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**MAKING THE MOST OF INTERNATIONAL INVESTMENT AGREEMENTS:
A COMMON AGENDA**

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**Technical assistance and capacity building,
lessons learned from experiences and the way forward**

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Introduction

A qualitative change has taken place in the negotiating environment, since the first generation of Bilateral Investment Treaties (BITs) were negotiated by Sri Lanka. This Paper seeks to deal with Sri Lanka's experience in the ICSID Investor-State dispute settlement system and to address the issue of technical assistance and capacity building in the context of a range of new issues and challenges posed by an emerging environment of economic integration Agreements.

In the South Asian region, Sri Lanka was the first to liberalise its economy way back in 1977. As part of its newly liberalised economic policy, Sri Lanka commenced negotiating bilateral treaties for the Promotion and Protection of Investments (BIT^s) in the early 1980s and the first BIT, the Agreement between Sri Lanka and the United Kingdom was concluded on 14 January 1981, based on the OECD Draft. Since then, Sri Lanka has concluded BITs with 26 countries including capital exporting countries in Europe and South East Asia, as well as with key trading and economic partners within the region. In order to accord high political priority to the negotiation of these Treaties, an Inter-ministerial Committee of senior officials chaired by the Secretary to the President and comprising representatives of the Ministry of Foreign Affairs which functioned as the principal arm in treaty negotiations, the Board of Investment, Commissioner General of Inland Revenue and the Attorney General's Department, among others, was constituted.

With the objective of creating a conducive political and legal environment to generate investor confidence, the Bilateral Investment Treaty regime is supported by a strong constitutional guarantee under Article 157 of the Constitution of Sri Lanka. In terms of this provision, a Bilateral Investment Treaty approved by Parliament with a two third majority, as being essential for the development of the national economy of Sri Lanka is given the force of law in Sri Lanka and no legislative, executive or administrative action could be taken in a contravention of its provisions, unless on the limited grounds of public security.

Sri Lanka's past experience

Sri Lanka's first experience in Investor-State dispute settlement was in the application filed before International Centre for Settlement of Investment Disputes (ICSID) by Asian Agricultural Products Ltd. (AAPL) against the Government of Sri Lanka¹ which brought up for determination, inter-alia, scope and content of the "full protection and security" provisions in the Sri Lanka-UK Bilateral Investment Treaty. In these proceedings the claimant investor alleged that the investment in question had suffered damage consequent to an operation by the security forces.

The central issue which arose for determination in the Arbitration was the contention of the claimant investor that the provisions of Article 2(2) of the Treaty created a "strict liability" regime which renders the host State liable for any loss arising from the destruction of the investment, even if caused by a person whose acts are not attributable to the State and under circumstances beyond the State's control.

The ICSID Tribunal determined that the provision in the BIT on the grant of "full protection and security" to a foreign investor was a reflection of the intention of the Parties to require, within their treaty relationship, **nothing more than the customary international law standard of "due diligence"** and that the words in question, ie. "full protection and security", were not in themselves sufficient to establish that the Parties intended to transform their mutual obligations, to one of "strict liability". The AAPL Arbitration was thus a clear forerunner in establishing the threshold for determining the standard of "full protection and security" for foreign investment.

The standard of "full protection and security" for foreign investment appears to be now well settled with recent treaty practice and jurisprudence confirming the customary international law standard. However, the application of this obligation continues to be one of considerable relevance to developing host countries which are confronted with varying degrees of civil insurrection and internal conflicts. The sum effect of recent jurisprudence appears to be that the obligation to accord "full protection and security" to foreign investment places an obligation of good faith efforts on the part of host countries to ensure that conditions of domestic instability does not have a negative effect on foreign investors. This indeed would be a continuing challenge for most developing countries, particularly those confronted with situations of internal armed conflict.

In the second Investor-State dispute settlement experience for Sri Lanka, namely the Mihalee Arbitration before the ICSID Tribunal² the Government of Sri Lanka was required to address the issue whether the jurisdiction of ICSID should be liberally widened to cover a new category of disputes in the form of pre-investment expenditure, in respect of an ultimately abandoned project, specifically whether such expenditure amounts to an "investment" for the purposes of Article 25 of the ICSID Convention.

The ICSID Tribunal, no doubt, adopted a cautious approach in dealing with the assertion of the claimant investor that the term "investment" ought to be given a broad interpretation so as to include pre-investment expenditure. From a developing country perspective, the approach of the tribunal is consistent with the idea that the aim of international investment agreements is to encourage long term commitment of resources to the host country and should include only capital flows with a particular maturity, as falling within the definition of term "investment". However, certain observations made in concurring opinion of one of the arbitrators that the protectionist mechanism of ICSID should be available to those who are encouraged to embark on large scale expensive private foreign investment infrastructure projects, cause

¹ ICSID Award, dated 21 June 1990 (Case No. ARB/87/3). This is reported to be the first case in which the provisions of a BIT had been invoked before ICSID.

² ICSID Arbitration: Mihalee International Cooperation Vs. the Government of Sri Lanka: Award dated 15 March 2002 (Case No. ARB/00/2)

some concern to developing host countries, since this could trigger a different approach to that followed in the Mihalev Arbitration, in future arbitrations.

Pre-investment tender processes in respect of large scale private foreign investment projects, almost always involve a number of unsuccessful tenderers, each one of whom could potentially pursue a claim against the host state. If the ICSID protection mechanism is extended to cover such expenditure, the impact of defending such a bundle of claims on the vulnerable economies of developing host countries would be of a potentially de-stabilizing nature. The economic cost of defending multiplicity of claims, sometimes, before multiple arbitration fora, all arising out of one transaction would necessarily involve, substantive resource implications for host developing countries.

