities in equity include shares, stock or other interests in the risk-bearing part of an enterprise's capital. These are the most common form of investments revealed by the corpus of investment treaty awards and are covered by clause (c) of the USA Model BIT (2004), clause (b) of the Germany Model BIT (2005) and clauses (b) and (e) of the definition in Chapter 11 of NAFTA. It is appropriate to classify an 'enterprise' or 'company' under this category, for this investment is equivalent to the investor owning *all* the shares or stock in the enterprise in question. This covers clause (a) of the USA Model BIT (2004) and clause (a) of Chapter 11 of NAFTA.

377. Investment securities in debt include bonds, loan notes and debentures and are covered by clause (c) of the USA Model BIT (2004) and clause (c) of NAFTA. Clause (c) of the Germany Model BIT (2005) reads 'claims to money which has been used to create an economic value or claims to any performance having an economic value'. This clause is wide enough to cover both investment securities and receivables.

378. Investment securities in debt issued by private companies, state enterprises and governments are generally negotiable instruments. A common example is a promissory note, which is an unconditional promise made in writing by one person to another signed by the issuer, engaging to pay, on demand or a fixed or determinable future time, a sum certain in money, to, or to the order of, a specified person or to bearer.[82] A promissory note is a document of title to money; it is the physical embodiment of the payment obligation to the holder. As such it is a negotiable instrument and thus the question arises whether the subsequent indorsement of a promissory note (like other negotiable instruments) would constitute an investment in view of the requirements in Rule 23. The problem is the nexus between the funds transferred as consideration for the negotiable instrument and the employment of those funds for commercial purposes in the economy of the host state. At one end of the spectrum, it seems clear that trading on the short-term money market in negotiable certificates of deposit or treasury and commercial bills cannot constitute an investment

[82] See: Bills of Exchange Act (England), s 83(1).

because this nexus is too weak.[83] But the answer is not necessarily provided by reference to the duration for the commitment of funds. Speculative trading on the long-term capital market in Eurodollar bonds, for instance, is no more likely to satisfy the requirements of Rule 23 either. The nexus between the funds transferred as consideration for the negotiable instrument and the employment of such funds for an investment purpose in the host state requires a certain degree of transparency in the transaction that invariably will only be present as between the issuer and the first holder. Hence, subsequent indorsements of the instrument will not generally satisfy the requirements in Rule 23, save in exceptional circumstances, such as where there is contractual documentation making the nexus explicit.

378C. Fedax NV v Republic of Venezuela[84]

Fedax, a Dutch company, was the endorsee of certain debt instruments (promissory notes) issued by the Government of Venezuela to a Venezuelan corporation for services provided by the latter to the former.[85] The tribunal reasoned that, if Fedax had been the entity providing the services to the Government, then that transaction would have constituted an investment.[86] The subsequent endorsements of the promissory notes did not, according to the tribunal, change the character of the underlying transaction as an investment:

> [A]lthough the identity of the investor will change with every endorsement, the investment itself will remain constant, while the issuer will enjoy a continuous credit benefit until the time the notes become due. To the extent that this credit is provided by a foreign holder of the notes, it constitutes a foreign investment which in this case is encompassed by the terms of the [ICSID] Convention and the [Netherlands/Venezuela BIT].[87]

The difficulty with this reasoning is that the tribunal has aggregated certain aspects of the underlying transaction with certain aspects of the endorsement in order to justify the existence of an investment. The original contract for the provision of services by a Venezuelan company to the Venezuelan Government may have evidenced the necessary attributes of an investment but Fedax was not privy to that arrangement and hence cannot rely upon those attributes to establish *its* investment in Venezuela. It is difficult to accept that those attributes can be invoked by one of the subsequent endorsees to the promissory notes issued by the

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83 *Fedax v Venezuela* (Preliminary Objections) 5 ICSID Rep 183, 199/43.

84 (Preliminary Objections) 5 ICSID Rep 183; (Merits) 5 ICSID Rep 200; *African Holding Co. v Congo* (Preliminary Objections) para. 81 (the tribunal appeared to adopted the same reasoning as in *Fedax*).

85 (Preliminary Objections) 5 ICSID Rep 183, 197/37.

86 *Ibid*. 197/38.

87 *Ibid*. 198/40.

Government to the Venezuelan company in the event that the endorsee has the requisite foreign nationality to benefit from the protection of an investment treaty.

379. In view of the difficulties arising in *Fedax*, clause (c) of the definition in Chapter 11 of NAFTA strikes a sensible balance in defining the types of debt securities that qualify as an investment as those issued by an enterprise which is an affiliate of the investor and for which the original maturity of the debt security is at least three years. Debt securities in state enterprises do not in any circumstances qualify as an investment.

380. The key to distinguishing covered investment securities from other interests in stocks and shares that do not attract investment treaty protection is the proprietary nature of the interest. Mere contractual rights to units in investment funds would not, for instance, fall within the definition of an investment. This was an issue before the tribunal in *Gruslin v Malaysia*.

380C. Philippe Gruslin v Malaysia[88]

A Belgian investor, Gruslin, purchased some USD 2.3 million in securities listed on the Kuala Lumpur Stock Exchange ('KLSE') through a mutual fund known as the Emerging Asian Markets Equity Citiportfolio (the 'EAMEC fund') registered in Luxembourg and managed by Citiportfolios S.A.[89] Gruslin claimed that he suffered losses of his entire interest in the EAMEC fund due to exchange controls imposed by Malaysia in September 1998.[90] Malaysia contended that Gruslin had made no investment in the KLSE securities because, as a holder of units in the EAMEC fund, he had no severable individual property right to the investments made by that fund in Malaysia.[91] (The tribunal had correctly ruled that the territorial requirement for a covered investment necessitated that Gruslin had rights to the securities listed on the KLSE in Malaysia in addition to rights in the EAMEC fund in Luxembourg.)[92] Instead, all Gruslin had acquired as a unit holder were contractual rights to the proper administration of the mutual fund.[93]

In the event, the tribunal upheld Malaysia's objection to jurisdiction on a different ground and thus declined to rule on Malaysia's submission with respect to the necessity of a proprietary interest in the securities.[94] It is submitted, however, that if Gruslin's interest in the EAMEC fund was

[88] (Preliminary Objections) 5 ICSID Rep 484.
[89] A Luxembourg company. *Ibid*. 487/8.1.
[90] *Ibid*. 487–8/8.3.
[91] *Ibid*. 489/10.3, 496/15.6.
[92] *Ibid*. 493/13.8–13.11.
[93] *Ibid*. 496/15.6.
[94] The Intergovernmental Agreement between the Belgo-Luxembourg Economic Union and Malaysia (1979) included a proviso that, to fulfil the requirements of a covered investment, the assets 'are invested in a project classified as an "approved project" by the appropriate Ministry in Malaysia, in accordance with the legislation and the administrative practice, based thereon.' The

limited to a contractual right in relation to the proper management of the fund, in accordance with Luxembourg law, this would have provided the tribunal with another basis to decline jurisdiction for the absence of an investment.

(iv) Credit

381. The provision of credit by the investor to an entrepreneur or enterprise engaged in commercial activities in the host state qualifies as an investment. The investor acquires rights to a debt, which can be assigned and thus has the feature of a right *in rem*. Credit can take the form of a loan, be part of a sales transaction, or be provided by finance leasing.

382. A loan is the payment of money by the investor to the debtor (an entrepreneur or enterprise engaged in commercial activities in the host state) upon terms that the sum advanced, with any stipulated interest, must be repaid by the debtor in due course.[95] A loan as a form of an investment is expressly mentioned in clause (c) of the USA Model BIT (2004). Clause (c) of the Germany Model BIT (2005) refers to 'claims to money which has been used to create an economic value' and thus covers a loan. Clause (d) of the Chapter 11 definition in NAFTA expressly refers to a 'loan to an enterprise' but restricts the definition to loans to an enterprise which is an affiliate of the investor or where the original maturity of the loan is at least three years. Moreover, clause (d) of NAFTA carves out loans to a state enterprise from the definition of an investment.

383. A loan is the form of credit that features most prominently as an investment in the corpus of investment treaty precedents. Other types of credit that might be extended by an investor include sale credit, which involves the purchaser's deferment of the payment of the price upon the sale or supply of land, services or facilities by the investor, and finance leasing, which envisages the lease of equipment where the legal title remains with the investor (lessor) but the economic benefits of ownership belong to the lessee. The rent payable to the investor is calculated to ensure that the investor is reimbursed for its capital outlay and achieves a desired return on the capital.

384. It is to be expected that the extension of credit by an investor to an entrepreneur or commercial entity in the host state will in most cases be backed by the acquisition of rights over the debtor's assets to secure the payment of the debt. In other words, the extension of credit will be a form of secured financing and thus the investor will not simply compete with other creditors *pari passu*

tribunal held that no such approval had been granted by the appropriate Ministry in Malaysia in the case of Gruslin's putative investment and hence the tribunal did not have jurisdiction to hear the claim (*ibid*. 507–8/25.5–25.7).

[95] R. Goode, *Commercial Law* (2004, 3rd edn) 578–81.

upon the bankruptcy of the debtor. Thus it will be common for the extension of credit to be accompanied by the acquisition of a consensual security in the form of a pledge, lien, mortgage or charge, which independently qualify as investments pursuant to the definition in most investment treaties.

(v) Rights to future income/claim to money

385. Of all the investment categories considered thus far, it is a 'claim to money'[96] or 'right to future income' or 'claim to performance' which generates the most controversy in practice. There is clearly a significant degree of overlap between each of these rights and an analysis of them must grapple with an additional problem of distinguishing between rights *in rem* capable of constituting an investment pursuant to Rule 22 and simple contractual rights that are not. The problem is the subject of a separate Rule 24 and much of the discussion accompanying it is directly relevant to the investment category now under consideration. Investment securities confer a right *in rem* to a 'claim for money' and therefore are capable of being an 'investment' pursuant to Rule 22. The category of 'rights to money or future income' tends to feature in BITs where there is no separate reference to investment securities, such as the Germany Model BIT. Insofar as the category under consideration is introduced in the Germany Model BIT as an 'asset', it would seem to follow that there must be a proprietary foundation for any alleged investment in the form of a 'claim to money or future income'.

386. The USA Model BIT (2004) makes no reference to the rights in this investment category.[97] The Germany Model BIT in clause (c) does contain a reference – 'claims to money which has been used to create an economic value or claims to any performance having an economic value' – which is among the widest formulations in existence. By contrast, clause (i) of the definition in Chapter 11 of NAFTA expressly carves out certain types of 'claims to money' arising out of sale of goods contracts and credit contracts and any other claim to money which does not memorialise a right *in rem* mentioned in the proceeding clauses (a) to (h) of the NAFTA definition.

387. The essential difficulty with this investment category is where to draw the line; a lottery ticket is capable of being described as a 'claim to money' and a metro ticket as a 'claim to performance'. These examples demonstrate the importance of incorporating *both* legal and economic elements in the definition of a covered investment, as reflected in Rule 22 and Rule 23. If, in order to

[96] *EnCana v Ecuador* (Merits) 12 ICSID 427, 475–6/182–4, 477/188 (accrued entitlement to a VAT refund as a 'claim to money').
[97] Nor does the previous version of 1994: UNCTAD Compendium (Vol. VI, 2002) 502.

qualify for investment treaty protection, it were sufficient for the claimant to have secured a legal right to claim money, then one must inevitably determine that a winning lottery ticket bought in the host state is an investment. But such a conclusion obviously does violence to the ordinary meaning of the term 'investment' and this is avoided if the economic characteristics of an investment are considered in tandem with the legal rights that are enumerated by the investment treaty as examples of investments. Applying those economic characteristics in Rule 23, it is manifest that a lottery ticket cannot constitute an investment.

388. In *PSEG v Turkey*[98] the claimant asserted that an option was capable of meeting the definition of a 'a claim to money or a claim to performance having economic value, and associated with an investment' for the purposes of Article 1(c)(iii) of the USA/Turkey BIT. The tribunal rejected this argument but without providing reasons.[99] It is clear that an option cannot satisfy the requirements for the economic materialisation of an investment in Rule 23. Even if the claimant has an undisputed legal right to the option and thus a 'claim to performance having economic value', the existence of such a right does not necessarily entail a 'transfer of resources into the economy of the host state by the claimant entailing the assumption of risk in expectation of a commercial return' pursuant to Rule 23.

389. The tribunal in *Saipem v Bangladesh*[100] 'left open' the possibility that an arbitral award rendered in a commercial arbitration could amount to an investment as 'credit for sums of money or any right for pledges or services having an economic value connected with investments, as well as reinvested income' for the purposes of Article 1(c) of the Italy/Bangladesh BIT. Whether or not an ICC award is capable of meeting this definition[101] must be secondary to the more obvious impediment to recognising an award or judgment as an investment by reference to the economic test in Rule 23.

(vi) Public licences and other public acts

390. Public licences and other public acts can generate rights *in rem* for the holder in accordance wirth the municipal law of the host state and such rights are capable of constituting an investment. For instance, 'intangible property' in the English Theft Act 1968 includes 'assignable export quotas' granted by the government. Such quotas can therefore be stolen.[102]

[98] (Preliminary Objections) 11 ICSID Rep 434.
[99] *Ibid*. 469/189–190.
[100] (Preliminary Objections).
[101] The tribunal stated that 'the rights arising out of the ICC Award arise only *indirectly* from the investment' and hence could not satisfy the test in Article 25(1) of the ICSID Convention in any case: *ibid*. para. 113.
[102] S. 4(1). *Attorney-General of Hong Kong v Nai-Keung* [1988] Cr LR 125.

391. The USA Model BIT (2004) includes a note to make explicit the link between the rights arising under the public act and the existence of an investment:

> Whether a particular type of license, authorization, permit, or similar instrument (including a concession, to the extent that it has the nature of such an instrument) has the characteristics of an investment depends on such factors as the nature and extent of the rights that the holder has under the law of the Party. Among the licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law.[103]

392. This proviso is nothing more than a confirmation of the choice of law principle in Rule 4.

393. There are limited examples in the investment treaty jurisprudence of public acts being found to constitute an investment but such examples do exist. In *Pope & Talbot v Canada*,[104] the tribunal found that a permit giving 'access to the US market is a property interest subject to protection'.[105] In *Generation Ukraine v Ukraine*,[106] certain public acts such as an 'Order on Land Allocation'[107] and a construction permit[108] were found to be part of the covered investment in Ukraine.

(vii) Intellectual property

394. There are two broad categories of intellectual property rights. The first is legal protection of ideas or their expression and include copyrights, patents for inventions, industrial design rights, database rights, plant variety rights, and so on. The second category relates to the protection of distinguishing signs that are used for the marketing and distribution of goods and services.

