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Bilateral Investment Treaties (BITs): To Hope or Not To Hope?

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Abstrac

This paper analyses the possibility of balancing of relations between foreign investment rules and the domestic regulations. It does so, by attempting to examine the normative orders of Bilateral Investment Treaties (BITs) along with their attending obligations and implications for the parties.

Keywords: Bilateral Investment Treaties – Obligations – Implication –States- Foreign Investors – Host state.

• كلية القانون، جامعة اليرموك.

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ملخص

في أي اتفاقية دولية، تضع معاهدات الاستثمار قيودا على الحق السيادي للدولة تتضمن إخضاع المستثمرين الأجانب للامتثال الكامل لنظامها القانوني الإداري المحلي. وحيث أن جميع البنود الرئيسية المدرجة في معاهدة الاستثمار تحديد أنواع اللوائح الإدارية المحلية التي يجب على المستثمرين الأجانب الخضوع لها.

ولمعالجة مخاوف المستثمرين فقد صيغت هذه السياسات حماية لهم ولضمان القدرة على التنبؤ بالمشكلات التي يمكن ان تواجههم واستقرار الإطار القانوني الذي ينظم استثماراتهم في الدولة المضيفة. حيث ان توقعات المستثمرين الأجانب للاستقرار الإداري وتوقعات الدولة المضيفة بالسيادة للسيطرة على الإطار التنظيمي الداخلي يتم تحقيقها من خلال معاهدة استثمار تساعد بشكل أساسي على رعاية مصالح المستثمرين الأجانب بالمقارنة مع القواعد العامة للقانون الدولي المطبقة في حال عدم وجود المعاهدة. قام الباحث بتحليل إمكانية موازنة العلاقات بين قواعد الاستثمار الأجنبي واللوائح المحلية. وهو يفعل ذلك من خلال محاولة فحص الأوامر المعيارية لمعاهدات الاستثمار الثنائية إلى جانب التزاماتها وآثارها على الأطراف.

Introduction:

Ever since its origin, investment treaties have multiplied rapidly(1), creating a distinct *corpus juris* on the international investment related laws. Like any international agreement, an investment treaty,(2) commonly puts limitation on the sovereign right of a state to subject foreign investors to comply fully with its domestic administrative legal system. All the main clauses typically incorporated in an investment treaty function in multiple ways to define and narrow the types of domestic administrative regulations to which foreign investors- must subject themselves. Such policies are formulated as a measure to ensure proper redressal of investors' concerns, and for ensuring the predictability and stability of the legal framework governing their investments in the host state.

Foreign investors' expectations of administrative stability and the host state's expectations of the sovereignty to control its domestic regulatory space are brought. Into a balance by an investment treaty that essentially favours the interests of foreign investors when compared to the general rules of international law applicable in the absence of a treaty.(3) In a fast-paced globalizing economy, theinvestment treaties are commonly seen as a fundamental tool to enhance the flow of investment between states. Or they may also be viewed as institutionalized legal safeguardsfounded on the sovereignty of each host state, but which also takes due notice of the legal-jurisdictional diversities between countries, participating in these treaties.

From a systemic point of view, which sees foreign investment as a methodicale lement to reduce poverty and thereby promote growth, BITsconstitute an pre-arranged set of rules that attempts to catch foreign investment by lessening the space and scope for arbitrary functions of the host state and thus serves the purpose of good governance, which, in turn, is a required condition for achieving the economic goals in the host state.

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(1)The first recorded Bilateral Investment Treaty was signed between Germany and Pakistan in 1959. Ever since then, many BITs have been concluded. Currently, there are more than 2500 BITs in existence. See, UNCTAD, World Investment Report (2012) Vol. XVII, 26.

(2)Investment treaties, as generally understood, are instruments of international law by which states undertake commitments to other states with respect to the treatment they will accord to investors and investments from those other states and provide a mechanism for enforcement of those commitments. *See*, Jeswald W. Salacuse, THE LAW OF INVESTMENT TREATIES (Oxford University Press, 2010) 1.

(3) Rudolf Dolzer, *The Impact of International Investment Treaties on Domestic Administrative Law*, 37 New York University Journal of International Law and Politics (2005) 935.

Normative Order of BITs

In the post-World War II period, many developing countries have come to rely on private foreign capital, as well as technological and management skills, from capital-exporting countries. Private foreign investment has thus increasingly come to play an integral role in the development process, and BITs have served to establish the rules according to which such investments could be safeguarded.

