



Negotiating Group on the Multilateral Agreement on Investment (MAI)

Drafting Group No.1 on Selected Topics Concerning Investment Protection

**REPORT OF THE DRAFTING GROUP ON SELECTED TOPICS
CONCERNING INVESTMENT PROTECTION**

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Note

In the context of the negotiation of the Multilateral Agreement on Investment and based on the mandate given to it, the Drafting Group has discussed certain subjects related to investment protection. The group met on 23-24 and 26-27 October, as well as 30 November and 1 and 4 December 1995.

The meetings of the Drafting Group were very friendly and constructive.

The results of these discussions are attached: this document consists of five articles, followed by a series of "comments" on each of the five articles.

The comments serve various purposes. Several of them are simply explanations of the choices made by the experts, particularly to note alternative propositions which were not accepted or remain under consideration. Others highlight certain issues which do not fall within the competence of the Drafting Group and need to be addressed at a later stage, taking into account the implications for the subjects discussed by this Group.

Finally, certain comments are intended to pose to the Negotiating Group some questions which embody precise choices in relation to specific topics which the Drafting Group believes it is not able to address, at least at this stage.

The experts have realised that these questions concern the entire agreement and therefore the Negotiating Group may wish to deal with them at a later stage. In practice, only one principle appears ready for debate without further delay - the question of exchange rate risk in the context of expropriation.

Draft Articles on Selected Topics on Investment Protection

Article A GENERAL TREATMENT¹

(1) Each Contracting Party shall accord to investments in its territory of investors of another Contracting Party fair and equitable treatment and full and constant protection and security. In no case shall a Contracting Party accord treatment less favourable than that required by international law.

(2) A Contracting Party shall not impair by [unreasonable or discriminatory] [unreasonable and discriminatory] measures the operation, management, maintenance, use, enjoyment or disposal of investments in its territory of investors of another Contracting Party.

¹ One delegation proposed to delete paragraph 2 and revise paragraph 1 as follows:

“Each Contracting Party shall accord to investments in its territory of investors of another Contracting Party fair and equitable treatment and full and constant protection and security. Such treatment shall also apply to the operation, management, maintenance, use, enjoyment or disposal of such investments. In no case shall a Contracting Party accord treatment less favourable than that required by international law.”

Article B
EXPROPRIATION AND COMPENSATION²

- (1) A Contracting Party shall not expropriate or nationalise directly or indirectly an investment in its territory of an investor of another Contracting Party or take any measure or measures having equivalent effect (hereinafter referred to as "expropriation") except:
- a) for a purpose which is in the public interest,
 - b) on a non-discriminatory basis,
 - c) in accordance with due process of law, and
 - d) accompanied by payment of prompt, adequate and effective compensation in accordance with paragraphs (2) to (5) below.
- (2) Compensation shall be paid without delay.
- (3) Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation occurred. The fair market value shall not reflect any change in value occurring because the expropriation had become publicly known earlier.
- (4) Compensation shall be fully realisable and freely transferable. It shall be payable in a freely [convertible] currency.
- (5) Compensation shall include interest at a commercial rate established on a market basis for the currency of payment from the date of expropriation until the date of actual payment.³
- (6) Due process of law includes, in particular, the right of an investor of a Contracting Party which claims to be affected by expropriation by another Contracting Party to prompt review of its case, including the valuation of its investment and the payment of compensation in accordance with the provisions of this article, by a judicial authority or another competent and independent authority of the latter Contracting Party.

² Compensation appeared as a separate item on the list of "selected topics concerning investment protection". However, it is usually dealt with in the same article as expropriation.

³ One delegation proposes an alternative approach, for the reasons explained in the comments, according to which the last sentence of paragraph 4 and paragraph 5 would be replaced with the following:

“The compensation to be paid shall be calculated by summing:

- (a) the fair market value of the expropriated investment on the date of expropriation, expressed in a freely usable currency at the market rate of exchange prevailing on that date, plus
- (b) interest at a commercially reasonable rate for that freely usable currency accrued from the date of expropriation until the date of payment.