395. Intellectual property rights have frequently been the object of international reclamations[109] and there is no conceptual problem in recognising such rights as investments. It is, nonetheless, important to emphasise the territorial nature of intellectual property rights and the role of the law of the host state pursuant to Rule 4.

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[103] See Appendix 11.
[104] (First Merits) 7 ICSID Rep 69.
[105] *Ibid*. 85/96.
[106] (Merits) 10 ICSID Rep 240.
[107] *Ibid*. 278–9/18.22.
[108] *Ibid*. 283/18.46.
[109] E.g. *Chorzów Factory* (*Germany v Poland*) (1928) PCIJ (Ser. A) No. 17 (Merits). Intellectual property rights have been recognised as 'possessions' for the purposes of Art. 1 Protocol 1 of the European Convention on Human Rights: *Smith Kline and French Laboratories v Netherlands* (1990) 66 DR 70, 79; *Lenzing AG v United Kingdom* [1999] EHRLR 132 (patents).

396. An intellectual property right does not vest the holder with a property right in an idea (patent) or an expression (copyright) or in any other intangible subject matter. An inventor of an industrial process does not need to register a patent in order to exploit that process; rather, he needs a patent to prevent others from exploiting it. An intellectual property right is therefore negative in character: it is a right to exclude others and corresponds to an obligation *in rem* by which all subjects of the legal system have a negative duty to refrain from exploiting an invention or representing one's business or its products by a certain name or symbol and so on.[110] Hence intellectual property rights are 'monopolies defined in terms of ideas and expressions and symbols'.[111]

397. The legal monopoly represented by an intellectual property right is territorial in the sense that it only creates duties for those subject to the legal system that has created that monopoly. Where intellectual property rights are asserted to be part of a covered investment in an investment treaty dispute, it is, therefore, critical to ensure that such rights are recognised by the municipal law of the host state. This issue is considered in the commentary to Rule 4. It is certainly true that the Agreement in Trade-Related Aspects of Intellectual Property Rights ('TRIPS'), within the conspectus of the World Trade Organisation, is having the effect of harmonising the municipal laws of states on the substantive and procedural rules for recognising intellectual property rights. But this does not absolve a tribunal from the task of applying the municipal law of the host state to resolve any dispute about the existence of intellectual property rights as part of a covered investment.

(viii) 'Pre-investment expenditures'

398. The problem of whether 'pre-investment expenditures' constitute an 'investment' within the terms of the investment treaty or the ICSID Convention only arises by usage of the vacuous term 'pre-investment expenditures'. If expenditures in the host state lead to the acquisition of a property right pursuant to Rule 22 and the economic characteristics of an investment have materialised for the purposes of Rule 23, then there is an investment in the host state and the protection of the treaty is engaged. If expenditures in the host state do not result in the acquisition of a property right cognisable as an investment and the economic characteristics are not present, then there is no investment. The sole question is whether the claimant has made an investment in the host state; the notion of a 'pre-investment' is meaningless.[112]

110 J. Penner, *The Idea of Property* (1997) 119.
111 *Ibid*.
112 It is conceptually on par with new parents insisting that their child should be deemed to have been born at the start of their ante-natal classes.

398C(1). Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka[113]

The claimant successfully participated in a tender process for the construction of an electricity power generating facility in Sri Lanka. Negotiations with the Sri Lankan Government ensued, but no agreement was ultimately concluded. The claimant brought an investment treaty claim to recover its substantial preparatory costs.

The tribunal's reasoning in dismissing the objection to its jurisdiction is not persuasive. The problem started with the tribunal's characterisation of the issue as whether the definition of 'investment' covered 'pre-investment expenditures'.[114] As previously noted, this formulation of the issue simply begs the question as to when an investment is consummated.

The issue before the tribunal, properly defined, was whether various transactional documents concluded between the claimant and the Sri Lankan authorities memorialised a right under Sri Lankan law that was cognisable as an 'investment' pursuant to Article I of the USA/Sri Lanka BIT. More specifically, did the transactional documents in accordance with their governing law vest the claimant with 'any right conferred by law or contract' for the purposes of Article I(1)(a)(v) of the USA/Sri Lanka BIT? The relevant transactional documents were analysed by the tribunal and the conclusion was that 'there was never any contract entered into between the Claimant and the Respondent for the building, ownership and operation of the power station'.[115] This conclusion should have been dispositive for the absence of an investment pursuant to the definition in the USA/Sri Lanka BIT, which was not quoted or analysed in the tribunal's decision. Instead, the tribunal purported to survey the 'sources of international law'[116] to determine whether 'pre-investment and development expenditures in the circumstances of the present case could automatically be admitted as an "investment"'.[117]

398C(2). Zhinvali Development Limited v Republic of Georgia[118]

The consent to ICSID arbitration in *Zhinvali* was not recorded in an investment treaty but rather in the national investment law. The claimant sought compensation for its 'pre-investment expenditures' and the tribunal defined

[113] (Preliminary Objections) 6 ICSID Rep 310.
[114] *Ibid*. 317/34.
[115] *Ibid*. 319/47.
[116] *Ibid*. 322/60.
[117] *Ibid*. The tribunal probably came to the correct result in upholding the jurisdictional objection because it had found that the three relevant transactional documents (the Letter of Intent, Letter of Agreement and Letter of Extension) did not create any contractual obligations with respect to the building, ownership and operation of the power station (*ibid*. 319/48). This conclusion appears to be correct due to the stipulations in the instruments that they were subject to a final contract.
[118] (Preliminary Objections) 10 ICSID Rep 3.

the issue as 'whether the Claimant's purported expenditures qualify as an "investment" under the 1996 Georgian Investment Law',[119] which supplied the operative definition of an 'investment' for the purposes of Article 25(1) of the ICSID Convention.[120] It is not, however, expenditures that might qualify as an investment, but rather it is the product of those expenditures. Unlike in *Mihaly*, however, the tribunal did confront squarely the issue as to whether the claimant had acquired a property right within the relevant definition of an investment. Thus, in particular, the tribunal considered whether, pursuant to the Georgian Investment Law, the claimant had obtained 'intellectual property' by virtue of its expenditure on preparatory studies and feasibility reports in respect of a proposed project for the rehabilitation of a hydroelectric power plant and its tailrace tunnel. The tribunal was not satisfied that the claimant had acquired such a right.[121] The tribunal went on to consider, following the example of *Mihaly*, whether the claimant's 'development costs' independently qualified as an investment.[122] The question posed by the tribunal was whether Georgia had consented to the treatment of 'development costs' as an investment for the purposes of Article 25(1) of the ICSID Convention independently of the definition of an investment in the 1996 Investment Law. Unsurprisingly, the tribunal found no evidence of such consent on the record.[123]

Rule 23. The economic materialisation of an investment requires the commitment of resources to the economy of the host state by the claimant entailing the assumption of risk in expectation of a commercial return.[124]

[119] *Ibid*. 88/375.

[120] And was also the enactment containing Georgia's offer to submit investment disputes to ICSID arbitration.

[121] *Ibid*. 93/333.

[122] The tribunal's choice of words in its actual formulation was unfortunate but produced no mischief in its ultimate decision on the point: 'In keeping with the learning of the *Mihaly Case* award, we must, in divining the presence or absence of an Article 25(1) "investment" in this case, determine whether Georgia assumed State responsibility for the Claimant's "development costs"' (*ibid*. 98/406). The reference to 'State responsibility' in this context is difficult to fathom.

[123] *Ibid*. 102/415.

[124] The requirements of commitment of resources and assumption of risk are confirmed in: *Salini v Morocco* (Preliminary Objections) 6 ICSID Rep 400, 413/52; *LESI (Dipenti) v Algeria* (Preliminary Objections) para. 13(iv); *LESI (Astaldi) v Algeria* (Preliminary Objections) para. 72(iv); *Bayindir v Pakistan* (Preliminary Objections) paras. 104–38; *Jan de Nul v Egypt* (Preliminary Objections); *Saipem v Bangladesh* (Preliminary Objections) para. 99; USA Model BIT (2004), Definition of an 'Investment' ('every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk'), see Appendix 11; OECD, Negotiating Group on the Multilateral Agreement on Investment (MAI), 'Definition of Investment and Investor' (DAFFE/MAI(97) 7, 7 February 1997). The definition of the economic materialisation of the investment is very close to the submission of the Slovak Republic in *CSOB v Slovak Republic* (Preliminary

A. THE IMPORTANCE OF CERTAINTY

399. Of all the provisions of an investment treaty, legal certainty about the proper scope of the term 'investment' is perhaps most critical if the treaty is to achieve its objective of attracting foreign investment. A putative investor is entitled to structure its investment to benefit from the protection of an investment treaty and the concomitant reduction of sovereign risk attaching to the investment (see Rule 51) – a putative investor fashioning its conduct in this way is an example, *par excellence*, of the investment treaty fulfilling its proclaimed objective. As noted in *Bayview v Mexico*:[125]

> When the investment is made in a different country which has concluded an investment protection treaty covering that investment, the investor is entitled to rely upon the fact that the State Parties to the treaty have decided to commit themselves to give a minimum level of legal protection to such foreign investments.[126]

400. For that reason, the putative investor must be in a position to know whether or not its investment project will qualify for investment protection at the time the decision is made to commit capital in the host state.

401. If the fundamental objective of an investment treaty is to attract foreign capital, then the concept of an investment cannot be one in search of meaning in the pleadings submitted to an investment treaty tribunal that is established years, perhaps decades, after the decision to commit capital to the host state was made. It is for this reason that the approach advocated in *Salini v Morocco*, which combines inchoate 'typical' investment characteristics with a wide margin of appreciation in the tribunal, cannot be endorsed without significant refinement. According to the *Salini* test, the following elements typically characterise an investment: (a) a contribution of money or other assets of economic value; (b) a certain duration; (c) an expectation of profit; (d) an element of risk; and, (e) a contribution to the host state's development.[127] The nature of the inquiry was recently described in the following terms:

Objections) 5 ICSID Rep 335, 353–4/78 ('the acquisition of property or assets through the expenditure of resources by one party (the "investor") in the territory of a foreign country (the "host State"), which is expected to produce a benefit on both sides and to offer a return in the future, subject to the uncertainties of the risk involved'). According to the Slovak Republic, CSOB's loan did not constitute an investment. The tribunal acknowledged that 'CSOB's loan did not cause any funds to be moved or transferred from CSOB to the Slovak Collection Company in the territory of the Slovak Republic' (*ibid*.) but nevertheless 'the basic and ultimate goal of the Consolidation Agreement was to ensure a continuing and expanding activity of CSOB in both Republics' and hence CSOB qualified as an investor (*ibid*. 356/88).

[125] *Bayview v Mexico* (Preliminary Objections).

[126] *Ibid*. para. 99.

[127] *Salini v Morocco* (Preliminary Objections) 6 ICSID Rep 400, 413/52; C. Schreuer, *The ICSID Convention: A Commentary* (2001) 140. For a critique of the *Salini* criteria: *Biwater v Tanzania* (Merits) paras. 312 *et seq*.

> The classical *Salini* hallmarks are not a punch list of items which, if completely checked off, will automatically lead to a conclusion that there is an 'investment.' If any of these hallmarks are absent, the tribunal will hesitate (and probably decline) to make a finding of 'investment.' However, even if they are all present, a tribunal will still examine the nature and degree of their presence in order to determine whether, on a holistic assessment, it is satisfied that there is an ICSID 'investment.'[128]

402. There is a premium for precision in defining a protected investment and hence the subjectivity inherent is this test, and reflected in this quotation, makes it unfit for the purpose.

403. Rule 23 retains only three of the *Salini* characteristics of an investment in modified form; namely: (i) commitment of resources to the economy of the host state, (ii) assumption of risk, and (iii) expectation of a commercial return. It is these elements that are capable of generating an objective test and the necessary level of certainty for putative investors. It is also these three characteristics that featured in the draft definition of an investment in the Multilateral Agreement on Investment.[129]

B. 'COMMITMENT OF RESOURCES TO THE ECONOMY OF THE HOST STATE'

(i) The requisite territorial connection

404. The requisite territorial connection has already been analysed in terms of the law applicable to an issue relating to the existence or scope of property rights comprising the investment (Rule 4) and the *situs* of the bundle of rights in property for the purposes of the legal materialisation of an investment (Rule 22). The territorial nexus between the claimant's contribution of capital and the economy of the host state is also a fundamental aspect of the economic materialisation of the investment; indeed it is the realisation of the prime objective for the contracting state parties to enter into an investment treaty in the first place. It is self-evident that this aspect of the economic rationalisation of the investment must be interpreted strictly to ensure that the claimant has fulfilled its side of the *quid pro quo* before resorting to arbitration with the host state. In other words, the territorial connection between the claimant's contribution of capital and an investment enterprise in the host state must be direct rather than indirect or consequential.

[128] *Malaysian Salvors v Malaysia* (Preliminary Objections) para. 106(e).

[129] OECD, Negotiating Group on the Multilateral Agreement on Investment (MAI), 'Definition of Investment and Investor' (DAFFE/MAI(97)7, 7 February 1997).

405. Among the cases considered below, the first two – *Bayview v Mexico* and *Petrobart v Kyrgyz Republic* – provide unambiguous illustrations of the absence of the requisite territorial connection, albeit that the point was wrongly decided in the latter case. Much closer to the borderline for the requisite territorial connection are the *SGS v Pakistan* and *SGS v Philippines* cases, which are examined thereafter.

405C(1). Bayview Irrigation District *et al* v United Mexican States[130]

The US claimant alleged that it had a right to take a certain amount of water from the Rio Bravo/Rio Grande River in Texas pursuant to Texan law and that this right had been interfered with upstream and across the border by acts attributable to the Mexican Government. The tribunal was prepared to find that the right to water established under Texan law falls within the definition of 'property' in Article 1139(g) of NAFTA:[131]

> [R]eal estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes[.]