While one major purpose of the BITs is to create an incentive for new investments, it would be incorrect to assume that this is its only function. Typically, BITs are concluded in the broader framework of economic cooperation and most recent treaties explicitly state that their applicability is not restricted to new investments made after entry into force of the treaty but also extends to certain or all existing investments.(1)

Whether legal rules protecting foreign property in fact influence the foreign investor in his decision-making has often been debated. Certainly, in the absence of economic opportunities, legal rules have little significance. Suffice it to say here that the legal framework and its positive or negative effect on facilitating a particular venture and ensuring compensation in the event of expropriation will no doubt play a role in the decision of any would-be investor. In this context, the existence of a BIT is a significant element in what makes up a particular country's investment climate. Indeed, the negotiation and conclusion of a BIT by a capital-importing country may be said to send an important signal to the international business community, to the effect that that country not only welcomes foreign investment but will also facilitate and protect certain foreign ventures.

BITs' Objectives

The common elements in the BITs are to provide that neither party shall mandate as condition for the establishment, acquisition, expansion or operation of a covered investment satisfying any of the six performance requirements as listed below:(2)

(1) As for example, in negotiations over BITs, the US has maintained that the protection of existing investments is of primary interest. The US has viewed this approach as a way to reaffirm US understanding of traditional international law on foreign investment. See, Vandevelde, *The Bilateral Investment Treaty Programme of the United Nations*, 21 Cornell Int'l L. J. (1988) 203-11

(2) Andreas F. Lowenfeld, INTERNATIONAL ECONOMIC LAW, (OUP, 2003) 474. As for example, the standard American BITs provide that the prohibition on these performance requirements does not extend to conditions for receipt (or continued receipt) of an advantage, such as a subsidy, tax deferral, land grant, or similar benefit from the government. The North American Free Trade Agreement prohibits substantially the same performance, but except for the requirement to export a given level or percentage of goods and the requirement to transfer technology, the prohibition applies whether or not it is a condition for an advantage.

(i) to achieve a particular level or percentage of local content or to give a preference to products of services of domestic content, or source;

(ii) to limit imports in relation to a particular volume of production, exports, or foreign exchange earnings;

(iii) to export a particular level or percentage of products or services;

(iv) to limit sales in the party's territory in relation to a particular volume or value of production, exports, or foreign exchange earnings;

(v) to transfer technology to a national company in the party's territory; or

(vi) to carry out a particular type, level or percentage of research and development in the party's territory.

Fair and Equitable Treatment

The BITs provide a fair and equitable treatment as required under international law and hence no discrimination is allowed in respect of nationality or origin for matters such as access to local courts and administrative bodies, applicable taxes and administration of governmental regulations. Also a minimum international standard of behaviour is required for treatment of foreign investors even if no discrimination is directly visible.(1)

Full Security and Protection

BITs require that host governments should provide full security and protection to the investor, his property and person and to defend these rights of the investor against any violations.(2)

Expropriation(3)

BITs contain provisions on expropriation, which is lawful and not inconsistent with the BITs provided, (i) it is carried out for a public purpose; (ii) it is not discriminatory; (iii) it is carried out in accordance with due

(1) See *Metaclad Corporation v. United Mexican States*, Award of Aug. 30, 2000, para 99, ICSID case No. ARB (AF) 197/1.

(2) See *Asian Agricultural Products Ltd.* v. *Republic of Srilanka*, Award of June 27, 1990, paras 85-86, 41 ICSID Rep. 246 (1997).

(3) Expropriation in the context of international investment law is the act of confiscation, appropriation or freezing of the assets of a foreign investor by the host government in public interest. There is always a risk of such expropriation in every foreign investment. To mitigate this risk is the endeavour of every that exports capital and to reserve the right to is the endeavour of every capital importing country. See, Achintya Nath Saxena, EXPROPRIATIONS UNDER INTERNATIONAL INVESTMENT LAW: AN OVERVIEW, (Lap Lambert Academic Publishing GmbH KG, 2013) 4-5.

process; and (iv) it is accompanied by payment of compensation- in some treaties as qualified by the word 'just', 'prompt', adequate and effective compensation.(1) Many of these treaties also speak of expropriation or nationalisation, of direct or indirect expropriation or nationalisation etc.