That sum shall be expressed in the currency of payment at the market rate of exchange for that freely usable currency prevailing on the date of payment.”

Article C
PROTECTION FROM STRIFE

(1) An investor of a Contracting Party which has suffered losses relating to its investment in the territory of another Contracting Party due to war or to other armed conflict, state of emergency, revolution, insurrection, civil disturbance, or any other similar event in the territory of the latter Contracting Party, shall be accorded by the latter Contracting Party, as regards restitution, indemnification, compensation or any other settlement, treatment no less favourable than that which it accords to its own investors or to investors of any third State, whichever is most favourable to the investor.

(2) Notwithstanding paragraph (1), an investor of a Contracting Party which, in any of the situations referred to in that paragraph, suffers a loss in the territory of another Contracting Party resulting from

- (a) requisitioning of its investment or part thereof by the latter's forces or authorities, or
- (b) destruction of its investment or part thereof by the latter's forces or authorities, which was not required by the necessity of the situation,

shall be accorded by the latter Contracting Party restitution or compensation which in either case shall be prompt, adequate and effective and, with respect to compensation, shall be in accordance with Article B, paragraphs 2 to 5.

Article D TRANSFERS

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

- a) the initial capital and additional amounts to maintain or increase an investment ;
- b) returns⁴;
- c) payments made under a contract including a loan agreement;
- d) proceeds from the sale or liquidation of all or any part of an investment ;
- e) payments of compensation under Articles B and C;
- f) payments arising out of the settlement of a dispute;
- g) earnings and other remuneration of personnel engaged from abroad in connection with an investment.

(2) Each Contracting Party shall further ensure that such transfers may be made in a freely [usable/convertible]⁵ currency.

(3) Each Contracting Party shall also further ensure that such transfers may be made at the market rate of exchange prevailing on the date of transfer.

[(4) In the absence of a market for foreign exchange, the rate to be used shall be the most recent exchange rate for conversion of currencies into Special Drawing Rights.]

(5) Notwithstanding paragraph (1)(b) above, a Contracting Party may restrict the transfer of a return in kind in circumstances where the Contracting Party is permitted under the GATT 1994 to restrict or prohibit the exportation or the sale for export of the product constituting the return in kind. Nevertheless, a Contracting Party shall ensure that transfers of returns in kind may be effected as authorised or specified in an investment agreement, investment authorisation, or other written agreement between the Contracting Party and an investor or investment of another Contracting Party.⁶

[(6) Notwithstanding paragraphs (1) to (5), a Contracting Party may require reports of transfers of currency or other monetary instruments and ensure the satisfaction of judgments in civil, administrative and criminal proceedings through the equitable, non-discriminatory, and good faith application of its laws and regulations. Such requirements shall not unreasonably impair or derogate from the free and undelayed transfer ensured by this Agreement.]

⁴ As defined in the Article on definitions.

⁵ The term used here may be the same as in Article B, paragraph 4.

⁶ One delegation has difficulties with the obligations referred to in the second sentence.

Article E
SUBROGATION

(1) If a Contracting Party or its designated agency makes a payment under an indemnity, guarantee or contract of insurance [against non-commercial risks] given in respect of an investment of an investor in the territory of another Contracting Party, the latter Contracting Party shall recognise the assignment of any right or claim of such investor to the former Contracting Party or its designated agency and the right of the former Contracting Party or its designated agency to exercise by virtue of subrogation any such right and claim to the same extent as its predecessor in title.⁷

(2) A Contracting Party shall not assert as a defence, counterclaim, right of set-off or for any other reason, that indemnification or other compensation for all or part of the alleged damages has been received or will be received pursuant to an indemnity, guarantee or insurance contract.

⁷ One delegation has difficulties with the obligations in this paragraph.

