FOREIGN INVESTMENT PROTECTION TREATIES: OPPORTUNITIES IN THE PETROLEUM INDUSTRY

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Over the last decade or so, foreign investment protection and promotion agreements have grown dramatically in number and in strength. The investment obligations and dispute resolution provisions available in these agreements have emerged as an attractive option for businesses seeking protection of their investments in foreign jurisdictions. The author presents an overview of Canada's existing investment agreements and provides a specific application of these agreements in the oil and gas sector by reviewing a recent arbitration decision.

Le nombre et la force des accords de protection et de promotion d'investissements étrangers ont augmenté de manière dramatique au cours des dix bonnes dernières années. Les dispositions relatives aux obligations d'investissement et de résolutions de conflits contenues dans ces accords en font une option attractive pour les entreprises qui cherchent à protéger leurs investissements à l'étranger. L'auteur donne un aperçu des accords d'investissement qui existent actuellement au Canada et fournit une application précise de ces accords dans le secteur pétrolier et gazier à la lumière d'une récente décision arbitrale.

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International trade and investment agreements, including the *North American Free Trade Agreement*,[1] the agreements of the World Trade Organization (WTO)[2] and other regional and bilateral agreements are having a growing impact on Canadian business, including the oil and gas sector. This is due, in large part, to the growing scope of these agreements and to significant improvements in the litigation and settlement of disputes that arise in respect of matters covered by them.

I. INTRODUCTION

Over the last five decades, international trade law has achieved a measure of success in reducing tariffs and restricting the use of many non-tariff barriers to trade on imported goods. More recently the scope of trade law has expanded to address other measures that inhibit the flow of world trade and investment. These efforts include, for example, liberalizing trade in services, enhancing the protection of intellectual property rights, regulating governments' procurement of goods and services, restricting the use of technical barriers to trade, and prohibiting the use of other measures that improperly obstruct international trade or discriminate against foreign direct investment.

Obligations regarding the protection of foreign direct investment, which until recently could only be found in bilateral agreements between developed and developing countries (and which were expected to be enforced only by the former against the latter), have found their way into international trade agreements between industrialized countries — the most notable example being Chapter 11 of the *NAFTA*. The multilateral liberalization of trade in services under the *General Agreement on Trade in Services*[3] of the WTO has also led to the imposition of certain obligations regarding the treatment of investors as between industrialized countries.

Along with the expanding coverage of international trade and investment obligations, there has been a significant improvement in the dispute settlement and enforcement mechanisms contained in these treaties. Obligations that arise under the *NAFTA* and the agreements of the WTO are binding on countries that are party to those agreements in the sense that one country's failure to comply with them will permit other countries to impose sanctions, most often by suspending benefits and concessions accorded to the offending

[1] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can. T.S. 1994 No. 2, 32 I.L.M. 289 (entered into force 1 January 1994) [*NAFTA*].

[2] *Marrakesh Agreement Establishing the World Trade Organization*, 15 April 1994 [*Marrakesh Agreement*].

[3] *General Agreement on Trade in Services*, Annex 1B to the *Marrakesh Agreement*, *ibid.*

country under the particular trade agreement at issue. Generally speaking, these trade obligations are enforced on a government-to-government basis: complaints are launched and disputes are negotiated or litigated by the governments of the countries that implement or are affected by the measures at issue, and not by private entities that could be directly affected by the offending measures.[4]

A. IMPACT ON THE STRATEGIC DECISION-MAKING PROCESS

As many organizations in the oil and gas sector have already recognized the significance of international trade and investment agreements to their business operations, often the next challenge is to ensure that business decisions take into account the impact and opportunities these agreements provide. From the perspective of the corporate organization, the benefits of staying abreast of developments in these areas are at least threefold.

First, these agreements assist in identifying market opportunities. For example, an exporter may become aware of and seek to improve its access to new geographic or product markets arising as a result of continuing trade negotiations under existing agreements, the negotiation of new free trade agreements or the accession of new members to trading arrangements, such as China's recent accession to the WTO. More than ever before, governments are encouraging participation and input from interested parties in these processes.