Compensation

The compensation criteria adopted in most of the BITs centres around the words 'prompt', 'effective' and 'adequate compensation'. Adequate compensation is defined as market value or 'fair market value' before the expropriation/nationalisation took place and is supposed to exclude any change in value occurring because the plan to expropriate had become known before the actual measure being undertaken.(2)

The typical example of adequate compensation can be found in BITs between Japan and China of 1988 which specifically incorporated that the compensation 'shall be such as to place nationals and companies in the same financial position as that in which the nationals and companies would have been if expropriation, nationalisation or any other measures, the effects of which would be similar to expropriation or nationalisation, had not been taken. Such compensation shall be paid without delay. It shall be effectively realised and freely transferrable at the exchange rate in effect on the date used for the determination of the amount of compensation.'(3)

Prompt compensation means that interests accruing from the date of nationalisation shall be paid and included in any agreement. Some agreements, including the US Model Agreement(4), states that interest shall be paid at 'a commercially reasonable rate' for the currency in which the compensation is paid. Some BITs refer expressly to the London Interbank Rate (LIBOR).(5)

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(1) *Supra* n. 5 (Andreas F. Lowenfeld).
(2) *Supra* n. 4 (Vandevelde).
(3) See Article 5(3) of the Agreement Concerning the Encouragement and Reciprocal Protection of Investment Between Japan and China, done at Beijing 27 Aug. 1989; Reproduced in 28 I.L.M. 575 (1989).
(4) See Article 6, U.S. Model Bilateral Investment Treaty, 2012 *available at*https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf (last accessed Jan. 24, 2017).
(5) The London Interbank Offered Rate is the daily rate at which babks lend to each other without security on the London market. There are 150 published LIBOR rates, ranging in both periods of the loan and in currency. These rates are published by the British Bankers' Association, based on a survey of its member banks. See http://www.bbalibor.com/ (last accessed Jan. 20, 2017).

Dispute Settlement

The settlement of disputes in the BITs is by way of arbitration which normally is taken under the International Centre for the Settlement of Investment Disputes (ICSID) as part of the World Bank, provided both the investor state and host state are parties to the ICSID Convention. ICSID Convention 1966 provides for the settlement of investment disputes within the World Bank.(1) Many of the recent BITs provide alternatives to ICSID arbitration particularly for arbitration under UNCITRAL(2) rules, and in some treaties for arbitration under the auspices of International Chamber of Commerce or under purely ad-hoc arbitration if agreed by the parties to the dispute. The arbitral proceedings under BITs are purely confidential, and participation by non-governmental organisations or other amicus curie has not been allowed.(3)

The Nature of Foreign Investment Treaties

When the international movement of capital began, the state of international law governing foreign investment was rudimentary and filled with uncertainties. As late as 1970, the International Court of Justice in the well-known *Barcelona Traction case* sated:

Considering the important developments of the last half-century, the growth of foreign investments and the expansion of international activities of corporations, in particular of holding companies, which are often multinational, and considering the way in which the economic interests of states have proliferated, it may at first sight appear surprising that the evolution of law has not gone further and that no generally accepted rules in the matter have crystallized on the international plane.(4)

Ever since this seminal observation, the *corpus juris* on investment laws in the form of both, bilateral and multilateral treaties, has grown exponentially. This rapid growth has, to a large extent, brought certainty as regards the rules governing foreign investments in the host countries.

(1) See 575 U.N.T.S. 159, entered in force 16 Oct. (1966).

(2) UNCITRAL stands for United Nations Commission on International Trade Law.

(3)On the desirability or otherwise of the role of *amicus curiae* ininternational investment arbitration, see generally Katia Fach Gomez, *Rethinking the Role of Amicus Curia International Investment Arbitration: How to Draw the Line Favourably for Public Interest*, 35 Fordham International Law Journal (2012) 510-564.

(4) *Barcelona Traction Company* (*Belg.* v. *Spain*) 1970 I.C.J. 3, 46-47.

International investment treaties are founded on the principle that the protections guaranteed to foreign investors by the host state's legal system might turn out to be inadequate and hollowas regards the special purposesenvisaged under those treaties. So, in order to create an investment-friendly climate, whichis meant to attract the foreign investment, the host state must concede more favourable legal-administrative regulations, which could foster confidence in foreign investors, leading to increased flow of foreign capital investment in the host country. This rationale underpins classical bilateral investment treaties and alsothe growth of free trade agreements incorporating investment rules.