Further, the 'a priori' consent clause in BITs through which a state consents in advance to submit to ICSID jurisdiction in respect of future disputes and recognizes the right of an individual investor to pursue a claim against a State in his own right, without the intervention of his home state, must be interpreted and applied strictly in the context of its innovative and sui generis character in international treaty law. It is a significant departure from the traditional position as reflected in customary international law wherein the individual lacks the international legal personality to pursue such claims. Accordingly, Arbitration Tribunals need to be wary of liberally applying the 'a priori consent' of a state in respect of a new class of disputes such as those involving pre-investment expenditure, which a host state would most likely have excluded from the scope of arbitration, had the issue presented itself at the time of negotiating the BIT.

A contrary approach to liberally expand ISCID jurisdiction could lead to a cautious approach by the developing host countries, with regard to the scope of arbitration clauses in BITs, given the uncertain legal terrain they would be entering into.

Proposals currently under consideration to improve the system of investor-State Dispute Settlement, such as avoiding multiplicity of proceedings arising from a single set of measures, the possible dismissal in limine of unmeritorious claims, deserve close attention in order to generate the confidence of host countries in the dispute settlement process.

The Way Forward

A clear trend towards Bilateral and Regional Economic Partnership Agreements is becoming increasingly evident in the South Asian Region. Sri Lanka is convinced that the conclusion of Free Trade and Economic Partnership Agreements would facilitate the expansion of trade and investment in the region and that such integration arrangements would attract foreign investors to use Sri Lanka as a regional export base to the large markets of South Asia.

The Free Trade Agreement (FTA) with India providing for liberalization of goods which resulted in a quantum leap in Indo/Sri Lanka trade led to the commencement of negotiations on a Comprehensive Economic Partnership Agreement (CEPA) with India, with a separate chapter containing substantive provision on Investment Promotion and Protection. A similar CEPA with Singapore with a substantive investment chapter is also in the pipeline, while a FTA with Pakistan has recently being concluded.

In addition, trade barriers are also being liberalized at the regional level. Seven countries which comprise the South Asian Association for Regional Cooperation (SAARC) has progressed towards a South Asian Free Trade Agreement (SAFTA). To facilitate the implementation of SAFTA, a Regional Investment Promotion and Protection Agreement as well as a Regional Double Tax Avoidance Agreement is being considered. The Regional Investment promotion and Protection Agreement, contains elaborate provision on investor/State dispute settlement, including through recourse to conciliation or arbitration under ICSID.

A key feature in these integration arrangements is that they contain investment provisions, which are linked to specific trade and development goals with the objective of widening and deepening economic integration. The trend towards economic integration Agreements together with investment provisions has brought to surface a host of new challenges to the developing host countries. These developments call for the re-negotiation of the first generation investment agreements, since the provision of these BITs now need to be viewed in a broader context of achieving GATS plus treatment in the services sector under the umbrella of the economic integration agreements.

In this emerging environment, where a host of new issues surface, which were not central to the negotiations when the first generation BITs were concluded in the 1980s, technical assistance and capacity building of developing host countries becomes a crucial factor.

In Sri Lanka's experience it has become necessary to address the following issues in its negotiations of Comprehensive Economic Partnership Agreements.

- The question of pre-establishment coverage for investment;
- Should such coverage be provided only in respect of specifically identified sectors of significance to the achievement of national development goals ;
- The applicability of international dispute settlement provisions to the pre-establishment phase. The approach to this issue must necessarily take into account, Sri Lanka's past experience in Investor-State dispute settlement;
- The standard of treatment to be extended at the pre-establishment stage;
- The issue of MFN plus treatment consistent with WTO rules, in promoting investment;
- The inter-play between indirect expropriation and government regulatory measures. This issue needs to be addressed in the context of emerging jurisprudence in the light of cases brought under NAFTA and provisions in Free Trade Agreements concluded by the United States and Canada.

On the latter issue Sri Lanka believes that an expansive interpretation of regulatory measures could circumvent the national policy space hindering the government's right to regulate, creating a risk of "regulatory chill", with governments hesitant to undertake legitimate regulatory measures in the public interest for fear of claims for compensation being preferred by investors. The issue raises fundamental concerns for developing countries with regard to post investment regulation making in the public interest. If the cost of pursuing such regulatory measures were to make governments liable to pay compensation to foreign investors, the economic gains to be derived by developing host countries from foreign investment could be jeopardized. Therefore, the policy challenges raised by the question of regulatory governmental measures is critical for the capacity of developing host countries to achieve some of the important development goals that the promotion of foreign investment is intended to deliver.

In the backdrop of these challenging issues, technical assistance and capacity building for developing host countries, to facilitate the effective participation of these countries in trade and economic integration negotiations and to maximize the opportunities offered by trade liberalization, becomes extremely vital.

The principal thrust of technical assistance and capacity building initiatives must be to ensure that through the effective participation in the negotiating process, the developing countries are in a position to influence the outcome in the direction of their essential national interests and acquire a sense of ownership

in the resulting agreement. For many developing countries these will require substantial contributions by way of technical assistance and capacity building.

The range of new issues which are arising in the context of economic integration agreements, including investment dispute settlement, should be of high priority in any structured programme of capacity building and technical assistance.

In this context, the proposed work program of UNCTAD, in particular the development of a second generation of research papers on international investment policies for development, a research paper on investment chapters in economic integration agreements and on new generation bilateral investment treaties is most timely and to be welcomed as a meaningful contribution to current demands.