Second, these agreements can provide effective tools to deal with market access or competitive issues facing the organization. An importer encountering difficulties in accessing the Canadian market may look to Canada's obligations under international trade and investment agreements as one of the available remedies for addressing the situation. For example, importers of motor vehicles from Japan and Europe now benefit from non-discriminatory access to the Canadian market as a result of their governments' successful challenges of Canada's Auto Pact at the WTO.[5] Foreign investors may also rely on bilateral investment treaties or the investment dispute provisions of Chapter 11 of the *NAFTA* to challenge discriminatory or expropriatory measures undertaken by host governments.

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[4] It should be noted that, although a private entity may not challenge a measure before the WTO, formal mechanisms exist in the domestic laws of the U.S. and the European Union that facilitate bringing cases under international trade agreements at the behest of commercial interests in those territories. Under s. 301 of the U.S. *Trade Act of 1974*, as am. (19 U.S.C. ch. 12, § 2411), a petition may be filed with the U.S. Trade Representative requesting an investigation of a foreign country's practices and their consistency with trade obligations. Under the European Union's *Trade Barrier Regulations*, European firms can formally petition the European Commission to investigate other countries' compliance with international trade agreements. Since no such mechanism exists under Canadian law, Canadian exporters and investors encountering measures that violate WTO or other trade agreement obligations must informally lobby Canada's Department of Foreign Affairs and International Trade to bring a case under the auspices of the specific agreement at issue.

[5] A WTO Panel and the WTO's Appellate Body determined that the duty-free treatment accorded by Canada to imports of automobiles, buses, and specified commercial vehicles by certain manufacturers that satisfied production and value-added requirements was inconsistent with Canada's WTO commitments. See WTO, *Canada Certain Measures Affecting the Automotive Industry* (2000), WT/DS139,142/AB/R (Appellate Body Report) 19 June 2000. Effective 18 February 2001, the legislative provisions constituting Canada's Auto Pact were repealed. See *Order Repealing the Motor Vehicles Tariff Order, 1998 and Amending the Schedule to the Customs Tariff*, S.O.R./2001-81 (15 February 2001).

Third, companies need to be aware of and plan for the potential negative impact on their business of trade agreements and the dispute resolution process — as is the case when a measure that has protected a domestic producer's market must be removed (either through negotiations or as required by a trade agreement ruling) or when importers find themselves in the crossfire of a trade dispute, the result of which is the imposition of sanctions in the form of significant surtaxes on targeted imported products. A recent example of the latter is Canada's imposition of a 15 percent retaliatory surtax on imports of certain products from the U.S. in response to the U.S. failure to repeal its WTO-inconsistent Byrd Amendment.[6]

As the significance of trade and investment agreements grow, oil and gas companies need to have mechanisms in place to ensure that this information is fed into their strategic decision-making process in their business planning systems. Although this paper focuses on obligations to protect foreign investment, it is important to note that internal decision-making systems should incorporate all trade and investment agreements, including the *NAFTA*, the agreements of the WTO, Canada's regional trade agreements, as well as agreements currently being negotiated.[7]

B. FOREIGN INVESTMENT PROTECTION

This article considers investment agreements — referred to as bilateral investment treaties (BITs) in the U.S. and in many international circles, and as foreign investment protection and promotion agreements (FIPAs) in Canada — with particular focus on their application in the oil and gas sector. These include the investment obligations and dispute resolution provisions contained in *NAFTA* Chapter 11, a trilateral investment agreement between Canada, the U.S., and Mexico.

There exist strong incentives for both capital importing and capital exporting nations to conclude these agreements. Most host governments do so to create an image of stability, and through the guarantees offered in these agreements, to attract much needed direct foreign investment in their countries. Governments of capital exporting countries see obvious benefits arising under these agreements for their businesses operating in foreign jurisdictions.