Generally, the guarantees contained in BITs are bestowed on the foreign investor, which are, in addition to those existing in the national system of host state. The host state's legal system must extend respect to the recognised principles such as National Treatment Rules.(1) The treaties calls only for the non-discriminatorily treatment of foreign investors, and are indifferent to issues relating to the nationals of the host state.There is a possibility that such provision under BITs may cause reverse discrimination to the utter detriment of investors who, sometimes happen to be nationals of the host state. In such situation, the host state's legal system is expected to ensure that such discrepancy does not result in undue favours to one at the cost of another. However, it remains the case, that in such matters, host state remains competent to decide by applying its own judgment, and that the foreign investment treaty does not, in this regard, attempt in any way to regulate the response of the host state.

It is generally seen that even within the third world economies, the debate surrounding sovereignty has shifted dramatically towards more liberal regime, allowing for the host state's legal system to suitably change, so as to comfortably address the concerns of foreign investors. Host states, in that sense, do not raise much concern about the sovereignty issues, as they are rather busy to reap the investment-related dividends, which the BITs may offer.(2) Since the global competitionfor attracting foreign capitals has increased, the host states commonly resorts to designing an attractive investment climate within their respective national legal systems.

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(1)See, e.g., Article 3, U.S. Model Bilateral Investment Treaty, 2012, (*supra* n. 12).("Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory").

(2)For examples this aspect was clearly reflected in the 1960s' and 1970s' jargon of the "permanent sovereignty over national resources," see G.A. Res. 1803 (XVII), U.N. Doc. 1803 (Dec. 14, 1962).

The legal frame work devised by an international investment treaty isonly one component among several that states frequently use to persuade foreign investors, but, in any case, it has become an inevitable component of such efforts made by states around the world. The effect on national law that ensues from theacceptance of such an international treaty regime is nowadayscommonly perceived as inevitable repercussions of a friendly investment climate, so any 'negativity' surrounding BIT is to be avoided in principle. Hence, the focus of states has changed from sovereignty to inviting foreign investment. But, it is reaffirmed that the consequences of this paradigm change on the host state's domestic laws remains very real, andso it should be legally examined, in order to adjust domestic laws and regulations in accordance with the obligations imposed by the international investment treaty.

At present, most of the estimated 2300 BITs currently in force have seen negotiations involving developing countries on one hand, and developed countries on the other, the latter being traditional capital-exporting countries. But, post 2000 BITs are also increasingly concluded among developing countries. The capital-exporting countries have shown increased interests in entering into BITs arrangement with countries from developing block. As the trend towardsglobalization and liberalizationcontinued, states started seeking deeper integration in the areas of investment and economy based on mutual and competitive interests. Multilateral trade rules as formed under WTO framework agreements, though beneficial for trade liberalization, didn't yield desired results, both for capital-exporting and importing countries. This situation then led countries to believe that BITs would better facilitate the investments, even though broadly committing to the settled principles as contained in TRIMs.(1)

BITs scope essentially covers all economic activities of foreign investors; this results from the broad definitions of the term "investment" found in practically all of the treaties.(2) This implies that nearly every aspect of the legal system of the host state is likely to be affected and may invite international review in terms of compliances of set rulesof investment treaty. This further impliesthe need to settle disputes in accordance with the mechanisms provided under the treaty's system of dispute settlement.

(1)The Agreement on Trade-Related Investment Measures (TRIMs), one of the principal legal agreements under WTO, contains rules that are applicable over the internal regulations a member state applies to foreign investors, generally as a component of its industrial policy.

(2)See Rudolf Dolzer, The Notion of Investment in Recent Practice, in Charnovitz *et al* (ed.) LAW IN THE SERVICE OF HUMAN DIGNITY : ESSAYS IN HONOUR OF FLORENTINO FELICIANO (Cambridge University Press, 2005) 263-266.

