Bilateral Investment Treaty Arbitration – An Overview

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International *commercial* arbitration is a well-known means of dispute resolution for those who specialise in construction and engineering, energy and infrastructure projects.

The extent to which parties – and, for example, contractors operating internationally – might be able to avail themselves of remedies under bilateral investment treaty arrangements – or indeed, if a State, become vulnerable to claims brought on such an entirely different basis – is an interesting subject, and certainly a growth area.

Whilst a 'treaty claim' and a 'commercial claim' are fundamentally different in nature, and notions of an easy transition from the one to the other must be disregarded, there are situations where contractors who qualify, by their project involvement, as 'investors', may have some remedies against the State or its emanation where the project is undertaken, if there is an investment treaty between the State and the country where the contractor is incorporated. This is a complex and emerging area and what follows is only an overview and, as such, seeks to identify some of the basic considerations that will apply.

A bilateral investment treaty ("BIT") is a treaty between two States by which each State grants rights and protections to investors from one State investing into the other and their investments.

A key feature of BITs is that they commonly give investors, including contractors and developers, and also project sponsors, the right to bring a claim directly against the State into which their investment is made ("the host State") before an international arbitral tribunal for contraventions of treaty obligations. International arbitration under a BIT can provide an alternative neutral forum to the domestic courts of the host State. The relationship between what might be termed local remedies, and remedies which might exist by reference to the host State's treaty obligations, is a difficult area. There is often, for example, a requirement to pursue local remedies up to a fixed point in time.[1]

Basic Requirements – 'investor', 'investment', remedies and a right to arbitrate …

It is often pointed out that there are three basic 'threshold' requirements which will govern the contractor's ability to bring an arbitration against a host State in almost all instances (accepting that the exact terms of the BIT will be important in defining with precision the requirements in each case):

There will, first of all, be a question about whether the contractor is properly to be regarded as an "investor" of the home State and therefore benefits from the host State's obligation to protect investors of the home State. Questions of whether the contractor qualifies as an "investor" will in turn lead to questions as to whether the involvement in the transaction which it seeks to protect constitutes as "investment" for the purposes of the BIT in question.

Where the contractor qualifies in respect of "investor" status, there will, next, be a question as to whether the BIT in question confers upon that contractor, as an investor of the home State, protections such that contravention by the host State gives rise to a right of action which, typically, would be resolved by way of arbitration.

The third important element is the basis upon which investment disputes are to be resolved. The agreement to refer future disputes is not so much consensual – as it would be in a commercial agreement to refer future disputes to a third party – but grounded in the standing offer of the host State, contained within the text of the BIT, to any party which has made a qualifying "investment" and which, of course, has an appropriate connection to the other State named in the BIT.

What interests does the BIT typically protect?

The range of interests which are typically protected by *commercial* contracts are not the same as the range of "investor" interests which will typically be protected under a BIT.[2]

1 See *Içkale v. Turkmenistan*, ICSID Case No. ARB/10/24, Award, 8 March 2016.

2 This is a topic discussed in detail in *Impregilo SpA v Pakistan* ICSID Case No ARB/03/3, decision on jurisdiction, 22 April 2005; and in *Bayindir Insaat Turizm Ticaret ve Sanayi AS v Pakistan* ICSID Case No ARB/03/29, 14 November 2005.

The range of provisions contained in most BITs will typically cover the following in one way or another:

(1) **Measures to prevent expropriation by the host State.** Typically, a BIT will provide that the investment will not be nationalized, expropriated or subjected to measures having the equivalent to nationalization or expropriation except for a proper purpose related to the internal needs of the [host State] and on a non-discriminatory basis and with prompt and adequate compensation paid.[3]

(2) **Fair and equitable treatment provisions.** Typically, a BIT will provide that investments are to be accorded fair and equitable treatment and are to enjoy full protection and security in the territory of the host State. The BIT will often go on to provide that there shall be no impairment, by unreasonable or discriminatory measures, in the management, use, enjoyment or disposal of the investment.