The fatal flaw in the claimant's attempt to establish a protected investment under NAFTA was that its right to water did not satisfy the territorial nexus requirement in Rule 22 and Rule 23 . The claimant did not have a property right situated in Mexico and recognised by Mexican law:

> [T]he holder of a right granted by the State of Texas to take a certain amount of water from the Rio Bravo/Rio Grande does not 'own', does not 'possess property rights in' a particular volume of water as it descends through Mexican streams and rivers towards the Rio Bravo/Rio Grande and finds its way into the right-holders irrigation pipes. While the water is in Mexico, it belongs to Mexico, even though Mexico may be obliged to deliver a certain amount of it into the Rio Bravo/Rio Grande for taking by US nationals.[132]

Mexico's obligation referred to in this passage stems from a bilateral treaty between the USA and Mexico concerning the utilisation of the waters of the rivers in question. The tribunal noted that that bilateral treaty does not create property rights for the benefit of private

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[130] (Preliminary Objections).
[131] *Ibid*. para. 111.
[132] *Ibid*. para. 116. The US Supreme Court would have decided the case the same way in an action invoking the Fifth Amendment: *United States v Willow River Power Co*., 324 US 499 (1945) (the claimant had no property interest in the head of water in a river).

individuals or entities that are capable of constituting an investment for the purposes of NAFTA.[133]

405C(2). Petrobart Limited v Kyrgyz Republic[134]

The alleged investment was a debt arising out of a 'Goods Supply Contract' for gas condensate between between Petrobart (a Gibraltar company) and KGM,[135] a company owned by the Kyrgyz Republic.[136] Petrobart relied upon Article 1(6)(f) of the ECT, which provides:

> (6) 'Investment' means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:
>
> [...]
>
> (f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

The drafting in the ECT leaves much to be desired and the definitional section in Article 1 is no exception. The tribunal failed to appreciate that there must be territorial connection between the investment and the host state respondent and thus Article 1(6)(f) should be interpreted as a right to 'undertake any Economic Activity in the Energy Sector' of the particular Contracting Party whose acts are alleged to have caused prejudice to the investment. In the ECT, the requisite territorial connection is made explicit in Article 26(1), which circumscribes the *ratione materiae* jurisdiction of the tribunal:

> Disputes between a Contracting Party and an Investor of another Contracting Party relating to an Investment of the latter in the Area of the former, which concern an alleged breach of an obligation of the former under Part III...[137]

If Article 26(1) determines the scope of the tribunal's jurisdiction, and that provision refers to a territorial nexus between the respondent host state and the investment, then the tribunal was bound to satisfy itself of that territorial nexus before upholding its jurisdiction.

An analysis of other provisions of the ECT confirms the requirement of a territorial nexus. The definition of 'Economic Activity in the Energy Sector' in Article 1(5) of the ECT extends to 'economic activity concerning the

133 *Ibid*. para. 121.
134 (Merits).
135 Kyrgyzgazmunaizat.
136 *Ibid*. para. 4.
137 Art. 26(1) of the ECT. See Appendix 4.

exploration, extraction, refining, production, storage, land transport, transmission, distribution, trade, marketing, or *sale* of Energy Materials and Products'. From this the tribunal inferred that the Goods Supply Contract conferred a right 'to undertake an economic activity concerning the *sale* of gas condensate' and, therefore, constituted an investment. But it is tolerably clear from the 'Understandings' accompanying the Final Act of the European Energy Charter Conference,[138] that 'sale' in this context means the right to sell Energy Materials and Products on the territory of the host state by means of some kind of permanent establishment. The relevant section of the 'Understandings' reads:

> The following activities are illustrative of Economic Activity in the Energy Sector:
> (i) prospecting and exploration for, and extraction of, e.g., oil, gas, coal and uranium;
> (ii) construction and operation of power generation facilities, including those powered by wind and other renewable energy sources;
> (iii) land transportation, distribution, storage and supply of Energy Materials and Products, e.g., by way of transmission and distribution grids and pipelines or dedicated rail lines, and construction of facilities for such, including the laying of oil, gas, and coal-slurry pipelines;
> (iv) removal and disposal of wastes from energy related facilities such as power stations, including radioactive wastes from nuclear power stations;
> (v) decommissioning of energy related facilities, including oil rigs, oil refineries and power generating plants;
> (vi) *marketing and sale of, and trade in Energy Materials and Products, e.g., retail sales of gasoline;* and
> (vii) research, consulting, planning, management and design activities related to the activities mentioned above, including those aimed at Improving Energy Efficiency.[139]

No problems would arise in the identification of the territorial connection between a 'right … to undertake any Economic Activity in the Energy Sector' and the respondent Contracting Party in examples (i) to (v) because the natural resources listed in (i) and the 'facilities' listed in (ii) to (v) have an obvious *situs*. Example (vi), which is particularly relevant to the case under discussion, mentions 'retail sales of gasoline'. The retail sale of Energy Materials and Products must obviously be carried out through a business established in a Contracting Party and hence, once again, the *situs* is readily identified. Suppose Petrobart was engaged in retail sales of gasoline through an established retail network in Gibraltar and its supplier, the Kyrgyz Republic, failed to make a

[138] To which reference is made by a footnote to Article 1(5) of the ECT. See Appendix 4.
[139] Final Act of the European Energy Charter Conference, Understandings, IV/2/b, 25 (emphasis added).

delivery. Does Petrobart have the right to pursue a claim against the Kyrgyz Republic under Article 26 of the ECT? Clearly not, because Petrobart does not have an asset in the energy sector of the Kyrgyz Republic. Would the situation change if Petrobart is the supplier and it is the Kyrgyz Republic which is engaged in retail sales within its own territory?

405C(3). Société Générale de Surveillance SA v Pakistan[140] and Société Générale de Surveillance SA v Republic of the Philippines[141]

In both cases, Société Générale de Surveillance SA ('SGS') had concluded contracts with the host states to provide 'pre-shipment inspection' services (a 'PSI Agreement')[142] with respect to goods to be exported from certain countries to the host states. By providing this inspection service, SGS ensured that the goods were properly classified for the imposition of duties by the host states, thus increasing the efficiency of customs revenue collection. In each case, the host state objected to the jurisdiction of the tribunals on the basis that SGS had not made an investment in the territory of the host state as required by the BIT, and the ICSID Convention.

The tribunal in *SGS v Pakistan* approached the question by referring exclusively to the definition of an investment in the Switzerland/Pakistan BIT. According to the tribunal, the PSI Agreement between SGS and Pakistan constituted a 'concession under public law' and gave rise to 'claims to money' and 'rights given by law' and 'by contract'; hence there was an investment pursuant to the definition in the BIT.[143] The tribunal did not, however, consider the independent territorial requirement for the investment to qualify for protection under the BIT, save for its observation that SGS had to make certain 'relatively small' expenditures in the territory of Pakistan in order to perform its obligations under the PSI Agreement.[144] There is no doubt that the substantial part of SGS's performance of the PSI Agreement had taken place outside Pakistan. The locus for pre-shipment inspections is naturally outside the country of destination for the goods. It is true that SGS had established two liaison offices in Pakistan and funded these offices to assist in the performance of its obligations under the PSI Agreement; however, the liaison offices did not engage in any commercial activities and thus did not generate any revenues.[145] All that could be said in relation to the territorial requirement was that there was an expenditure of

140 (Preliminary Objections) 8 ICSID Rep 406.
141 (Preliminary Objections) 8 ICSID Rep 518.
142 This is the term used in *SGS v Pakistan*. In *SGS v Philippines* the contract was for the 'provision of comprehensive import supervision services' ('CISS Agreement'). The tribunal in *SGS v Philippines* noted that the agreement in *SGS v Pakistan* was 'for analogous services to those in the present case' (*ibid*. 543/94).
143 *Ibid*. 433/135.
144 *Ibid*. 433/136.
145 *Ibid*. 421/77. There was no dispute between the parties on this point: *ibid*.

funds in Pakistan that was incidental to SGS's performance of its primary obligations abroad. The tribunal instead reinforced its conclusion that SGS had made a covered investment by noting that the functions delegated to SGS were of a *jure imperii* character.[146] But this must be irrelevant to the question. Although unlikely to happen in practice, suppose Pakistan had delegated part of its consular services by employing a private company in a third state to process visas for travel to Pakistan. This is undoubtedly a delegation of a *jure imperii* function, but the private firm's commitment of resources in the third state could hardly satisfy the territorial requirement for an investment in Pakistan.[147]

Another unsatisfactory feature of the tribunal's reasoning on the question of the existence of an investment in *SGS v Pakistan* was its failure to acknowledge, let alone consider, the prior decision of the Supreme Court of Pakistan on this point.[148] Of course the tribunal was not bound by the Supreme Court's judgment in ruling upon its own jurisdiction, but considerations of judicial comity might have persuaded the tribunal to engage with the matters debated by the parties before this forum. The Supreme Court had concluded that there was no investment because, pursuant to the PSI Agreement, 'mere services had been acquired for evaluation of the goods mostly in foreign countries and there is no element of laying money by [SGS] for acquisition of any species of property'.[149]

In *SGS v Philippines*, the tribunal recognised explicitly that there is a requirement that the investment is made in the territory of the host state. The Philippines argued that there was no investment in its territory because 'the place of substantial performance' of SGS's obligations under the PSI Agreement was in the countries of export;[150] moreover, SGS was not tax resident in the Philippines despite its establishment of a liaison office in Manila.[151] The tribunal acknowledged that 'the bulk of the cost of providing the service was incurred outside the Philippines'[152] but nevertheless 'a substantial and non-severable aspect of the overall service was provided in the Philippines'[153] and that 'SGS's entitlement to be paid was contingent on that aspect'.[154] The 'substance' test proposed by the Philippines was thus rejected. This conclusion can be supported: there is no reason in principle to search for the 'centre of gravity' of the investment, so long as there is a

[146] *Ibid*. 434/139.
[147] In *SGS v Philippines*, the tribunal cited the examples of the construction of an embassy in a third state or the provision of security services to the embassy as instances where there would be no investment in the territory of the state whose embassy it was: (Preliminary Objections) 8 ICSID Rep 518, 545/100.
[148] (Judgment of Munir A. Sheikh J, 3 July 2002) 8 ICSID Rep 356.
[149] *Ibid*. 371/38.
[150] (Preliminary Objections) 8 ICSID Rep 518, 532–3/58.
[151] *Ibid*. 547/104.
[152] *Ibid*. 546/106.
[153] *Ibid*. 546/102.
[154] *Ibid*.

commitment of resources into the economy of the host state which has resulted in the acquisition of some form of proprietary interest cognisable as an investment. The tribunal found on the evidence that this was the case, due to the substantial expenditure incurred by SGS in running the Manila office, which was essential to the inspection operation abroad and which rendered the inspection certificates to the Government.[155]

(ii) The provision of services does not entail a 'commitment of resources'

406. The ICSID annulment proceedings in *Mitchell v Congo*[156] were concerned first and foremost with the question of whether the provision of legal services might constitute an investment pursuant to the definition of such in Article I of the USA/Congo BIT. In the absence of a cognisable investment the tribunal would not have had jurisdiction, and thus a decision to the contrary would entail that the tribunal had manifestly exceeded its powers for the purposes of Article 52(1)(b) of the ICSID Convention. The problem raised in this case illustrates the importance of testing the existence of an investment by reference to the requirements for both the legal and economic materialisation of the investment.

406C. Patrick Mitchell v Democratic Republic of Congo[157]

The key finding of the tribunal that became the focus of the annulment proceedings is reproduced below:

> The Tribunal finds that in respect of items of Mr. Mitchell's property seized during the intervention of the military forces on March 5, 1999, the requirement listed under Article I(c)(i) of the BIT is met. This concerns movable property and any documents, like files, records and similar items. It further appears from the text of the provision as quoted that the investor's right to 'know-how' and 'goodwill' (iv) as well as the right to exercise its activities (vi) are elements which are stated as being covered by the protection of investments under the BIT. This concerns also the payments registered on the accounts of Mr. Mitchell in the United States to which Claimant refers in order to demonstrate his activity within the DRC. Indeed, these payments are based on bills for fees referring to legal consultations provided by Mr. Mitchell and his employees through the office 'Mitchell & Associates' within the DRC.[158]

The claimant, Mr Mitchell, no doubt owned certain property (documents, files, etc.) in the host state as this passage of the award recognises. Furthermore, the claimant also employed his know-how in providing legal advice. These items do feature in the list of property rights that may

155 *Ibid*. 547/105.
156 (Annulment).
157 (Annulment).
158 *Ibid*. para. 48.

comprise an investment in Article I of the BIT; but is that dispositive of the matter? The question is whether the acquisition and use of those items of property capable of satisfying the requirements for the legal materialisation of the investment in Rule 22, also resulted in the economic materialisation of the investment pursuant to Rule 23. The answer must be no: there is no expectation of profit and assumption of risk in the acquisition of 'documents and files'.

The reference to know-how in some investment treaties surely envisages a formal contribution of know-how to the charter capital of an enterprise where its value is assessed and its existence is registered. The know-how represented by a manufacturing process which is contributed to a manufacturing plant in the host state by the claimant might, therefore, qualify as an investment. By contrast, the know-how deployed in the practice of one's profession is not assignable and does not have the characteristics of property.

The tribunal's reasoning would have been more coherent if the asset constituting the investment in the Congo had been described as the legal services firm. There is no difficulty in describing the legal services firm as an investment according to the criteria in Rule 23. The annulment committee was wrong to fixate upon the items of property owned by the claimant in the host state that were incidental to the provision of legal services and hold that there was no investment in the 'economic sense'.[159]

C. ELEMENTS OF THE *SALINI* TEST NOT RETAINED IN RULE 23

407. Certain of the '*Salini* hallmarks' of an investment are not retained in Rule 23 – the reason being that their inclusion generates too much subjectivity where precision is essential for the investment treaty to fulfil its stated object and purpose. The difficulties attending these discarded elements of the *Salini* test are exposed in the following critique of the award in *Malaysian Salvors v Malaysia*.

407C. Malaysian Historical Salvors Sdn, Bhd v Government of Malaysia[160]

The alleged investment concerned the claimant's location and salvage of the cargo of a British vessel that sank off the coast of Malacca in 1817 pursuant to a contract concluded with the Government.[161] The claimant's remuneration under the contract was wholly contingent upon its success in locating the vessel.[162] The vessel was in fact located and its cargo was salvaged and a

[159] *Ibid*. para. 38.
[160] (Preliminary Objections).
[161] *Ibid*. para. 7.
[162] *Ibid*. para. 10.

dispute arose concerning the parties' respective entitlements upon the subsequent sale of the cargo.[163] The claimant commenced proceedings pursuant to the arbitration clause in the contract to recover certain amounts from the Government which it alleged were due. The seat of the arbitration was Kuala Lumpur. The claimant's claims were dismissed by the arbitral tribunal and the claimant alleged that it suffered a denial of justice in the Malaysian High Court in seeking to have the award set aside.[164] The claimant then commenced ICSID proceedings based on Malaysia's consent to arbitration in the Malaysia/UK BIT.

The claimant asserted that its performance under the salvage contract constituted an investment pursuant to the following provisions of the Malaysia/UK BIT:

> Article 1 Definition
>
> For the purposes of this Agreement:
> (1) (a) "investment" means every kind of asset and in particular, though not exclusively, includes:
>
> […]
>
> (iii) claims to money or to any performance under contract, having a financial value;
>
> […]
>
> (v) business concessions conferred by the law or under contract, including concessions to search for, cultivate, extract or exploit natural resources.