COMMENTS

Article A

1. Reference to "encouragement and promotion of investments", usually found in BITs does not constitute a principle of general treatment but may be included at some other place of the MAI.
2. Depending on the definition of investment/investor adopted in the MAI, the wording of Article A ("investments of investors") and subsequent articles may have to be changed.
3. Reference to international law is critical in this article and worded in the most simple manner. This may be a general issue to be discussed when other references to international law are made in other articles of the MAI.
4. The link between General treatment and NT/MFN was underlined as critical. However, since General treatment was considered as an "absolute" principle as opposed to NT/MFN considered as "relative" principles, it was agreed that it was justified to separate the articles on General treatment and NT/MFN respectively.
5. In the course of discussions it was agreed to suggest that special commitments entered into by a Contracting Party vis-à-vis an investor should be addressed in the MAI in a manner to be discussed at a later stage.
6. Obligations apply in all circumstances (i.e. "at all times"), although specific language was not considered necessary on this point.
7. Regarding paragraph 2, three formulations were suggested which have in practice three different implications. The proposal by one delegation is reflected in a footnote and calls for no additional standards with respect to which a government's actions would be measured, but makes clear that the standards in the first paragraph apply to all activities relating to an investment. The other two formulations are shown in brackets and provide either: (i) that a government's actions would be measured as against either one of the two concepts (unreasonable, discriminatory), applied independently or (ii) that a government's actions would be measured against both concepts, applied conjunctively. The group stresses that this choice will have to take into consideration the choices to be made on other aspects of the MAI, such as National Treatment and taxation.

Article B

1. The terms "public purpose" and "public interest" derive from different legal traditions but have very similar meanings. The term chosen "for a purpose which is in the public interest" is considered consistent with both legal traditions; it was previously agreed in the Energy Charter Treaty (ECT).
2. The Group understands that the violation of criminal laws could result in the loss of an investment (or part thereof) which would not be deemed expropriation, provided those laws and their application are non-discriminatory and otherwise consistent with the standards of this agreement.

3. In cases where the investment consists in total or in part of shares, the rights of the shareholders, if an expropriation takes place, have to be defined. This should derive from the definition of investments in the MAI, if not, a special provision may be needed in Article B.
4. Expropriation in cases where the investment consists in total or in part of intellectual property rights was seen as critical. It was decided not to suggest specific language on this issue and that it would need to be further revisited in a global context.
5. "Creeping expropriation" in general is covered by the words of Article B: "measures or measures having equivalent effect". "Creeping expropriation" through tax measures were mentioned but no specific wording was suggested, notably in as much as no final decision has been taken yet on the treatment of tax issues in the MAI in general.
6. One delegation proposed additional text on blocking, freezing, sequestration or any similar measures having expropriatory effect [DAFFE/MAI/DG1/RD(95)4]. After discussion, it was agreed that these concerns were already addressed: temporary actions, when ended, would result in restitution of the property, and, any unlawful aspects of the temporary measure could give rise to damages for breach of other articles, such as Article A. Should the measures take on a permanent or expropriatory character, they would, (i) if lawful, be subject to Article B, or (ii) if unlawful, give rise to a right to restitution under customary international law.
7. **Regarding paragraphs 4 and 5, the question is: should a compensating Contracting Party accept responsibility for exchange rate losses occurring to the investor where there is delay in payment? And, if so, how that responsibility should be measured? One option is to leave the exchange rate responsibility explicitly to the investor. Another option would be for the compensating Contracting Party to accept the responsibility implicitly, so that in the event of a breach of the obligation to pay without delay, the investor would be entitled to compensation for exchange rate losses as an element of damages in addition to interest, even without an explicit provision on this matter in this agreement. The third option would consist of the compensating Contracting Party explicitly accepting such an exchange rate responsibility. Several drafting proposals were made.**

It remains to be decided in which currency compensation should be payable.

The Group considered the problem of exchange rate risk only in the case of delay in the payment of compensation for expropriation to the exclusion of other exchange rate risks to which the investor may be exposed.

8. It will need to be borne in mind, when considering the accession of non-OECD Members, that the convertibility of the national currency will be important with respect to the transfer obligations of the agreement, including transfers of compensation for expropriation.