(3) **Treatment of investors.** A BIT will routinely provide that the host State will not treat investors or their investments less favourably than the host State's own investors (sometimes referred to as the "National Treatment Provisions" within a BIT) and their investments, or those of any third country (often referred to as "Most Favoured Nation Provisions" within a BIT).[4]

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The nature and extent of the protections available will depend upon the exact terms of the BIT under consideration. Commentators often illustrate this point by reference to very old treaties[5] which, upon close analysis, do not apparently have protections against expropriation which, in the modern context, would be regarded as the paradigm of protection under a BIT. Again, this problem can arise under older Chinese treaties, many of which continue to operate today; however, with notable exceptions aside, most modern BITs contain all these protections. Indeed, in the context of modern, trans-national investment, it is vital that essential protections are in place for investors.

In terms of international contracting, or investments in major international projects, the sorts of actions that are likely to trigger considerations as to whether the terms of a BIT have been contravened might include: the seizure of assets, such as an airport or infrastructure project; assuming control of the investor's business operations within the host State; requiring the contractor or other investor to deliver up to the host State, or an emanation of the host State, a share of profits without a contractual or other right to do so; or the imposition of new forms of taxation of the investment activities, or perhaps one-off or 'windfall' taxes on profits or possibly upon reduction or withdrawal of investment by the investor.

Foreign investments in the construction sector have given rise to a significant proportion of the known investment treaty disputes. Claims have been brought under BITs in relation to the construction of major infrastructure works including highways, canals, hydro-electric projects and pipelines, as well as smaller or individual projects and developments. BIT protection could extend to the pure financing phase of such projects, including a claim by a project sponsor for an alleged unfair revocation of a license.

Is the contractor as 'investor' within the meaning of the BIT?

The threshold jurisdictional issues for any claim brought under a BIT will be whether the contractor qualifies as an "investor" from its home State, and whether that

3 This language is taken from Art. 5 of the UK/Pakistan BIT, 30 November 1994.

4 See for example Art. 3 in the Pakistan/UK BIT, 30 November 1994.

5 *Berschader v. Russian Federation*, SCC Case No. 080/2004, SCC, Decision of 21 April 2006.

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contractor's project in the host State qualifies as an "investment" under the BIT in question. If the conditions for "investors" and "investments" under the BIT are not met, the contractor or their project will not be protected by the host State.

In general, investment treaties define "investors" as persons of a State party to the treaty, other than the State where the investment takes place. Typically, this includes a juridical person (i.e. a company) incorporated in the investor's home State. While simple incorporation may be sufficient for certain home States, other States may require their BITs to define "investor" more strictly, for example also requiring a company to have its seat in the relevant home State and/or to carry out certain activities there in order to qualify as an investor of the home State.

Whether a contractor is an investor will, first and foremost, depend on the definition of "investment" which is found within the BIT itself.[6] The question will then often, in terms of the position of a contractor, be whether the contractor made a contribution in terms of such things as know-how, equipment and personnel; and then whether there was a financial contribution. However, there will then be questions of the *object* of the contract said to be the basis for the investment of the contractor, and there will also be consideration of whether the elements of an investment identified in the decision in *Salini v Morocco*[7] have been met, in terms of a) a contribution, b) a certain duration over which the project in question has been implemented, c) sharing of the operational risks and d) a contribution to the host State's development.

With regards to the language and terms of the BITs themselves, different contracting States adopt very different approaches to the way in which they decide to treat investments.

A State which has often not placed strict limits on the criteria for its qualifying "investors" is the Netherlands. Many Dutch BITs require only that an entity is incorporated within the jurisdiction to benefit from BIT protection. For example, the Netherlands - Czech BIT defines Dutch "investors" to be simply "*legal persons constituted under the laws of* [The Netherlands]". Other States prefer that only entities with genuine commercial activity within their territory may benefit from protective rights offered by other State parties to their investors. Ultimately, this comes down to a question of policy in terms of the real degree of economic activity which the host State wishes to see on its territory.

A number of disputes have arisen where the contractor is originally a national of a State which has a BIT with the host State, so no investment structuring is necessary. For example, in the case of *Toto Construzioni v Lebanon* involving the construction of a highway in Lebanon, the Italian contractor Toto brought an investment treaty arbitration against Lebanon directly under the Italy-Lebanon BIT.[8] A foreign shareholder or a foreign party to a joint venture project may obtain BIT protections as a foreign "investor", even if its local partners may not.