The tribunal formulated the question to be resolved as 'whether there is an "investment" within the meaning of that term as found in the Malaysia-UK BIT as well as in Article 25(1) of the ICSID Convention'.[165] It answered this question by an analysis of five 'characteristics of an investment'.

First: 'the regularity of profits and returns'.[166] The tribunal noted that there was no regularity of profits and returns on the present facts but found that this criterion 'is not always critical' or 'determinative' or a 'classical hallmark of "investment"'. If all these descriptors are accurate, then it is difficult to fathom the utility of the criterion as one of the limbs of an important judicial test.
Second: 'contributions'.[167] The tribunal found that 'the Claimant has expended its own funds, whether in the form of equipment, know-how

[163] *Ibid*. paras 11–14.
[164] *Ibid*. para. 16.
[165] *Ibid*. para. 42.
[166] *Ibid*. para. 108.
[167] *Ibid*. para. 109.

or personnel, or in the performance of the Contract in its entirety'.[168] This requirement bears semblance to the first element of Rule 23: 'the commitment of resources to the economy of the host state'. But the semblance is superficial because Rule 23 includes a territorial element insofar as the commitment of resources must be to the economy of the host state. In the present case, it is difficult to ascertain how the claimant would have satisfied that requirement by expending resources on its salvage efforts.

Third: 'duration of the contract'.[169] The tribunal found that the contract had required four years to complete, and, therefore, 'complied with the minimum length of time of two to five years' in *Salini*.[170] It is very doubtful that a tribunal could legislate for a specific minimum duration for an investment in such a manner that would have preclusive effect in subsequent cases. The tribunal then noted that the contract had in fact been for an initial term of 18 months but had been extended by mutual consent. There was, according to the tribunal, an element of 'fortuity' in this extension because it was a function of whether or not the claimant found the vessel. The tribunal then concluded that 'although the Claimant satisfies the duration characteristic in the quantitative sense, it fails to do so in the qualitative sense'.[171] The significance of this distinction is by no means clear. Finally, similar to the first criterion, the tribunal held that 'such failure does not, by itself, mean that the project was not an "investment"… since a holistic assessment of all the hallmarks still needs to be made'.[172] Once again, the 'duration' requirement cannot provide concrete guidance as to what constitutes an investment if it is susceptible to being waived by the tribunal.

Fourth: 'risks assumed under the contract'.[173] The tribunal noted that 'all risks of the Contract were borne by the claimant' but that most salvage contracts entail risk because they are on a 'no-finds-no-pay' basis and thus if risk were the solitary criterion then all salvage contracts would be investments.[174] The tribunal classified these contractual risks as 'anything other than normal commercial risks' and that 'an ordinary commercial contract cannot be considered as an investment'.[175] The tribunal appears to conflate two elements of the concept of an investment here. The 'assumption of risk' is a factor included in Rule 23: the assumption of risk must have accompanied the commitment of resources to the host state. It is thus a condition precedent for an investment

[168] *Ibid*.
[169] *Ibid*. para. 110–11.
[170] *Ibid*. para. 110.
[171] *Ibid*. para. 111.
[172] *Ibid*.
[173] *Ibid*. para. 112.
[174] *Ibid*.
[175] *Ibid*.

pursuant to Rule 23 but it does not feature as part of the test in isolation because otherwise, as the tribunal experienced in the present case, it is devoid of utility. To the extent that an 'ordinary commercial contract' might not be an investment, that is because there might not be an acquisition of a property right in the host state memorialised by the contract, or because it does not entail the commitment of resources to the host state. But to disqualify an 'ordinary commercial contract' on the basis of a distinction between 'normal commercial risks' and some other category of risks (not defined by the tribunal) is highly problematic.
Fifth: 'economic development of host state'.[176] As previously noted, in the absence of specific criteria set out in the investment treaty or the ICSID Convention, this requirement compels a tribunal to make a highly subjective and possibly invidious distinction between investments that make a 'significant contribution to the host state's economy' and those that do not. The tribunal's assessment of this requirement in the present case illustrates the difficulties:

> Unlike the Construction Contract in *Salini* which, when completed, constituted an infrastructure that would benefit the Moroccan economy and serve the Moroccan public interest, the Tribunal finds that the Contract did not benefit the Malaysian public interest in a material way or serve to benefit the Malaysian economy in the sense developed by ICSID jurisprudence, namely that the contributions were significant.
>
> … To the extent that the claimant had provided gainful employment to [approximately 40] Malaysians, the Tribunal accepts that the Contract did benefit the Malaysian public interest and economy to some extent. However, this benefit is not of the same quality or quantity envisaged in previous ICSID jurisprudence. The benefits which the Contract brought to the Respondent are largely cultural and historical. These benefits, and any other direct financial benefits to the Respondent, have not been shown to have led to significant contributions to the Respondent's economy in the sense envisaged in ICSID jurisprudence.[177]

The tribunal's ultimate conclusion on the existence of an investment was that 'while the Contract did provide some benefit to Malaysia, they did not make a sufficient contribution to Malaysia's economic development to qualify as an "investment" for the purposes of Article 25(1) or Article 1 (a) of the BIT'.[178]

[176] *Ibid*. paras 113–45.
[177] *Ibid*. paras 131–2.
[178] *Ibid*. para. 143.

408. In *Mitchell v Congo*,[179] the *ad hoc* annulment committee ruled that the provision of legal services did not qualify as an investment. Central to that conclusion was the finding that 'the existence of a contribution to the economic development of the host State as an essential – although not sufficient – characteristic or unquestionable criterion of the investment'.[180] It is submitted that this is an unworkable criterion for the existence of an investment because of its subjective nature;[181] whether or not a commitment of capital or resources ultimately proves to have contributed to the economic development of the host state can often be a matter of appreciation and generate a wide spectrum of reasonable opinion. The *ad hoc* committee's caveats to this criterion illustrate its weakness; for in the words of the committee '[it] does not mean that this contribution must always be sizable or successful' and 'this concept of economic development is, in any event, extremely broad but also variable depending on the case'.[182] Such an elastic concept is hardly conducive of legal certainty and a prospective investor is entitled to know with a degree of certitude whether or not its commitment of capital attracts the protection of an investment treaty and/or the ICSID Convention.[183]

Rule 24. Where the claimant relies upon a contract to establish an investment pursuant to Rule 22 and Rule 23, the tribunal should differentiate between rights *in personam* as between the contracting parties and rights *in rem* that are memorialised by the contract.[184] The rights *in personam* do not generally qualify as an investment independently of the rights *in rem*.

A. THE IMPORTANCE OF DISTINGUISHING RIGHTS *IN REM* AND RIGHTS *IN PERSONAM*

409. In this chapter we are concerned with the essential characteristics of an investment, the existence of which is the gateway to the substantive and procedural protection afforded by the investment treaty. This question is distinct from the scope of the tribunal's *ratione materiae* jurisdiction. The tribunal may have jurisdiction over contractual claims arising in connection with the investment depending upon the particular provision in the treaty that defines the types of disputes capable of being submitted to investment treaty arbitration.

[179] (Annulment).
[180] *Ibid*. para. 33.
[181] It was rejected as a criterion essentially for this reason in: *LESI (Dipenti) v Algeria* (Preliminary Objections) para. 13(iv); *LESI (Astaldi) v Algeria* (Preliminary Objections) para. 72(iv).
[182] *Ibid*.
[183] *Casado v Chile* (Merits) para. 232.
[184] (*Semble*) *Mytilineos v Serbia* (Preliminary Objections) paras. 124–5.

But whether or not contractual rights *per se* can constitute an investment is a different matter; it is a question that arises before the inquiry into the scope of the tribunal's *ratione materiae* jurisdiction because the tribunal's adjudicative power is predicated upon the existence of a qualifying investment.

410. This distinction is manifest in the USA Model BIT (2004) in the definition of an 'investment agreement'. Article 24 of the Model BIT allows the investor or the investment to bring a claim based upon an investment agreement and thus the scope of the tribunal's *ratione materiae* jurisdiction extends to contractual claims. But this does not mean that an 'investment agreement' constitutes an investment *per se*; rather, it is defined as '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'.[185] Thus, a covered investment is memorialised by an investment agreement but these concepts are distinct.

411. The principle reflected in Rule 24 is that it is generally rights *in rem* that constitute an investment. This section probes the principle further by defining the circumstances where a contractual relationship can generate property rights. Contractual rights arising out of a contract for the supply of goods and services, for instance, would not satisfy the requirements for the economic materialisation of the investment in Rule 23 because the claimant would be unable to establish a territorial nexus with the host state. On the other hand, a more complex contractual arrangement may evidence the claimant's contribution of resources to the economy of the host state in return for property rights within the host state's legal order.

412. The essential distinction between property and contract in general international law on the protection of the rights of foreign nationals, and the numerous international treaties with the same objective, is justified by reference to the core principles of each legal institution. A right *in rem* is a right in respect of a thing (a *res*) whereas a right *in personam* is a right in the conduct of someone. A right *in rem* binds the whole world, whereas a right *in personam* binds only specific individuals or legal entities.

413. Rights *in rem* have a special significance in every legal system. According to Penner:

> Norms *in rem* establish the general, impersonal practices upon which modern societies largely depend. They allow strangers to interact with each other in a rule-governed way, though their dealings are not personal in any significant respect.[186]

[185] See Appendix 11.
[186] J. Penner, *The Idea of Property* (1997) 30. See also: J. Waldron, *The Right to Private Property* (1988) 42–3.

414. As a result of this special significance, property law and contract law operate very differently:

> Contract law typically permits free customization of the rights and duties of the respective parties to any contractual agreement; in other words, contract rules are generally default rules. Property law, in contrast, requires that the parties adopt one of a limited number of standard forms that define the legal dimensions of their relationship; generally speaking, these are mandatory rules that may not be modified by mutual agreement.[187]

415. The unique characteristics of a right *in rem* are distilled by Hohfeld in his classic study 'Fundamental Legal Conceptions as Applied in Judicial Reasoning':[188]

> (1) *in rem* rights are characterized by both an indefinite class of dutyholders and by large numbers of dutyholders; (2) *in rem* rights are not simply aggregations of *in personam* rights but are qualitatively different in that they attach to persons through their relationship to particular things rather than as persons; (3) *in rem* rights are numerous and indefinite in two directions – not only does each *in rem* right give rise to a large and indefinite number of duty holders, but also each dutyholder holds such duties to a large and indefinite number of rightholders; (4) *in rem* rights are always claims to abstentions by others as opposed to claims to performances on the part of others.[189]

416. Due to the possible impact of rights *in rem* upon third parties, all national legal systems limit property rights to a small number of well-defined types. This is most conspicuous in civilian countries in accordance with the *numerus clausus* principle. Systems of registration are established for the more valuable property rights in a legal system to facilitate actual notice of those rights and to ensure that a doctrine of constructive notice operates fairly and justly.

417. A state, like all individuals or entities within its jurisdiction, has actual or constructive notice of rights over property because such rights bind everyone in

[187] T. Merrill and H. Smith, 'The Property/Contract Interface' (2001) 101 *Columbia LR* 773, 776; T. Merrill and H. Smith, 'Optimal Standardization in the Law of Property: The *Numerus Clausus* Principle' (2000) 110 *Yale LJ* 1, 9–24. For a critique of this approach: H. Hansmann and R. Kraakman, 'Property, Contract, and Verification: The *Numerus Clausus* Problem and the Divisibility of Rights' (2002) 31 *J of Legal Studies* 373.

[188] (1917) 107 *Yale LJ* 710.

[189] This definition of a right *in rem* is an adaption from Hohfeld's study by Merrill and Smith: T. Merrill and H. Smith, 'The Property/Contract Interface' (2001) 101 *Columbia LR* 773, 789. See also: A. Honoré, 'Rights of Exclusion and Immunities Against Divesting' (1960) 34 *Tulane LR* 453. English law contains no settled definition of a right *in rem* but there are some judicial pronouncements of interest: *National Provincial Bank v Ainsworth* [1965] AC 1175, 1247–8 per Lord Wilberforce ('Before a right or interest can be admitted into the category of property, or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability').

the jurisdiction. By virtue of this actual or constructive notice, it is fair and just to impose international obligations upon the state with respect to the protection of property rights. Conversely, in relation to contracts between private parties, the state is obviously not privy to the rights and obligations generated therein and cannot be held to be on notice of their existence. The value of the rights and obligations under a contract is directly linked to the 'personality' or 'individuality' of the specified persons or legal entities who are bound by the contract, rather than the ability of the right holder to exclude all others from use of the thing over which the right is asserted. Insofar as value for contractual rights and obligations is inexorably tied to the identity of free agents (individuals or legal entities), it is neither fair nor just to superimpose a form of international responsibility upon states for the disappointment of expectations within private contractual relationships.

418. The distinction between property and contract is thus fundamental as a matter of legal principle. But it is also important as a matter of economics. Merrill and Smith elaborate upon the distinction in the following terms:

> On the one hand, contract rights are *in personam*; that is, they bind only the parties to the contract. The contracting parties are in the best position to evaluate the costs and benefits of adopting novel legal terms to govern their relationship, and in the typical bilateral contract there are no significant third-party effects associated with the adoption of idiosyncratic terms. Property rights, on the other hand, are *in rem* – they bind 'the rest of the world'. Thus, the adoption of novel forms of property has implications not only for the immediate parties to the transaction but also for third parties, who must incur additional costs of gathering information in order to avoid violating novel property rights or to decide whether to seek to acquire these rights. Indeed, even if third parties want nothing to do with novel property rights, the very possibility that such rights exist would require them to engage in more scrutiny of the property rights they encounter in order to make sure they are not infected with unwanted novelty. Thus, free customization of property forms would create an information-cost externality; mandatory standardization is the legal system's way of reducing these external costs to an acceptable level.[190]

419. This insight provides the critical reason why investment treaty protection cannot extend to simple contractual rights as between private parties: governments would be priced out of their regulatory function. The cost of performing due diligence on the potential ramifications of any regulatory action upon private contractual relationships would be so prohibitive that governments would be rendered impotent to perform their essential role.

[190] Merrill and Smith, 'The Property/Contract Interface', 776–7.