Foreign Investors 'Right to Sue the Host State

Foreign investors could be either the public agencies of investing state or its private enterprises. Based on the model of bilateral investment agreement, BITs provides the foreign investors the right to sue the host country in case of "an alleged breach of an obligation" of the host state. Most of the early BITs contained only interstate arbitration and did not incorporate investor-state arbitration. In *Walter Bau* v. *Thailand*(1), the two states parties to the BIT did not give investors the right to make investor-state claims but provided only for state-state claims. In other words, initially the foreign investors did not enjoy the right to direct arbitration against the host state. They, however, could do so by relying on the willingness and ability of the investing state to sue the host state in adjudicatory bodies like investor-state arbitration. The persistent and strong opposition against attempts to restrain sovereign powers of developing countries in regulating foreign investments in their territory signal that a negotiating agenda involving the investor's right to sue the host state before international arbitration would be unfeasible. However, since provision on right to sue the state is central to any success of BIT, the negotiating states recognized the need of grant of such right on the investors. Following the establishment of the International Centre for Settlement of Investment Disputes between States and Nationals of Other States under the ICSID Convention, a vital need to create a new dispute resolution for the purpose of the convention was recognized. The first BIT provided for investor-state arbitration is the 1968 BIT between the Netherlands and Indonesia.(2) Such

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(1)*Walter Bau Ag. v. The Kingdom of Thailand*, Confirmation of Arbitral Award, United States District Court for the Southern District of New York (March 14, 2011), *available at*http://itlaw.com/documents/USDC_SDNY_ConfirmationArbitralAward_14Mar2011.pdf (last accessed Jan. 20, 2017). See also e.g. ICJ Ahmadou Saido Diallo (Republic of Guinea v. Democratic Republic of the Congo), Merits, Judgment, ICJ Reports 2010, p. 639 (French Language text: authoritative version); ICJ, Dispute regarding Navigational and Related Rights (Costarica v. Nicaraguan), Judgment, ICJ Reports 2009, p. 213 (English language text: authoritative version.

(2)The effect of the ICSID investor-arbitration clause in the BIT is, however, unclear. See for example, Art. 11 of Indonesia-Netherlands (1968) provides that: "The Contracting Party (CP) in the territory of which a national of the other CP makes or intends to make an investment, shall assent to any demand on the part of such national and any such national shall comply with any request of the former CP, to submit for conciliation or arbitration to the Centre established by the Convention of 1965, any dispute that may arise in connection with the investment. The effect of the article is unclear. On one hand, it could be viewed as a binding obligation on the state to agree to arbitrate if an investment dispute arises. Under this interpretation, if the state fails to assent to a demand to arbitration, this failure could be subject to state-to-state arbitration, which provides that the investor "shall comply" with a request for arbitration. It is difficult to see how this provision could be enforced. If the investor failed to consent to arbitration the host state could proceed to state-to-state arbitration, but it is unclear how a private party's failure to consent to arbitration could be attributable to its home state.

clause became widespread in the 1970s and almost universal in the post 1990s BITs.

Since foreign investment treaties facilitate the economic interests of the foreign investors, it is in keeping with the objective of the treaties that parties depart from the common principle of international law in permitting not only the state parties to the BIT, but also the investors themselves to directly make a claim before an international tribunal. Moreover, many treaties are drafted to ensure that contracts concluded between the host state and a foreign investor under the laws of the host state are also subject to the international guarantees provided by the treaty, including the dispute settlement mechanism.

For purposes of ICSID proceedings, for example, the states have, as a matter of rule, agreed in advance, on the basis of Article 26 of ICSID Convention, to hold back from requesting that domestic remedies be pursued.(1) In turn, the home state of investors agrees not to give diplomatic protection.(2) Since the guarantees incorporated in the BIT are kept outside the domain of diplomatic negotiations on the state-to-state level, the laws and administrative regulations of the host state are subjected to international review if the foreign investor so chooses. It, thus, may be said, that classical understanding of international law as primarily a law between and among states standssignificantly modifiedin the domain of international investment by placing individuals onto the international plane as against the host state.(3)

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(1) See, Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1965, opened for signature Mar. 18, 1965, 575 U.N.T.S. 159, available];athttps://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf

(last accessed Jan. 23, 2017) (Art. 26 of the Convention reads: "Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.").

(2) Id. Art. 27 ("No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.").

Traditionally, diplomatic protection has been seen as a right of the state, not of the individual that has been wronged under international law. An injury to an alien is considered to be an indirect injury to his home country and in taking up his case the State is seen as asserting its own rights. This means that a State is in no way obliged to take up its national's case and resort to diplomatic protection if it considers this not to be in its own political or economic interests. Annemarieke Vermeer-Künzli, As If: The Legal Fiction in Diplomatic Protection, The European Journal of International Law Vol. 18 no. 1(2007).