The BIT may also stipulate that a foreign parent can claim on behalf of a local subsidiary. The case of *Tulip Real Estate v Turkey* involved the construction of a residential and commercial complex in Turkey.[9] The foreign contractor Tulip Real Estate, a subsidiary of a major European contractor, held 65% of the shares of a local Turkish JV company which it had established for the project. Tulip brought an arbitration against Turkey by qualifying as an "investor" under the relevant BIT (its claim was limited to the proportional shareholding amount of the alleged damage suffered by the local JV company), but Tulip's local partners did not qualify for similar rights of recourse against Turkey.

The difficulty which very often arises is where an international contractor (incorporated within a contracting State) is required to have a local partner, for example where the project is the construction of a major infrastructure project and 'local law' requires a local partner to have a certain percentage interest or holding. In such a case, and as illustrated above, it will be an important question as to whether the international contractor, who is the "investor" for the purposes of a BIT claim, can only claim in respect of its share, or whether it can claim remedies in relation to the whole operations of what might be a joint venture. The conventional analysis, based upon the nature of BIT rights and remedies, and as confirmed by the *Tulip* decision, is that the 'local' party has no recourse or remedy under the BIT, unless this is expressly and clearly permitted.

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Qualifying "investments" under a BIT

Each BIT usually also contains its own definition of the "investment" to be made by the "investor" which would then qualify for BIT protection by the host State. Typically, the definition is broad and covers "every kind of asset", including tangible and intangible property, shares, bonds, licenses, IP and concessions (e.g. to construct and operate an infrastructure project). However, a BIT may also impose conditions, such as that an investment must be approved by the host State, or must have certain characteristics such as the commitment of capital or other resources.

Tribunals generally assess whether a project is an "investment" on the basis of its features or characteristics, and by taking into account the circumstances of the case. Features that may be used to point to the existence of an "investment" include the allocation or contribution by a foreign investor of capital, an element of risk, a long-term duration, the expenditure of funds by a foreign entity for the expectation of profit in the host State, or a claim to money or the purchase of an asset. It has been said that qualifying as an investment may be more hazardous in the case of ICSID arbitrations, although it is fair to say that the existence or extent of this problem invites conflicting opinions.[10]

The wide scope of these provisions would generally encompass international construction projects, but this is a question of fact and varies from case to case.

In the construction sector, arbitral tribunals have held that risk-bearing activities at various stages of a project may be "investments" qualifying for host State protection. These include investment activities such as the purchase by the claimant contractor of shares in a local construction consortium; the grant of a long-term concession by a host State which "could have generated significant returns" despite the contractor not yet having made significant contributions; a contractor's provision of know-how, equipment and personnel to a project, as well as the contractor incurring significant bank charges for providing bank guarantees equivalent to the value of the employer's advance payment; a contractor's supply of services and materials and the mobilisation of its resources for the performance of a construction contract; an operator's two-year commitment to provide vessels and services for a dredging contract; and a project company's claim to a share of profits or returns flowing from the right to operate a project following its construction.

This is a complex area and a great deal will depend on careful examination of the potentially applicable BIT or range of BITs,[11] and the nature of the difficulties which have arisen on the project, in order to begin to consider whether an investment treaty claim is something which is even viable. However, with the growth of international work, and the massive growth in bilateral investment particularly in parts of the world where 'the state' is the driver and vehicle for projects and development, this is an area which is likely to become of increasing interest and importance to our clients who are active internationally.

6 This was the approach taken by the tribunal in the *Bayindir* decision (*supra*) at paragraph [105] et seq. where Art I(2) of the BIT was in terms of "... every kind of asset, in particular, but not exclusively..." [and then a list].

7 ICSID Case No ARB/00/4 decision on jurisdiction 23 July 2001.

8 *Toto Construzioni Generali S.P.A, v. Republic of Lebanon*, ICSID Case No. ARB/07/12, Decision on Jurisdiction, 11 Sept. 2009.

9 *Tulip Real Estate Investment and Development Netherlands* B.V. v. Republic of Turkey, ICSID Case No. ARB/11/28, Award, 10 March 2014.

10 This is commonly known as the "Salini" problem, which featured in the *Toto* case discussed above.

11 Under a most favoured nation clause in the BIT between the host and home states, where the host state has granted better investor and investment terms under another treaty with a third-state, that other third-state BIT may also be used. At a simpler level, the host and home states may have more than one treaty between them, as so often happens.