420. The American jurisprudence on the Takings Clause of the Fifth Amendment to the Constitution provides many illustrations of this distinction between *rights in rem* and *rights in personam* informing the scope of protection. In *Pro-Eco, Inc v Board of Commissioners of Jay County, Indiana*,[191] the Court of Appeal of the Seventh Circuit considered a claim by Pro-Eco that the Board, when it acted *ultra vires* by issuing an ordinance to prohibit the operation of a landfill, took Pro-Eco's property within the meaning of the Fifth Amendment. Pro-Eco did not own the land in question; instead it had an option to buy the land. Pro-Eco argued that this option amounted to a compensable property interest.[192]

421. The Court of Appeal found that, under the relevant state law of Indiana, an option to buy property does not create any interest *in rem* in that property. Nevertheless, Pro-Eco asserted that the rights under the option contract itself constituted property for the purposes of the Takings Clause. This argument was rejected:

> If local governments had to pay compensation for every contract they frustrated when enacting ordinances within their substantive powers, localities would eventually lose their abilities to govern themselves.

422. At least since its landmark decision in *Board of Regents v Roth*,[193] the US Supreme Court has been careful to insist that claimants invoking the Due Process Clause and the Takings Clause of the Fifth Amendment of the Constitution must establish that their economic interests constitute 'property'. Contract rights have not been regarded as property, at least in respect of the Takings Clause. The relevant principle is stated by Merrill:

> Contract rights are not property for takings purposes insofar as they reflect nothing more than a bilateral agreement; as contract rights break free from the initial contracting parties and enter into general circulation as investments or money, they become property.[194]

423. This distinction applies with equal force to the investment treaty context.[195]

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[191] 57 F.3d 505.

[192] *Ibid*. 509.

[193] 408 US 564 (1972).

[194] T. Merrill, 'The Landscape of Constitutional Property' (2000) 86 *Virginia LR* 885, 993–4.

[195] The ECHR has taken a similar line in relation to Art. 1 of Protocol 1: *Gustafsson v Sweden* (Case 18/1995/524/610, 28 March 1996) para. 60 ('Admittedly, the State may be responsible under Article 1 (P1-1) for interferences with peaceful enjoyment of possessions resulting from transactions between private individuals (see the *James and Others v the United Kingdom* judgment of 21 February 1986, Series A no. 98, pp. 28–9, paras. 35–6). In the present case, however, not only were the facts complained of not the product of an exercise of governmental authority, but they concerned exclusively relationships of a contractual nature between private individuals, namely the applicant and his suppliers or deliverers. In the Court's opinion, such repercussions as the stop in deliveries had on the applicant's restaurant were not such as to bring Article 1 of Protocol No. 1 (P1-1) into play.').

B. CONSEQUENTIAL ERRORS PRODUCED BY A FAILURE TO CHARACTERISE INVESTMENT RIGHTS

424. International law, including investment treaties, has a set of substantive obligations that address the state's interference with property rights. Conversely, it has no system of contract law capable of answering even the most basic questions that arise within a contractual relationship, such as the circumstances when a party may rescind the contract on the basis of its counterparty's breach. If the distinction between contract and property is blurred in respect of the threshold question of whether a qualifying investment has been made by the claimant, the consequential error will be the tribunal's application of the substantive international obligations of investment protection to a contractual dispute involving the host state or one of its emanations. The result of this mismatch will be a decision applying the wrong law or no law at all with varying layers of specious reasoning, as demonstrated by an analysis of the frequently cited award in *Revere Copper v OPIC*.

424C. Revere Copper and Brass, Inc v Overseas Private Investment Corporation[196]

The Overseas Private Investment Corporation ('OPIC') had insured the investment of Revere Copper and Brass, Inc[197] ('Revere') in the construction and operation of a bauxite plant in Jamaica through its wholly owned subsidiary Revere Jamaica Alumina[198] ('RJA'). The investment was made pursuant to an agreement between the Government of Jamaica and RJA of 10 March 1967 which had a term of 25 years (the '1967 Agreement'). A change of political leadership in Jamaica brought Michael Manley into power for the People's National Party, who commenced a review of the bauxite and alumina industry soon after the elections.[199] This review led to the adoption of a policy with four objectives:

(1) a drastic increase in revenues from bauxite mining and alumina production;
(2) recovery of bauxite ore leased to the mining companies;
(3) reacquisition of all lands owned by such companies; and
(4) national majority ownership and control of the bauxite industry.[200]

In furtherance of these objectives, the Bauxite (Production Levy) Act 1974 was enacted, which imposed a tax on bauxite at an initial rate of 7.5 per cent on the minimum quarterly quantities of bauxite that each producer was

[196] (Award, 24 August 1978) AAA Case No. 16/10/0137/76, 17 ILM 1321.
[197] A Maryland corporation. *Ibid*. 1322.
[198] Also a Maryland corporation. *Ibid*. 1322.
[199] *Ibid*. 1324.
[200] *Ibid*. 1324–5.

deemed to have produced during that quarter.[201] The impact of the levy could be severe if the production fell below the prescribed minimum.[202] In addition, the Mining Act was amended to increase the rate of royalty under the bauxite leases to 50 cents per ton.[203]

As a result of these measures, RJA reported losses of USD 1.5 to 2 million in each of the first four months in 1975.[204] Operations at the plant ceased on 19 August 1975. OPIC refused to indemnify Revere for its losses and the latter instituted international arbitration proceedings in accordance with the dispute resolution clause in the OPIC Contract.

The tribunal defined the question of liability under the terms of the OPIC insurance contract as:

> [W]hether any action of the Government of Jamaica directly resulted in preventing RJA for a period of one year 'from exercising effective control over the use or disposition of a substantial portion of its property or from constructing the Project or operating the same'.[205]

Revere contended that the state measures in question effectively abrogated the 1967 Agreement.[206]

The tribunal recognised that 'a mere breach of contract does not trigger the compensation provisions of the OPIC Contract'.[207] But the consensus among the members of the tribunal ended there. The majority found that:

> [T]he actions taken by the Government of Jamaica, having effectively put an end to the 1967 Agreement, directly prevented RJA from exercising effective control over the use or disposition of its property.[208]

The first issue the majority grappled with was the relevance of Jamaican law. The 1967 Agreement had no express governing law clause, but Jamaican law would have been applicable in accordance with the general choice of law approach. The majority's initial statement on the relationship between Jamaican law and international law appears to be consistent with the choice of law approach advocated in Chapter 2:

> [W]e accept Jamaican law for all ordinary purposes of the Agreement, but we do not consider that its applicability for some purposes precludes

[201] *Ibid*. 1327.
[202] *Ibid*. The Supreme Court of Jamaica had ruled that Revere Copper was not liable to pay the levy for periods where its production ceased altogether (*ibid*).
[203] *Ibid*. 1328.
[204] *Ibid*.
[205] *Ibid*. 1329. The text in quotation marks comes from Section 1.15(d) of the OPIC Contract.
[206] *Ibid*.
[207] *Ibid*. 1330.
[208] *Ibid*.

> the application of principles of public international law which govern the responsibility of States for injuries to aliens.[209]

This statement appears to suggest that the municipal law governing the contract applies to any issues arising out of the contractual relationship, but where the issue is an alleged abuse of regulatory power in relation to foreign property, it is international law that is applicable. Unfortunately, the majority then proceeded to undermine the coherency of this initial proposition by resorting to the theory of the 'internationalisation' of 'long term economic development agreements':

> [The majority] has concluded that the 1967 Agreement falls within this category of a long term economic development agreement and that principles of public international law apply to it insofar as the government party is concerned and that the question of breach by such party cannot be determined solely by municipal law.[210]

This approach rests upon pure sophistry. It operates by identifying the elements of the agreement in question that suggest an international dimension to the contractual relationship. The identification of such elements, which have never been defined in any normative document, invariably elevates the particular agreement to the status of a 'long term economic development agreement' with the effect that international law supersedes the otherwise applicable municipal law for the purposes of determining whether or not the agreement has been breached. At that point, the adjudicators concede that international law has no rules of contract law to determine that question, so the amorphous maxim of *pacta sunt servunda* is deployed to fill the void. The principle of *pacta sunt servunda* cannot possibly mean that all contractual obligations must be performed in any circumstances; indeed this is refuted by the maxim on the other side of the conceptual coin – *rebus sic stantibus*.

This 'internationalisation' approach is completely unnecessary. Within the contractual relationship, the host state may be liable by reason of its non-performance or it may not be. It will depend upon the precise manner by which the risks of non-performance have been allocated under the contract in accordance with the applicable law. Perhaps the state measure that underpins the host state's non-performance constitutes a *force majeure* event under the terms of that clause. The host state cannot, in such a case, be liable under the contract. Perhaps the host state has enacted legislation that purports to cancel certain obligations under the contract. If the governing law is the law of the host state, then the host state is not liable under the contract. But none of these conclusions *within* the contractual relationship prejudice the examination of the host state's sovereign acts *outside* it. International law has always been concerned with the legitimacy

[209] *Ibid*. 1331.
[210] *Ibid*.

of sovereign acts vis-à-vis foreign nationals. This is a domain where rules and principles of international law are relatively sophisticated and do provide solutions to concrete problems.

The majority in *Revere Copper* did not need to force the questions relating to the legitimacy of Jamaica's sovereign acts into a contractual box and then give that box another label – 'long term economic development agreement' – in order to resolve those questions with the assistance of international law. In fact by characterising the issues as relating to the breach of the 1967 Agreement, rather than the international legitimacy of Jamaica's sovereign acts, the majority deprived itself of the real guidance that international law could provide and instead found itself in a barren area where there are no international principles or rules at all. It is very instructive to follow their reasoning on these points.

First it was concluded that the 1967 Agreement was an 'internationalized contract'.[211]

Secondly, a study of the applicable principles of international law was undertaken. The principle extracted from the review of authorities was that:

> Under international law the commitments made in favour of foreign nationals are binding notwithstanding the power of Parliament and other governmental organs under the domestic Constitution to override or nullify such commitments.[212]

This principle is of course derived from the maxim *pacta sunt servunda* but does not take the analysis very far. The assertion that such commitments are 'binding' does not somehow deprive the state from the means to override or nullify contractual commitments; all it can signify is that in certain circumstances the state may be obliged by international law to pay compensation. The majority in *Revere Copper* acknowledged this:

> We find that the commitments made by the Government were internationally binding, although they may not, as in the *Shufeldt* case, have prevented the legislature, acting under its Constitutional powers, from enacting legislation contrary to their provisions. Action contrary to them, however, constituted a breach.[213]

Whether or not compensation is due depends upon the nature of the sovereign act in question and the assertion that the commitments are binding within the contractual relationship does not assist this inquiry. In fact it

[211] *Ibid*. 1338.
[212] *Ibid*. 1342–3.
[213] *Ibid*. 1345. The majority further stated: 'Admittedly Parliament could at any time legislate with respect to taxes and thus override contracts with private parties. It could not, however, deprive such parties of compensation, if the circumstances justified the payment of compensation under international law principles' (*ibid*. 1344).

merely obfuscates the issue. A state can nullify a contractual commitment without attracting international liability if, for instance, the exercise of that power was in a situation of an emergency affecting public health and safety.[214] Whether or not the doctrine of police powers can be invoked in such an instance cannot be answered from within the contractual relationship and thus the designation of the state measure as a breach or otherwise is irrelevant. Rather, the liability of the state under international law depends upon the circumstances extrinsic to the contract relating to the exercise of sovereign authority.

Thirdly, having concluded that the commitments were 'internationally binding', the majority proceeded to determine whether Jamaica 'repudiated its obligations under the Agreement'.[215] Having thrust the Agreement onto the international plane, it then fell upon the majority to search for the relevant principles of international law on the repudiation of contracts. Evidently that search was in vain because it was the American Law Institute's Restatement of the Law on Contracts that was invoked to supply the test for 'repudiation'.[216] Hence the ultimate result of the 'internationalisation' of the Agreement was the substitution of American law for Jamaican law. The majority found that Jamaica had, by its acts, repudiated the Agreement in accordance with the test propounded in the American Restatement.[217] The dissenting arbitrator came to the opposite conclusion.[218]

Finally, the majority then came to what they perceived to be the crux of the matter, which was whether the repudiation constituted an expropriation.[219] The issue was formulated as follows:

> This is not a claim against the Government of Jamaica for damages for breach or repudiation of the Agreement on the ground that such action constituted a violation of international law. The sole question for decision here is whether the Government actions repudiating the Agreement *directly prevented RJA from exercising effective control over the use or disposition of a substantial portion of its property or from operating the property*.[220]

[214] The OPIC Contract itself provides: 'Excluded [from the definition of "Expropriatory Action"] is any action resulting from: (1) any law, a decree, regulation, or administrative action of the Government of the Project Country which is not by its express terms for the purpose of nationalization, confiscation, or expropriation (including but not limited to intervention, condemnation, or other taking), is reasonably related to constitutionally sanctioned governmental objectives, is not arbitrary, is based upon a reasonable classification of entities to which it applies and does not violate generally accepted international law principles.'
[215] *Ibid*. 1345.
[216] *Ibid*.
[217] *Ibid*. 1348.
[218] *Ibid*. 1374.
[219] *Ibid*. 1348.
[220] *Ibid*.