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[6] The U.S. Byrd Amendment (*Continued Dumping and Subsidy Offset Act*, Pub. L. No. 106-387, Title X § 1002, 114 Stat. 1549 (2000) (codified at 19 U.S.C. 1675)), which permits U.S. producers to receive anti-dumping and countervailing duties paid upon importation of competitive product, was found by the WTO to be inconsistent with U.S. trade obligations. The U.S. failed to amend its legislation in accordance with the WTO recommendations and, as a result, Canada was permitted to retaliate with the imposition of a 15 percent surtax on U.S. live swine, cigarettes, oysters, and certain specialty fish starting 1 May 2005. See Canada, Department of Foreign Affairs International Trade, News Release No. 56, "Byrd Amendment: Canada to Retaliate Against United States" (31 March 2005).

[7] In addition to the *NAFTA* and the agreements of the WTO, Canada has free trade agreements in place with Chile, Israel, and Costa Rica, and is currently negotiating agreements with South Korea, the Central American Four (El Salvador, Guatemala, Honduras, and Nicaragua), the European Free Trade Association (Iceland, Norway, Switzerland, and Lichtenstein), and Singapore. Canada has initiated preliminary discussions considering possible free trade negotiations with the Andean Community (Bolivia, Columbia, Ecuador, Peru, and Venezuela), the Dominican Republic, and CARICOM (the Caribbean Community and Common Market), and is participating in the Free Trade Area of the Americas negotiations. Canada is also in the process of negotiating a Trade and Investment Enhancement Agreement with the European Union.

The benefits, however, extend beyond just the substantive obligations. Their most significant impact lies in their enforcement.

Traditionally, when their operations were subject to discriminatory measures, unfair treatment, or expropriation, foreign investors had only two means of addressing these problems with host governments: seek a diplomatic resolution of the issue through the investor's government and the government of the host state, or take action in the domestic court systems of the host state. However, achieving an effective diplomatic resolution of these matters requires strong support from the investor's government and the investor has little, if any, control over that process. At the same time, the investor may view the domestic court systems, for one reason or another, as being inadequate, slow, or biased towards the host government.

Over the last decade or so, international investment agreements have rapidly emerged as a third option for businesses seeking protection of their investments in foreign jurisdictions. These investment agreements are an attractive alternative since they enable an investor to seek damages from the foreign government by litigating a claim before an independent arbitral tribunal. The private investor-state dispute settlement mechanism represents a significant and growing exception to the general principle of government-to-government enforcement of obligations under international trade and investment agreements. This mechanism exists in Chapter 11 of the *NAFTA* and a number of bilateral investment agreements that Canada has negotiated with developing countries. Many of Canada's FIPAs with developing countries have been in force for almost 15 years, but more recent events have raised their prominence. The emergence of investor disputes under the *NAFTA*, failed attempts to negotiate a multilateral investment agreement under the auspices of the Organisation for Economic Cooperation and Development (OECD), and ongoing efforts to negotiate investment obligations at the WTO have led to much controversy of late.

The growth in these agreements has been extraordinary — at the end of 2004 there were approximately 2400 investment agreements in force worldwide, about eight times the number that existed in 1990.[8] This development is a significant one, as control of these disputes is now in the hands of foreign investors and not their home governments or the local courts in host jurisdictions.

As noted, industrialized or capital exporting countries negotiate investment agreements with a view to providing their investors with protection and stability in foreign jurisdictions, while developing or capital importing countries typically sign on to these agreements with the expectation of attracting much needed foreign investment.[9] That being said, the

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[8] As of the end of 2004, 2392 bilateral investment treaties were in force around the world: United Nations Conference on Trade and Development (UNCTAD), *International Investment Arrangements: Trends and Emerging Issues*, UNCTAD Series on International Investment Policies for Development, UNCTAD/ ITE/IIT/2005/11 (New York: United Nations, 2006). During 2004 alone, 73 bilateral investment treaties were concluded.