(3) Rudolf Dolzer, The Impact of International Investment Treaties on Domestic Administrative Law,37 N.Y.U. J. Int'l L. & Pol. 953 (2005).

Substantive Guarantees Made to Foreign Investors

The various substantive rules incorporated in BITs, which have implications for the domestic legal systems of the host countries,spring from different sources of international law. Commonly, a part of BIT, is based on independent treaty law(1) which has been specifically negotiated among the states parties to the treaties. Additional aspects of the BITsonly reiterate customary international law that remains applicable despitethe absence of a treaty.Further, in all such treaties, substantive rules are subject to careful interpretation and application by international adjudicatory bodies, such as arbitral tribunals.Hencethey become part of an institutionalized, rule-oriented system of formal and substantive compliance, which makes such a system different from what exists under the classical international law. Consequently,the authority to identify, apply, and bring the same into force, the rules under investment treaties has allowed the shifting away from the free will of states, due to their voluntary acceptance and adoption of these rules.

In practical terms, three types of clauses generally incorporated in bilateral investment treaties are said to create adverse effect on domestic legal systems of host state.They are categorised as:

(i) Clauses providing for rules on indirect expropriation;(2)

(ii) Clauses on fair and equitable treatment of foreign investors;(3) and,

(1) The principle of autonomous treaty interpretation is based on the fact that investment treaty law and domestic law constitute two self-contained normative systems. Thus, if investments treaties and domestic law use the same legal terms, the autonomy of both legal systems requires that the term used in the treaty is not automatically given the same meaning as it has under domestic law. Despite their identical wording, the term has to be interpreted independently. See Jonathan Bonnitcha, SUBSTANTIVE PROTECTION UNDER INVESTMENT TREATIES: A LEGAL AND ECONOMIC ANALYSIS (Cambridge University Press, UK 2014) 149.

(2) See *Tecnicas Medioambientales Tecmed S.A.* v. *Mexico*, ICSID Case No. ARB (AF)/00/2 (Award May 29, 2003) para 113. (The ICSID tribunal stated:"Although formally an expropriation means a forcible taking by the government of tangible or intangible property owned by private persons by means of administrative or legislative action to that effect, the term also covers a number of situations defined as de facto expropriation, where such actions or laws transfer cases to third parties different from the expropriating state or where such laws or actions deprive persons of their ownership over such assets, without allocating such assets to third parties or to the government".).

(3) See *Azurix Corp.* v. *Argentina*, ICSID Case No. ARB/01/12 (Award July 14, 2006) para 130. (The BIT was between Argentina and USA, The ICSID tribunal stated that: "It follows from the ordinary meaning of the terms fair and equitable and the purpose and object of the BIT that fair and equitable should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. The text of the BIT reflects a positive attitude towards investment with words such as 'promote' and 'stimulate'. Furthermore, the parties to the BIT recognize the role that fair and equitable treatment plays in maintaining 'stable framework for investment and maximum effective use of economic resources'".).

(iii) Clauses on the protection of investment agreements concluded between a foreign investor and the host country ("umbrella clauses").[1]

While some other provisions-such as those permitting investment or in relation to thetransfer of cross-border payments by the investor- would also be of practical significance, however, the routine and common aspects of investment will mainly be impacted by the interpretation, understanding and operation of the above-mentioned three rules.

It is affirmed that the interpretation and application of the BIT'srelevant clauses create a crucial taskfor drafters and interpreters of such treaties. The relevant treaty provisions are put into effect after understanding the effect of investment treaties on the legal system of host country, especially paying attention to the administrative regulatory system in the host state.

Regulatory Space and BITs

All treaties constrain sovereignty. Investment treaties constrain sovereign rights of control over the intrusive process of foreign investment which takes place entirely within the territory of the host state. To this extent, the erosion of sovereignty in such treaties is considerable. But, it is trite law that a treaty can control events that are entirely internal and domestic. It is seen that states haves various techniques of controlling foreign investment, and thus the state can promote its own developmental objectives. The issue arises as to whether the right to control investment by the host state is lost as a result of investment treaties. The answer depends on the type of treaty that is made. Where the treaty is of the type that the USA commonly makes, with rights of entry and national treatment, then the erosion of the regulatory space becomes considerable. Bur, in other treaties, there is always a negotiated balance between the right of regulation by the host state and the rights of protection and treatment given to the foreign investor.