The italicised part of the 'sole question' is the verbatim reference to the test for expropriation in the OPIC Contract, which broadly reflects the position under general international law:

> The term 'Expropriatory Action' means any action which is taken, authorized, ratified or concerned by the Government of the Project Country, commencing during the Guarantee Period, with or without compensation therefore, and which for a period of one year directly results in preventing: […] (d) the Foreign Enterprise from exercising effective control over the use or disposition of a substantial portion of its property or from constructing the Project or operating the same.[221]

The majority's formulation of the 'sole question' is very problematic. Whether or not a state repudiates a contract with a foreign national cannot provide an answer to the question of whether the foreign national has been prevented from exercising effective control over the use or disposition of its property. The issue of repudiation is one that must be answered within the contractual relationship. In contrast, rights *in rem* over property are enforceable against the whole world. Whether or not the state has unlawfully interfered with those rights *in rem* by reference to the standards of international law is an issue outside the contractual relationship. The OPIC Contract itself left no doubt about the correct principle:

> The abrogation, impairment, repudiation or breach by the Government of the Project Country of any undertaking, agreement or contract relating to the Project shall be considered an Expropriatory Action *only if it constitutes Expropriatory Action in accordance with the criteria set forth in this section*.[222]

Thus, whatever the effect of the Jamaican Government's measures on the contractual relationship between the parties, these measures could only constitute 'Expropriatory Action' if for a period of one year they prevented RJA from 'exercising effective control over the use or disposition of a substantial portion of its property'. In answering this question, the majority found itself in serious difficulty. Its ultimate conclusion was that the repudiation of the 1967 Agreement left RJA without 'effective control' because it could no longer make 'rational decisions' about its property.[223]

The dissenting arbitrator, a judge of the New York Court of Appeals, approaches this question in a rather more satisfactory way. Unlike the

[221] Section 1.15(d) of the OPIC Contract. *Ibid*. 1322.
[222] *Ibid*.
[223] *Ibid*. 1350.

majority, his focus was upon the effects of the Jamaican Government's measure on the property of RJA, as was required by the OPIC Contract:

> RJA remained in full control of its plant and of its business. The Jamaican government did not prevent RJA from managing its plant, or operating its business, or exporting alumina or by expropriation or otherwise directly prevent it from effective control of a substantial portion of its property.[224]

RJA's central complaint was the imposition of the bauxite levy in breach of the 1967 Agreement. The majority had concluded that the levy *did not* amount to Expropriatory Action under the OPIC Contract.[225] Thus, according to the dissenter, it was not open to the majority to invoke the breach of contract as a separately constituted Expropriatory Action in and of itself.[226] This is surely correct, both in accordance with the express terms of the OPIC Contract and general international law. The dissenter concluded that there had been no interference by the Jamaican government with the property of RJA;[227] the reason for the shutdown of the plant had been Revere's failure to obtain an extension of its labour contract due to problems with the unions.[228]

425. This analysis of *Revere Copper v OPIC* does not exclude the possibility that an investment treaty obligation may, by its own terms, purport to regulate the host state's conduct as a party to a contract with the investor. The obvious contender is the 'umbrella clause'. But even the adjudication of a claim based on this type of susbstantive obligation is parasitical upon the application of a law of contract at the first stage of any analysis.[229]

426. Investment treaty tribunals have made diverse and inconsistent findings in relation to the significance of contractual rights as an investment or as an object of an expropriation or breach of another substantive investment protection obligation. As already noted, these issues are distinct but they are often conflated in the awards. Once certain contractual rights are characterised as an investment, the logical next step if the investor's claim is upheld is to describe the object of the expropriation or other form of state interference as the same contractual rights.[230] It is certainly true that this problem strays deep into the tribunal's

[224] *Ibid*. 1373.
[225] *Ibid*. 1343–4. The dissenter noted that: 'By any reasonable standard the bauxite levy which Revere treats as expropriatory is within range of the proper taxing power of the Jamaica nation. Neither Revere nor its subsidiary RJA paid any income tax to Jamaica. The bauxite levy imposed in 1974 was measured by 7.5% of the average realized price of primary aluminium produced from the bauxite extracted in Jamaica' (*ibid*. 1376–7).
[226] *Ibid*. 1374.
[227] *Ibid*. 1376.
[228] *Ibid*. 1380.
[229] *SGS v Philippines* (Preliminary Objections) 8 ICSID Rep 518.
[230] The fallacy of such an approach was explored by the tribunal in: *RFCC v Morocco* (Merits) paras. 87–8 ('Un manquement à l'exécution d'un contrat, de nature à léser les intérêts du

adjudication of the merits. But in the present context it is important to justify the appeal to analytical rigour embodied in Rule 24 by illustrating the consequential errors that flow from a mischaracterisation of the investment rights. For this purpose, it is instructive to revisit the leading international precedents that are frequently cited for the proposition that contractual rights can be expropriated. A careful analysis of these precedents reveals that when international tribunals have made reference to the expropriation of a 'contractual right', the right in question has actually been a form of intangible property – most commonly a right over natural resources granted by a public act of the host state.

426C(1). Shufeldt Claim[231]

In the *Shufeldt Claim*, the contract related to a concession granted by the Government of Guatemala to extract chicle from certain public lands in Guatemala. A concession to exploit natural resources is a form of property, so it is more accurate to say that the contract in question memorialised a right *in rem*, and it was that right *in rem* that was expropriated, not a contractual right *per se*. If *any* contractual rights could constitute property and thus become the object of an expropriation, then it would have been pointless for the arbitrator to have posited the question 'did Shufeldt acquire any rights of property under the contract' and have come to the conclusion that 'Shufeldt did … possess the rights of property given to him under the contract.'[232] Hence the *Shufeldt Claim* is authority for the principle that a right to natural resources memorialized by a contract is a right *in rem* that is capable of being expropriated.

426C(2). Norwegian Shipowners Claims[233]

The mixed claims tribunal found that the United States had deprived the Norwegian shipowners of their contracts for the construction of vessels upon the US Government's requisition of the vessels for military use after war was declared on Germany in 1917. The US Government had effectively stepped into the shoes of the Norwegian shipowners in their contracts with the shipbuilders. This is clear from the following instructions accompanying the requisition order from the Government to the shipowners:

> For the work of completion heretofore and herein ordered the [US Government] will pay to you amounts equal to payments set forth in

cocontractant, ne peut s'analyser en une mesure d'expropriation. Une chose est de priver un investisseur de ses droits contractuels reconnus par la seule force de l'autorité étatique, autre chose est de contester la réalité ou l'étendue de ces droits par application du contrat. En l'espèce, le litige repose sur des divergences quant à l'interprétation du contrat et quant à la responsabilité contractuelle respective du maître de l'ouvrage ou de l'entrepreneur et ne dépasse par le désaccord normal entre cocontractants. Il s'agit d'un pur contentieux du contrat, et non de l'expropriation).

[231] (*USA v Guatemala*) 28 RIAA 1080 (1930).

[232] *Ibid*. 1097.

[233] (*Norway v USA*) 8 RIAA 308 (1922).

> the contract and not yet paid; provided that on acceptance in writing of this order you agree that on final acceptance of the vessel to give a bill of sale to the United States in satisfactory form conveying all your rights, title, and interests in the vessel.[234]

The US Government's intervention in the contractual relationship between the Norwegian shipowners and the American shipbuilders constituted a *force majeure* circumstance that relieved the shipbuilders of any liability to the shipowners under the contract.[235] Hence the claim on behalf of the Norwegian shipowners was not for performance of the shipbuilding contracts against either the shipbuilders or the US Government, or damages in lieu thereof, because those contracts had effectively come to an end. The tribunal thus noted that it 'has not the power to modify, correct or improve the contracts agreed between citizens of the two countries, nor modify their consequences'[236] and carefully pointed out that the juridical basis of the claims on behalf of the Norwegian shipowners was not the contracts but the interference with property rights evidenced by the contracts.[237] It is important to emphasise that the United States had defended the claims by characterising the foundation of the claims as contractual and thus the nature of the alleged loss as 'consequential', for which, according to the United States, damages are not awarded under American law or international law.[238] This characterisation was expressly rejected by the tribunal,[239] who focused on the rights *in rem* evidenced by the shipbuilding contracts that were taken by the US Government, rather than whether its conduct could be said to have breached those contracts:

> It has been proven that the claimants lost the use and possession of their property through an exercise by the United States of their power of eminent domain. When, for instance, on October 6, 1917, the [US Government] informed [the Norwegian negotiator] that the United States had taken the 'title', the [US Government] implicitly admitted that *the ownership of all the liens, rights and equities set forth in the fifteen shipbuilding contracts* had been transformed to the United States by operation of law.[240]

Thus it was not the contractual rights *per se* that were found to have been taken by the United States, but the rights *in rem* (in particular a lien over the vessel under construction) evidenced by the shipbuilding contracts.[241]

234 *Ibid*. 321.
235 *Ibid*. 323–4.
236 *Ibid*. 330.
237 *Ibid*. 333–4.
238 *Ibid*. 334.
239 *Ibid*.
240 *Ibid*. (emphasis added).
241 *Ibid*.

426C(3). Certain German Interests in Polish Upper Silesia (the Chorzów Factory case)[242]

The Chorzów factory was taken over by the Polish Government pursuant to a general law of 1920 expropriating certain properties of German nationals in Polish Upper Silesia. The Permanent Court of International Justice addressed the issue of whether, by expropriating the factory, the Polish Government had also expropriated the contractual rights of a German company, Bayerische, in relation to the factory. The contract in question was between Bayerische and the owner of the factory for the former's operational management of the factory on the latter's behalf.[243] But this was evidently more than just a service agreement, for Bayerische used certain of its own patented techniques in the operation of the factory. The language used by the Court in deciding this issue was imprecise, but it is tolerably clear that it was not the contractual rights of Bayerische that were found to have been expropriated, but Bayerische's rights *in rem* evidenced by the contract with the owner. The Court formulates the question thus:

> The question is whether, by taking possession of the Chorzów factory on July 3rd, 1922, and, by operating it, making use of the experiments, patents, licences, etc. *of the Bayerische*, Poland has unlawfully expropriated the contractual rights of that Company.[244]

There is a further elaboration of the particular rights of Bayerische that had been prejudiced by Poland's expropriation of the factory:

> The length of the period for which the contract with the Company [Bayerische] was signed proves that the intention was to establish the conditions necessary to enable it to bring into the concern [Chorzów factory] the patents, licences, etc. belonging to it, in spite of the fact that the factory was not its property.[245]

The pronoun 'it' in the phrase 'belonging to it' refers to Bayerische and suggests that the Court was concerned to differentiate between tangible property (the factory) and intangible property (patents, licences, etc.) rather than between property rights and contractual rights. This is further confirmed in the Court's conclusion on Poland's liability:

> [T]he rights of the Bayerische to the exploitation of the factory and to the remuneration fixed by the contract for the management of the exploitation and for the use of its patents, licences, experiments, etc., have been directly prejudiced by the taking over of the factory by Poland.[246]

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242 (*Germany v Poland*) 1926 PCIJ (Ser. A) No. 7 (Merits).
243 *Ibid*. 43.
244 *Ibid*. 44 (emphasis added).
245 *Ibid*.
246 *Ibid*.

Despite the Court's use of the terms 'contractual rights' in its judgment, it is clear from these passages that it was the rights *in rem* evidenced by the contract that was the object of the expropriation. The right to the exploitation of the factory could be characterised as a licence or a lease and the reference to patents, licences and experiments are obviously to intellectual property rights belonging to Bayerische.

426C(4). Landreau Claim[247]

Writers advocating the existence of an international delict in general international law for a state's interference with contractual rights struggle to find authority for their position. Jennings concedes that '[i]t is not often that one finds a claim in contract unassociated with a claim in property'[248] and cites the *Landreau Claim* as the only precedent that 'comes near to it'.[249]

The contract that formed the basis of the *Landreau Claim* was between Landreau[250] and the Government of Peru for the payment of a royalty by the Government for Landreau's discovery of guano deposits.[251] The Government later repudiated the contract and Landreau accepted this repudiation.[252] Landreau's claim was not, therefore, founded upon the contract[253] but upon notions of 'justice and fairness'.[254] There is no reference to any cause of action derived from international law in the award for the simple reason that international law was not applicable in accordance with the terms of the *compromis*.[255] The tribunal characterised the claim as follows:

> The principle on which the sum to be paid is to be computed is quite different from that on which the sum should have been assessed if [Landreau] was entitled to claim payment on the footing of that

247 (*USA v Peru*) 1 RIAA 347 (1922).

248 R. Jennings, 'State Contracts in International Law' (1961) 37 *BYBIL* 156, 169, note 2.

249 *Ibid*.

250 One of the confusing aspects of the award is that the claim was on behalf of John Célestin Landreau, whereas the contract was entered into by his brother John Teophile Landreau. The tribunal struggles with this issue considerably in its award due to contradictory representations by the brothers before various judicial fora as to their respective rights and interests in the contract. The tribunal's ultimate finding, however, was that the contract had been repudiated by the Government and that the claimant, John Célestin Landreau, had accepted that repudiation: (*USA v Peru*) 1 RIAA 347, 363 (1922). Hence there is no need, for the present purposes, for distinguishing between the two brothers.

251 *Ibid*. 354.

252 *Ibid*. 363.

253 *Ibid*.

254 *Ibid*. 364.

255 Article I of the 'Protocol for Arbitration of the Landreau Claim against Peru' read: 'The questions to be determined by the Arbitral Commission are: First. Whether the release granted by the Peruvian Government in 1892 by John Teophile Landreau eliminated any claim which John Celestin Landreau, the American citizen, may have had against the Peruvian Government, and if all claims were not thereby extinguished then, second: *what sum if any is equitably due* the heirs or assigns of John Célestin Landreau' (*ibid*. 349, emphasis added). The tribunal interpreted 'equitably' to mean 'in justice and fairness' (*ibid*. 364).

> contract ... The damage would have had to be assessed on the basis of what would have been payable in respect of the percentages on sales allowed by that contract. But as [Landreau] accepted the repudiation by Peru of that contract, the question is very different and is this: what was the fair value of the communication to Peru of the discoveries of guano which had been made by [Landreau]?[256]

The claim was in essence akin to an action for breach of confidence in common law jurisdictions.[257] This is hardly authority for the proposition that international law recognises a cause of action for the state's interference with simple contractual rights.

426C(5). Phillips Petroleum Company v Islamic Republic of Iran[258]

The tribunal's award in *Phillips Petroleum* is perhaps the clearest authority for the proposition that contractual rights can be the object of an expropriation in the pre-investment treaty arbitration era. The reasoning employed to achieve this result is, however, far from persuasive. Phillips Petroleum Company brought two claims in the alternative: an expropriation claim in respect of its rights under the 1965 contract with the National Iranian Oil Company ('NIOC') for the exploitation of the petroleum resources in a certain offshore area of the Persian Gulf, and a breach of contract claim in relation to the same contractual rights.[259] That these claims could be brought in the alternative is very significant. In investment treaty arbitration, it is often the case that the contractual counterparty is not the host state itself or the tribunal does not have jurisdiction over contractual claims. In the quest to seise the jurisdiction of an investment treaty tribunal, it has therefore become commonplace to describe the object of the treaty claim as a contractual right, but disavow the character of the dispute as contractual. Here there was no reason for Philips Petroleum to resort to this form of sophistry: it could state its claims in the alternative because there was no doubt that the tribunal had jurisdiction in respect of both under the Claims Settlement Declaration.[260] It follows that, in the estimation of the claimant, there was no difference in substance between the international delict and the contractual claim.

The tribunal decided upon its own motion to adjudge the claim as one of expropriation rather than breach of contract:

> The Tribunal considers that the acts complained of appear more closely suited to assessment of liability for the taking of foreign-owned

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[256] *Ibid*. 364.
[257] See, e.g., the Canadian Supreme Court decision in: *International Corona Resources Ltd v LAC Minerals Ltd* (1989) 61 DLR (4th) 14.
[258] (Case 425-39-2, 29 June 1989) 21 Iran-US CTR 79.
[259] *Ibid*. para. 1.
[260] Art. II(1).