Article D

1. All delegations agreed that the free transfer of returns was a critical element of the protection of the investors. Therefore a clear preference was voiced for listing the main categories of returns in Article D (1) b) and in particular: "profits, interest, dividends, capital gains, royalties, fees and return in kind". However it was finally agreed not to lengthen the text of Article D (1) b) provided

that these categories are explicitly listed in the definition of returns in the article on definitions of the MAI.

2. The free transfer obligation applies to earnings and other remuneration net after deduction of any withholding for tax or social security purposes. Dispute resolution would be available to investors but not their personnel.
3. The Group heard a presentation on transfers by an expert from the International Monetary Fund regarding the rights and obligations of countries under the Fund Agreement. It recommended that the Negotiating Group deal with this matter, for example, under general provisions concerning the relationship of the MAI to other international agreements.
4. Delegates wished to see no “balance of payments” clause in Article D. The Negotiating Group will nevertheless need to address the question of general exceptions and temporary derogations for reasons such as balance of payments, public order and preservation of monetary union, including their possible relation to this article. However, it was mentioned that any such provision should not apply to payment of compensation under Article B.
5. Article D, paragraphs 2 and 3 ensures -- without imposing it -- the freedom to make transfers in a freely [convertible] currency at a market rate. The reference to the exchange rate in Article D (3) pertains only to cases where the conversion of funds occurs on the date of transfer.
6. One delegation proposed that the exchange rate for transfers be the rate prevailing on the date on which the investor applies to make such a transfer. This proposal did not attract consensus.
7. If it were impossible to obtain a satisfactory current market rate for the national currency, a reference rate though not necessarily the SDR might be used. For such situations, an improved version of Article D (4) could be considered, but delegations did not consider it appropriate to pursue this question pending guidance from the Negotiating Group on the policy issues associated with accession to the MAI by non-Members of OECD.
8. In order to emphasise the freedom of transfer, one delegation proposed the following text for the first sentence of paragraph 5: “The freedom of transfer of returns in kind under paragraph 1(b) does not derogate from the rights of a Contracting Party under the Agreement established by the World Trade Organisation to restrict or prohibit the export or the sale for export of what constitutes the return in kind”. This proposal attracted support, but delegations required an opportunity to review the drafting.
9. Article D (6) is indirectly but closely linked with the issue of free transfer. It allows satisfaction of two important objectives. It is comparable to the language in the Energy Charter Treaty (ECT). Some delegations would include additional specific objectives, such as bankruptcy, insolvency or the protection of the rights of creditors; issuing, trading or dealing in securities; and records of transfers.

Other delegations questioned the need and desirability of Article D (6). To help bridge these different views, one delegation proposed the following alternative language: “Nothing in Article D shall be construed to prevent a Contracting Party from the equitable, non-discriminatory and good faith application of measures to protect the rights of creditors, ensure compliance with laws on the issuing, trading and dealing in securities, reports or records of currency transfers and the

satisfaction of judgments in civil, administrative and criminal proceedings, provided that such measures and their application shall be consistent with the provisions of Article A”.

Another important objective concerns taxation but this matter will need to be considered in the context of the general treatment of taxes in the MAI.

10. One delegation suggested adding the following text on forced transfers: “A Contracting Party shall not require the transfer of, or penalise the failure to transfer, the income, earnings, profits or other amounts derived from, or attributable to, an investment in the territory of another Contracting Party by one of its investors.” This proposal did not attract a consensus.

Article E

1. It was discussed whether to include reference to private insurance companies in the recognition given in Article E. A special provision to this effect was considered unnecessary since a Contracting Party may designate its “designated agency” regardless of its private or public status.
2. Some delegations expressed the view that the words “against non-commercial risks” were too narrow in scope and therefore suggested their deletion.
3. The question of subrogation is very directly linked to the settlement of disputes: it will have to be borne in mind as discussions on the latter subject take place. In particular, a key question will be the respective rights of the investor and the Contracting Party or its designated agency subrogated in the rights of this investor.
4. The second paragraph of Article E could be placed elsewhere in the agreement, possibly in the dispute settlement section.