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(1)Umbrella clauses are provisions found towards the end of some BITs containing catch-all statements that conditions and privileges that are negotiated by the parties to an investment agreement will be protected by the treaty. The significance of the umbrella clause is that it establishes a situation very similar to the one that the stabilization clause was intended to establish, namely, to protect the commitment that was made to the foreign investor at the time of the contract not to change the bargain by subsequent domestic legislation. So far as such umbrella clauses are concerned, the interpretation should be carefully done. In this regard, it is crucial to pinpoint that endency to give extensive meanings to such terms must be avoided, if such interpretations have the tendency to enhance the contractual obligations of the host state. See, *SGS Societe Generale de Surveillance S.A.* v. *Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13.

Many investment treaties preserve the regulatory regimes of the host state by confining the scope of the treaty or by defining the foreign investment that is protected in a restrictive manner. This point bears repetition. In most Southeast- Asian treaties, the practice has been to extend protection only to "investments specifically approved in writing". This ensures that only investments that are regarded as particularly beneficial to the state are given approval for the purposes of protection. In other treaties, the formula is to extend protection only to investments "made in accordance with the laws, policies and regulations" of the host state.[1] It is evident that there is a desire to ensure that the regulator regime plays a role in defining the extent of the treaty protection. It is evident that only investment which conforms to the state's regulatory structure will receive protection under such treaties. Another formulation is so subjective as to tilt the balance entirely in favour of the host state. This contains the subjective formula for the investment that is protected is an investment "made in accordance with the laws, policies and regulations from time to time in existence".[2] Such a formulation, while fully preserving regulatory space, deprives the treaty of all its protective content, as the host state could defeat the treaty's protection simply by changing its laws. The existence of this concern over the preservation of the regulatory space and the manner in which it has been achieved in different treaties indicates that a carefully negotiated balance is struck in every bilateral investment treaty. The preservation of regulatory space is achieved in individual provisions in the treaties through various methods. Thus limitations on the right of repatriation of capital in times of economic difficulties and on the safeguard provisions in some treaties are examples of preserving regulatory space in specified areas.[3]

Concluding Remarks

Proliferation of bilateral investment treaties in the last few decades has established a clear fact that states regard investment as a key source for enhancing the economic development. In that sense, investment treaties nowadays are recognized as a passport to catch the foreign investments amid growing competitions among states. This recognition is, however, accompanied by anattending loss of nationalsovereignty, thus creating complex legal questions before the host state. The reformistsin the developing world consider these bilateral investment treaties as strongmethods for bringing the desired modifications within the administrative legal system of the states. With the rise in investment treaties, states are increasingly subjected

(1) The Malaysian Model Treaty, 2002. A similar formula is used in recent Chinese treaties.

(2) This formulation is widely used in the newer treaties of Australia and Indonesia.

(3) M. Sornarajah, The International Law on Foreign Investment, (3rd edn., Cambridge Univesity Press, 2010) 232

to mechanisms of international dispute settlement, which demonstrates that states have accepted the notion that internationaleconomic relations necessarily demand internationally agreedruleswith their guaranteed enforcement within the domestic system of states.Whilethe international investmenthas its basis in domestic legal systemas applied by the regulators, this domestic framework is regularly tightenedby the decisions of international tribunals.

The treaty-basedrules for foreign investment have ushered in a new legal regime that governs most of the essential aspects of foreign investment.In relation to thesovereign rights of host state (as commonly understood), these rules operate asbarriers and create checks within the domestic regulatory space. These rules are to be given full respect while the domestic policies or legislations are formulated by the host state. For foreign investors,it is exactly this decreasein sovereign regulatoryspace that allows them to make up their mind regarding the investment. Such a system ensures a fair return to the investors, which is in keeping with their legitimate expectations.

Essentially, the normative order, disciplines andthe obligations laid down for host states underthe bilateral investment treatiescreate and contribute to the cause of good governance. It is no denying the fact thatunder certain situations, the focus on administrative and regulatorysovereignty wouldclash with the legitimate expectations of the foreigninvestor and with the notion of good governance itself. Thoughno single and uniform set of guidelines currently exists to direct states to strike a balance between BITs' rules and domestic laws, the contemporary international trend demonstratesa growing emphasis on an investment-friendlyclimateleading to spur in economic growth, rather than on rigid concept of legal andpolitical sovereignty. This trend certainly augurs well for the future of bilateral investment treaties by creating confidence in the current and future foreign investors.