> property under international law than to assessment of the contractual aspects of the relationship, and so decides to consider the claim in this light.[261]

This is a curious statement indeed. The claims were pleaded as identical alternatives so no mischief could be done by addressing the expropriation claim first. But the implication from this statement and the relevant section of the award is that liability for the expropriation of contractual rights can be determined in isolation from the 'contractual aspects of the relationship' simply by refashioning those rights as 'foreign-owned property'. This is little more than a device to absolve the tribunal from the tedium of having to consider the detailed and complex architecture of the contractual relationship: the specific contractual right invoked by the claimant can be extricated from the contractual documentation by its designation as 'property',[262] thereby liberating the tribunal to employ the abstractions of the law of expropriation in disposing of the case.

The injustice that might have been caused by resorting to this device was mitigated because the tribunal then proceeded to consider NIOC's defence based upon the *contractual* force majeure clause.[263] But this is hardly a principled approach: once the claim is characterised as one for the international delict of expropriation, it is difficult to fathom how a defence provided by a contract governed by municipal law could defeat it. Indeed, this would contradict a basic tenet of state responsibility: a state cannot rely upon its own municipal law to absolve itself from international responsibility.[264]

In short, the tribunal would have been on much surer ground by awarding damages for breach of contract.

426C(6). Flexi-Van Leasing, Inc v The Government of the Islamic Republic of Iran[265]

Flexi-Van argued that its contractual rights under lease agreements with two Iranian companies (Star Line and Iran Express) had been expropriated

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[261] (Case 425-39-2, 29 June 1989) 21 Iran-US CTR 79 at para. 75.

[262] There was no analysis of how a contractual right metamorphoses into a property right: the tribunal simply uses 'contractual right' and 'property right' interchangeably throught the award. See, e.g. *ibid*. paras 76, 88, 89, 97, 98, 100, 105, 106.

[263] *Ibid*. para. 77: 'The principal defense of the Respondents is that the revolutionary changes which took place in Iran totally frustrated the JSA due to conditions of force majeure, that is, conditions created by forces outside the control of the Government which made performance of the JSA impossible, thereby discharging the Parties' respective obligations under that agreement and relieving the Respondents of any liability for the acts complained of. This defense, while generally associated with the contractual aspects of a relationship, is relevant to the expropriation claim insofar as it relates to whether any contract rights remained to be taken following the Revolution.' The tribunal ultimately rejected the defence on the merits: *ibid*. para. 85.

[264] ILC's Articles on State Responsibility, Art. 3. Crawford, *ILC's Articles*, 86.

[265] (Case 259-36-1, 11 October 1986) 12 Iran-US CTR 335.

following the Iranian Government's assumption of control over those two companies. In particular, Flexi-Van asserted that the Government had caused Star Line and Iran Express 'to breach and repudiate their lease agreements' which had resulted in the 'expropriation' of 'rights to payment of accounts receivable and future rentals, and its rights to the return of leased equipment'.

The critical reason that this case is not a persuasive precedent for recognising a contractual right as the object of an expropriation is that the claim was *dismissed*. The tribunal noted that the two Iranian counterparties to Flexi-Van's leases (Star Line and Iran Express) were not before the tribunal and hence it was necessary to establish liability by reference to the Iranian Government's direct interference. Flexi-Van failed to do so for want of evidence. The tribunal recognised that Flexi-Van would have had a perfectly good claim for breach of contract against Star Line and Iran Express.[266]

The tribunal's *dicta* on the nature of the claim for expropriation of contractual rights has been adopted by subsequent tribunals and thus must be considered. It stated that, in order to prevail, the claimant must show that its contractual rights were breached and that such breach resulted from the 'orders, directives, recommendations or instructions' of the state. But if a party has breached a contract, what difference does it make if that party acted upon 'orders, directives, recommendations or instructions' of the state? Evidence of coercion from an alter ego does not supply a defence to the contracting party for liability in damages. Liability for breach of contract is strict rather than fault-based.

426C(7). Amoco International Finance Corporation v Government of the Islamic Republic of Iran[267]

Amoco International Finance Corporation ('AIFC')'s wholly-owned Swiss subsidiary 'Amoco' entered in to an agreement with the National Petrochemical Company ('NPC', an Iranian state-owned company) to establish a joint venture company, Khemco, for the purpose of building and operating a plant for the production and marketing of gas.[268] AIFC indirectly held 50 per cent of the shares in Khemco through Amoco. In January 1980, the Revolutionary Council of the Islamic Republic nationalised the oil industry by, *inter alia*, annulling 'all oil agreements' designated by the Ministry of Oil.

[266] Even the Dissenting Opinion of Judge Holtzmann appears to award damages on a contractual basis: 'I therefore would have awarded Flexi-Van damages for the breaches of the lease agreements.' The premise was that Star Line and Iran Express had been appropriated by the Iranian Government and hence the latter was responsible for the former's contractual arrangements.

[267] (Award No. 310-56-3, 14 July 1987) 15 US-Iran CTR 189.

[268] *Ibid*. para. 1.

AIFC advanced two claims on an alternative basis:

> First, the Claimant argues that NPC and Khemco have materially breached or repudiated the Khemco Agreement and that NIOC and Iran are liable as well because of their control over NPC and Khemco. The Claimant also argues that the record demonstrates that Iran has expropriated Amoco's rights under the Khemco Agreement or its shares and shareholders' rights in Khemco and that such expropriation was wrongful.[269]

The first claim was rejected by the tribunal: only NPC was a party to the Khemco Agreement and hence it was not possible for NIOC or Iran to breach the Agreement.[270] The second claim contains alternative formulations of the object of the expropriation: either Amoco's contractual rights under the Khemco Agreement or AIFA's shareholding in Khemco. The tribunal's discussion of this second claim addressed the alternative formulations interchangeably throughout its award. The critical paragraph reads:

> Clearly the purpose of the second sentence of Article IV, paragraph 2 is to protect the property of the nationals of one party against expropriation by the other party. Expropriation, which can be defined as a compulsory transfer of property rights, may extend to any right which can be the object of a commercial transaction, i.e., freely sold and bought, and thus has a monetary value. The rights created by the Khemco Agreement had such a monetary value as was expressly recognized in the Khemco Agreement itself. Article 20 provides that the shares of either party could be transferred under certain conditions to any other company or companies and Article 24 granted NPC the right to purchase the shares of Amoco upon the termination of the Khemco Agreement. It is because Amoco's interests under the Khemco Agreement have such an economic value that the nullification of those interests by the Single Article Act can be considered as a nationalization.[271]

The 'rights created by the Khemco Agreement' expressly envisaged by the tribunal was Amoco's shareholding in Khemco. A shareholding is intangible property and is distinct from the bilateral rights and obligations existing between Amoco and NPC under the Khemco Agreement. And yet the tribunal conflated property rights and contractual rights in its ultimate finding of liability: 'Amoco's rights and interests under the Khemco Agreement, including its shares in Khemco, were lawfully expropriated by Iran'.[272] This reveals a conceptual misunderstanding on the part

[269] *Ibid*. para. 78.
[270] *Ibid*. para. 164.
[271] *Ibid*. para. 108.
[272] *Ibid*. para. 182.

of the tribunal. The object of the expropriation was AIFC's indirect ownership of 50 per cent of the shares in Khemco, not Amoco's contractual rights to the performance of NPC as the counterparty to the Khemco Agreement. An assessment of the *value* of Khemco as a going concern (and therefore AIFC's share of that going concern) would no doubt reflect the contractual arrangements relating to Khemco's operations. But these are entirely separate things.

The tribunal appears to have finally recognised this distinction in its reasoning on valuation:

> In the instant Case the expropriation for which the Claimant seeks compensation occurred or was completed by the Special Commission's decision nullifying the Khemco Agreement. Formally, therefore, the Claimant was deprived of its contractual rights under the Khemco Agreement, and the compensation due relates to these rights. It is not disputed, however, that the value of such rights equals the value of the shares owned by Amoco in the joint stock company incorporated pursuant to the Khemco Agreement. The measure of the compensation to be paid, therefore, is half the value of Khemco at the date of valuation.[273]

426C(8). Southern Pacific Properties (Middle East) Limited v Arab Republic of Egypt[274]

The structure of the investment was as follows. A joint venture company ETDC was created for the development of a tourist complex on the Pyramids Plateau. The Egyptian General Organisation for Tourism and Hotels ('EGOTH') subscribed to 40 per cent of the shares of ETDC by contributing its rights of usufruct over the lands in question 'irrevocably' and 'without restriction of any kind' for the life of the joint venture.[275] The investor, SPP, subscribed to 60 per cent of the shares by making a capital contribution. The shareholding was held by SPP's wholly-owned subsidiary, SPP(ME).[276]

Construction began on the site in July 1977.[277] Following Egypt's ratification of the UNESCO Convention and the designation of the Pyramids Plateau as a world heritage site, the Egyptian Government converted the land to public property and prohibited any private development in May 1978.[278] The tribunal ruled that the SPP's activities on the Pyramids Plateau 'would have become internationally unlawful in 1979'[279] and hence it

[273] *Ibid*. para. 262.
[274] (Merits) 3 ICSID Rep 189.
[275] *Ibid*. 203/55.
[276] *Ibid*. 200–1/42–6.
[277] *Ibid*. 204/61.
[278] *Ibid*. 204/64.
[279] *Ibid*. 226/157.

ultimately decided that 'any profits that might have resulted from such activities are consequently non-compensable'.[280]

The tribunal upheld SPP's expropriation claim based upon the prohibition of expropriation in Egyptian Law No. 43 of 1974 concerning the Investment of Arab and Foreign Funds and the Free Zones. In relation to the object of the expropriation, the tribunal said the following:

> [T]he Tribunal [cannot] accept the argument that the term 'expropriation' applies only to jus in rem. The Respondent's cancellation of the project had the effect of taking certain important rights and interests of the Claimants. What was expropriated was not the land nor the right of usufruct, but the rights that SPP(ME), as a shareholder of ETDC, derived from EGOTH'S right of usufruct, which had been 'irrevocably' transferred to ETDC by the State. Clearly, those rights and interests were of a contractual rather than in rem nature. However, there is considerable authority for the proposition that contract rights are entitled to the protection of international law and that the taking of such rights involves an obligation to make compensation therefore.[281]

The authorities referred to were *Certain Interests in Polish Upper Silesia*, *Amoco International Finance Corp v Iran* and *Phillips Petroleum Co Iran v Iran*.[282]

If it was SPP(ME)'s contractual rights that had been expropriated, then one would expect that the tribunal would have assessed the value of those rights in its award of compensation. But the tribunal did no such thing:

> The cardinal point to be borne in mind, then, in determining the appropriate compensation is that, while the contracts could no longer be performed, the Claimants are entitled to receive fair compensation for what was expropriated rather than damages for breach of contract.[283]

It is difficult to make sense of this statement. The 'value' of contractual rights is generally assessed by the expected benefit that would have accrued to the claimant had the contract been performed. That is the measure of damages for a breach of contract and hence the contradistinction with 'what was expropriated' is difficult to understand. Alternatively, the tribunal might be taken to have distinguished the remedies available for a breach of contract and for a frustrated contract: this would explain the words 'while the contracts could no longer be performed'. That would entail a restitutionary remedy.

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[280] *Ibid*. 235/191.
[281] *Ibid*. 228/164.
[282] *Ibid*. 228–9/165–167.
[283] *Ibid*. 233/183.

> In the event, the tribunal's remedy for 'what was expropriated' is a combination of expectation damages for breach of contract[284] and restitution of 'out-of-pocket expenses'.[285] No authority was cited for this approach, which rests upon the simultaneous existence and non-existence of SPP(ME)'s contractual rights. The lack of coherency in the tribunal's consideration of remedies is the direct result of the conceptual difficulties attending the concept of an expropriation of contractual rights.

427. Certain other precedents from the Iran/US Claims Tribunal are also incorrectly relied upon for the proposition that contractual rights can be expropriated. In *SeaCo, Inc v Iran*,[286] SeaCo alleged the expropriation of certain contractual rights under lease agreements with private companies by the Government of Iran. The *dicta* from *Flexi-Van* were quoted by the tribunal but the claim was dismissed for lack of evidence.[287] In *Foremost Tehran, Inc v Iran*,[288] the expropriation claim in respect of Foremost's shares in an Iranian company, Pak Diary, was dismissed by the tribunal. Foremost also brought several claims for breach of various contracts with Pak Diary. Those claims were upheld; they were purely contractual claims and there is no reference at all to the expropriation or other state interference with contractual rights.[289]

C. THE PROVISIONS OF INVESTMENT TREATIES

428. There are two broad categories of provisions in investment treaties that require analysis in this chapter to complete the discussion of the principle in Rule 24.

429. The first category of provisions identify certain types of contracts that typically entail a significant commitment of resources by the foreign investor in the economy of the host state. By way of example, the definition of an investment in the USA Model BIT (2004) includes: 'turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts'.[290] This list of qualifying investments is predicated by a statement of the general characteristics of an investment that are similar to those advocated in Rule 23. Thus the investor's execution of a 'construction contract' must have entailed the

[284] Described as 'the loss of opportunity to make a commercial success of the project': *ibid*. 236/198.
[285] *Ibid*.
[286] (Case 531-260-2, 25 June 1992).
[287] *Ibid*. paras. 45–6.
[288] (Case 220-37/231-1, 10 April 1986) 10 Iran-US CTR 228.
[289] The tribunal concluded in respect of these claims: 'The Award in respect of Parts II and III of Case No. 231 is based on contractual obligations for which Pak Dairy alone is liable. No award is made against any other named Respondent [including the Government of Iran] in respect of those claims.'
[290] See Appendix 11.

commitment of resources in the host state with an expectation of a commercial return. The covered investment in this case will be the rights *in rem* acquired by the investor and evidenced by the construction contract rather than the bilateral contractual relationship with the investor's counterparty, which, in the absence of limiting language in this provision of the USA Model BIT, might be a private entity. This interpretation is reinforced by the inclusion of a separate definition of an 'investment agreement' in the Model BIT, which expressly stipulates that the counterparty must be the host state or its emanations. In relation to disputes arising out of an 'investment agreement' so defined, the *ratione materiae* jurisdiction of the tribunal extends to:

> [A] claim for breach of an investment agreement only if the subject matter of the claim and the claimed damages directly relate to the covered investment that was established or acquired, or sought to be established or acquired, in reliance on the relevant investment agreement.[291]

430. Moreover, the definition of an 'investment agreement' also indicates that it is not the contractual rights *per se* that constitute a covered investment, but instead it is the 'investment agreement' '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' in respect of natural resources, the provision of public services or undertaking public infrastructure projects. In these three domains, the particular 'investment agreement' would be predicated by, or be evidence of, a public act conferring certain rights upon the covered investment or investor.

431. The specific treatment of 'investment agreements' with the host state in the USA Model BIT (2004) means that the inclusion of 'turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts' in the general definition of an 'investment' must have a restricted meaning in accordance with the interpretive principle of *effet utile*. There would be little utility, for instance, in defining a concession contract with the host state as an 'investment agreement' and limiting the *ratione materiae* jurisdiction of the tribunal to breaches of that agreement where the subject matter of the claim directly relates to the covered investment that was acquired in reliance on that agreement, while at the same time allowing the investor to rely upon the term 'concession' in the general definition of an 'investment' to bypass this limitation altogether and to assert any contractual claims against the host state. The reconciliation of these two provisions is achieved if one acknowledges that the regime for 'investment agreements' is designed to confer a limited jurisidiction over contractual claims upon the investment treaty tribunal, whereas no such conferral is envisaged for contractual instruments that do not qualify as

[291] *Ibid*. Art. 24(1).

'investment agreements'. That means that an investor seeking to establish that it has a 'concession' in the general definition of an 'investment' in the Model BIT must demonstrate that it has an 'asset' in the host state that is evidenced by the concession which has entailed the commitment of resources in the host state. The tribunal's jurisdiction *ratione materiae* will accordingly be limited to disputes relating to the host state's alleged interference with the rights *in rem* comprising that asset and will not extend to contractual disputes with the host state.

432. The USA Model BIT (2004) regulates the problem of investment contracts in greater detail than other investment treaties. Thus, for instance, the Germany Model BIT (2005) simply includes 'business concessions under public law, including concessions to search for, extract and exploit natural resources' under the general definition of an investment.[292] In the context of ascertaining the existence of a covered investment, however, it is submitted that the approach is the same as for the USA Model BIT; viz. the rights *in rem* constituting the asset in the host state must be identified (the legal materialisation of the investment – Rule 22) together with an assessment of whether there has been a transfer of resources into the economy of the host state with an expectation of a commercial return (the economic materialisation of the investment – Rule 23). In determing the separate question of whether or not the tribunal has jurisdiction *ratione materiae* over contractual claims relating to the investment, Article 11 refers to 'divergencies concerning investments'[293] and hence is wide enough to encompass contractual claims.

433. The second category of provisions in investment treaties that require further consideration are those general definitions of an investment that include 'claims to money which has been used to create economic value' or 'claims to any performance having an economic value' and so on.[294]

434. The common denominator for all these enumerated rights is an entitlement to a liquidated sum. Even in respect of a 'right to performance having economic value', it is the value represented by that performance that is the economic interest in question that may form the basis of an investment. It is certainly true that these rights can originate as contractual rights, but in order to qualify as an investment they must be more than rights *in personam* against a contractual counterparty. To be an 'asset', the right must transmute into an entitlement to a liquidated sum and thus constitute a debt in some form. For that transmutation to occur, the right must have been adjudicated in accordance with its proper law so that the monetary value of the right has been ascertained. Only at that point can a

[292] See Appendix 7.
[293] *Ibid*.
[294] *Ibid*.

'right to performance having economic value', for instance, qualify as an investment. This means that in practice such rights must be evidenced in a court judgment or arbitral award.

435. This approach brings the operation of the substantive investment protection obligations in investment treaties into line with general international law. If a claimant asserts that it has certain contractual rights, then the correctness of that assertion must be tested by reference to the proper law of the contract. If the competent court or tribunal applying that proper law determines that such rights exist and have been breached, then a 'value' is assigned to those rights by means of a judgment or award of damages. If the claimant is frustrated in realising that value by the enforcement of that judgment or award, then international law provides a remedy. International law does not, however, contain a code on contracts for determining the rights and obligations of contracting parties; nor does it provide for contractual remedies under the guise of expropriation or any other international delict. In this respect, the substantive obligations of investment treaties do not go further than general international law, but investment treaty tribunals are sometimes conferred jurisdiction over contractual claims. The power of the tribunal to exercise that jurisdiction is still contingent, however, upon the existence of an investment, and hence a putative claimant cannot rely upon an unadjudicated 'claim to money' without more as its qualifying investment and then invoke the tribunal's jurisdiction *ratione materiae* over contractual claims relating to an investment to have that claim to money adjudicated in accordance with its proper law. For jurisdiction to be vested in an investment treaty tribunal, the economic characteristics of an investment pursuant to Rule 23 must have materialised, and an unadjudicated 'right to performance' would not be sufficient. The most likely reliance upon such rights once adjudicated would be to supplement the other assets comprising the investment for it would be very unusual for a claimant to rely upon a judgment or award by which the value of a 'right to performance' has been ascertained as the sole asset comprising an investment that satisfied the conditions in Rule 23.

436. This interpretation of 'rights to money' and similar rights listed in the general definitions of investments in investment treaties is consistent with the approach of the European Court of Human Rights in relation to Article 1 of Protocol No.1 ('A1P1') of the European Convention, which reads:

> Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of

> property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

437. According to the European Court of Human Rights in *Beshiri v Albania*:[295]

> Where the proprietary interest is in the nature of a claim it may be regarded as an 'asset' only where it has a sufficient basis in national law, for example where there is settled case-law of the domestic courts confirming it or whether it takes the form of a final enforceable judgment in an applicant's favour.[296]

438. The possibility that a judgment or arbitral award could constitute a 'possession' was established in *Stran Greek Refineries and Stratis Andreadis v Greece*.[297] The European Court distinguished a judgment of the Athens Court of First Instance, which was subject to appeal, and an arbitral award, which was final and binding. Only the latter could constitute a 'possession' for the purposes of A1P1 of the Convention:

> Although the Athens Court of First Instance would appear to have accepted the principle that the State owed a debt to the applicants … [t]he effect of such a decision was merely to furnish the applicants with the hope that they would secure recognition of the claim put forward. Whether the resulting debt was enforceable would depend on any review by two superior courts.
>
> This is not the case with regard to the arbitration award, which clearly recognised the State's liability up to a maximum of specified amounts in three different currencies …
>
> According to its wording, the award was final and binding; it did not require any further enforcement measure and no ordinary or special appeal lay against it.[298]

439. The European Court has been very careful to point out in numerous cases that A1P1 'does not guarantee the right to acquire property'.[299] An investment treaty works in the same way. It protects existing assets constituting an investment but is not designed to establish a legal framework for their acquisition. The substantive obligations of an investment treaty must therefore be interpreted in the same way as A1P1 in this respect.

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[295] (Case 7352/03, 22 August 2006).

[296] *Ibid*. para. 79. See also: *Draon v France* (Case 1513/03 [GC], 6 October 2005) para. 68; *Burdov v Russia* (Case 59498/00) (2002-III) ECHR, para. 40.

[297] (Case 13427/87, 9 December 1994).

[298] *Ibid*. paras. 60–1. See further: *Prodan v Moldova* (Case 49806/99, 18 May 2004) paras. 59–60; *Užkurėlienė v Lithuania* (Case 62988/00, 7 April 2005) para. 39.

[299] *Beshiri v Albania* (Case 7352/03, 22 August 2006) para. 77 and cases cited therein.

440. Investment treaty precedents are inconsistent on the meaning of rights 'to money' or 'to performance having an economic value' and the like,[300] but there are cases that confirm the interpretive approach adopted herein.

441. In *Joy Mining v Egypt*,[301] a dispute arose under a contract between Joy Mining (the investor) and the General Organization for Industrial and Mining Projects of the Arab Republic of Egypt ('IMC') in relation to the supply of mining machinery.[302] The price for the machinery had been paid in full by IMC by means of an irrevocable confirmed letter of credit.[303] The dispute related to Joy Mining's right to have the bank guarantees associated with the supply contract released.[304] Joy Mining argued that the bank guarantees were an asset and therefore an investment within the meaning of Article 1 of the UK/Egypt BIT. The tribunal rejected this submission: a bank guarantee is simply a contingent liability and 'to conclude it is an asset under Article 1(a) of the Treaty and hence a protected investment, would really go far beyond the concept of an investment'.[305]

442. In some cases the claimant may succeed in establishing the criteria for the legal materialisation of the investment pursuant to Rule 22 but fail in respect of the economic criteria in Rule 23. Although the present terminology did not of course feature in the award in *Petrobart Limited v Kyrgyz Republic*, the tribunal's finding is consistent with the approach advocated herein.

442C. Petrobart Limited v Kyrgyz Republic[306]

Petrobart (a Gibraltar company) concluded a 'Goods Supply Contract' for gas condensate with KGM,[307] a company owned by the Kyrgyz Republic.[308] The contract contained a jurisdiction clause in favour of the Kyrgyz courts.[309] Petrobart supplied certain quantities of gas condensate to KGM. KGM declined to pay for three of the five deliveries but did not contest its obligation to do so.[310]

Petrobart succeeded in obtaining a judgment from the Bishkek Court for the amounts owing from KGM under the Goods Supply Contract.

[300] Such rights in the definition of an investment in the relavant treaty are considered in: *Bayindir v Pakistan* (Preliminary Objections) paras. 10–12; *Salini v Morocco* (Preliminary Objections) 6 ICSID Rep 400, 411/45; *Nagel v Czech Republic* (Merits).
[301] (Preliminary Objections).
[302] *Ibid*. para. 15.
[303] *Ibid*. para. 31.
[304] *Ibid*. para. 41.
[305] *Ibid*. paras. 44–5.
[306] (Merits).
[307] Kyrgyzgazmunaizat.
[308] *Ibid*. p. 4.
[309] *Ibid*.
[310] *Ibid*. p. 5.

Petrobart then obtained orders of execution from the Court against funds held by KGM.[311] The Vice Prime Minister of the Kyrgyz Republic then wrote to the Chairman of the Bishkek Court requesting that the Court take into account the difficult financial situation at KGM and thereby delay the enforcement of the execution orders.[312] The Court acceded to KGM's request for a stay of execution for three months.[313]

In the intervening months between KGM's failure to pay the invoices raised by Petrobart and the Court decisions, the President of the Kyrgyz Republic had decreed that a new state company ('Kyrgyzgaz') would be established on the basis of KGM's assets.[314] After the stay of execution had been granted, certain assets of KGM were transferred to Kyrgyzgaz.[315] KGM then filed for bankruptcy and Petrobart became a creditor in those bankruptcy proceedings.[316]

Petrobart then invoked the dispute resolution mechanism provided by the Law of the Kyrgyz Republic on Foreign Investments ('Foreign Investment Law') by filing an arbitration notice against the Kyrgyz Republic pursuant to the UNCITRAL Arbitration Rules.[317] The Kyrgyz Republic objected to the jurisdiction of the UNCITRAL tribunal on the grounds that Petrobart had not made a 'foreign investment' in the Kyrgyz Republic and thus could not benefit from the substantive provisions of the Foreign Investment Law. 'Investment' was defined as 'investments appearing as contributions of foreign investors into objects of economic activity in the territory of the Kyrgyz Republic to derive profit'.[318] The tribunal upheld this objection and declined its jurisdiction on the following basis:

> Foreign investment is mostly defined as a transfer of tangible or intangible property from one country to another for the purpose of use in that country with a view to generating profit, or at least wealth, under the control of the owner of the property. Such transfers are to be distinguished from the much more frequent export transactions where goods are sold by manufacturers, or owners, in one state to traders or users in another state. Foreign investment involves a more permanent relationship between the foreign investor and the host state than is involved in the transitory international sales transaction. [The Contract] falls unquestionably into the latter category.[319]

[311] *Ibid*. p. 6.
[312] *Ibid*. p. 7.
[313] *Ibid*.
[314] *Ibid*. p. 5.
[315] *Ibid*. p. 7.
[316] *Ibid*. p. 8.
[317] *Ibid*. p. 9. Petrobart also had the option of arbitration under the auspices of the ICSID Convention, the ICSID Additional Facility Rules or the Regulations of the Chamber of Industry and Commerce of the Kyrgyz Republic.
[318] *Ibid*. p. 8.
[319] *Ibid*. p. 10.

Petrobart then commenced arbitration proceedings under the Energy Charter Treaty.

The Energy Charter Treaty ('ECT') defines an investment in Article 1(6) as follows:

(6) "Investment" means every kind of asset, owned or controlled directly or indirectly by an Investor and includes:

(a) tangible and intangible, and movable and immovable, property, and any property rights such as leases, mortgages, liens, and pledges;
(b) a company or business enterprise, or shares, stock, or other forms of equity participation in a company or business enterprise, and bonds and other debt of a company or business enterprise;
(c) claims to money and claims to performance pursuant to contract having an economic value and associated with an Investment;
(d) Intellectual Property;
(e) Returns;
(f) any right conferred by law or contract or by virtue of any licences and permits granted pursuant to law to undertake any Economic Activity in the Energy Sector.

[…]

The tribunal constituted pursuant to the ECT defined the issue:

> The Arbitral Tribunal further notes that the Contract did not involve any transfer of money or property as capital in a business in the Kyrgyz Republic but was a sales contract. It concerned the sale of goods at an agreed price. The arbitral tribunal in the UNCITRAL Arbitration found that this did not constitute a foreign investment under the Foreign Investment Law. The question in the present arbitration is whether it constitutes an investment according to the Treaty.[320]

In defining the issue in this way, the tribunal was essentially adjuding the existence of the investment by reference to economic criteria consistent with those stipulated in Rule 23. In applying those criteria, the tribunal concluded that the Goods Supply Contract and the judgment of the Bishkek Court did not constitute an investment pursuant to Article 1 of the ECT. It is submitted, however, that the judgment would have satisfied the criteria for the legal materialisation of the investment in Rule 22. The claimant's submission was, in effect, that the contract and the judgment were 'assets' in accordance with the definition of an investment in Article 1 (6) of the ECT. The tribunal rejected this approach:

> [A] correct legal analysis leads to the conclusion that the Contract and the judgment are not in themselves assets but merely legal documents or instruments which are bearers of legal rights, and these

[320] *Ibid*. p. 69.

> legal rights, depending on their character, may or may not be considered as assets. The relevant question which requires consideration is therefore whether the rights provided for in the Contract and confirmed in the judgment constituted assets and were therefore an investment in the meaning of the Treaty. In other words, the question is whether Petrobart's right under the Contract to payment for goods delivered under the Contract was an asset and constituted an investment under the Treaty.[321]

In relation to the Contract, this analysis is entirely consistent with the approach advocated herein. The Contract may provide evidence that Petrobart has acquired a qualifying investment in the Kyrgyz Republic, but it cannot constitute an investment in and of itself. In relation to the judgment, this would satisfy the legal test for an investment pursuant to Rule 22 but not the economic test in Rule 23. The conclusion in respect of Article 1 of the ECT must be that there is no investment.

[321] *Ibid*. p. 71.