[9] Some have noted that although developing countries have flocked to sign bilateral investment treaties in recent years, such agreements have had a questionable impact on the welfare of developing countries that would arguably be better off requiring potential investors to commit their investments without a binding bilateral investment treaty. See Andrew T. Guzman, "Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties" (1998) 38 Va. J. Int'l. L. 639.

governments of industrialized countries can also be the targets of investor claims as is evident from the number of cases that have been filed against Canada and the U.S. under *NAFTA* Chapter 11.[10] A growing body of jurisprudence has developed in this area, particularly with *NAFTA* Chapter 11 cases, and it will be referred to often in this review of investment agreements.

In discussing the opportunities that investment agreements afford to companies operating in the oil and gas sector, this article will cover the following: Part II provides an overview of Canada's existing investment agreements, including *NAFTA* Chapter 11, and the key substantive protections they afford; Part III contains a brief overview of the dispute resolution provisions, including the necessary jurisdictional requirements that must be satisfied in order for a claim to be brought under these agreements; Part IV will consider the specific application of these agreements in the oil and gas sector by reviewing a recent arbitration decision; and finally, Part V will briefly discuss three leading issues in bilateral investment disputes that will undoubtedly impact challenges launched by oil and gas investors under investment protection agreements, as well as the negotiation of future agreements.

II. AN OVERVIEW OF INVESTMENT AGREEMENTS AND THEIR SUBSTANTIVE PROTECTIONS

In addition to *NAFTA* Chapter 11, there are currently 23 investment protection agreements in force between Canada and countries in Latin America, Eastern Europe, Asia, and Africa. Between 1989 and the coming into force of the *NAFTA* in 1994, Canada negotiated investment agreements with a handful of countries modeled on an OECD framework for investment treaties. These FIPAs were concluded with Poland, the U.S.S.R. (Russia is the continuing state), Czechoslovakia (the Czech Republic and the Slovak Republic are the continuing states), Argentina, and Hungary. Although the investment obligations in these FIPAs are generally similar to those contained in *NAFTA* Chapter 11, there are differences of which potential claimants should be made aware. These include differences in the expropriation and compensation obligations and the treatment of tax measures, areas which are treated more favourably under the OECD model FIPAs from the perspective of the foreign investor.

In 1994, Canada began modeling its FIPAs on the investment obligations set out in the *NAFTA*. Canada has since concluded *NAFTA*-model FIPAs with over 15 developing or emerging market countries, all of which are identified in Appendix I.

NAFTA Chapter 11 and Canada's other investment agreements offer significant substantive foreign investment protections addressing discrimination and expropriation. The

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[10] As of 1 January 2005, under *NAFTA* Chapter 11, 11 cases have been filed against Canada, 13 cases have been filed against the U.S., and 15 cases have been filed against Mexico. US$27 million in damages have been awarded against Canada, US$18.2 million in damages have been awarded against Mexico, and no damages have yet been awarded against the U.S. (Scott Sinclair, *NAFTA Chapter 11 Investor-State Disputes*, Trade and Investment Research Project, Canadian Centre for Policy Alternative (CCPA) (11 January 2005), online: CCPA <www.policyalternatives.ca/documents/National_Office_Pubs/2005/chapter11_january2005.pdf>.

most significant of these include national treatment, most-favored-nation treatment, minimum standard of treatment (fair and equitable treatment), restrictions on the use of performance requirements, and compensatory and procedural guarantees regarding expropriation.[11] Although not found in the *NAFTA*, obligations on host states to abide by their contractual commitments to investors (so-called "umbrella clauses") appear in one form or another in numerous bilateral investment treaties, including certain Canadian FIPAs. Typically, investment agreements contain a number of exemptions and reservations and these will also be considered below. The *NAFTA*'s reservations concerning the oil and gas industry will be of particular interest.

In briefly reviewing the more common substantive obligations contained in investment agreements, reference will be made to these obligations as they are contained in the *NAFTA* since the *NAFTA* forms the basis of most of Canada's existing investment agreements as well as Canada's recently released 2004 Model FIPA.

A. NATIONAL TREATMENT

Most investment agreements contain basic national treatment obligations, that is, the requirement that signatory countries extend to foreign investors and their investments treatment no less favourable than that accorded, in like circumstances or like situations, to domestic investors "with respect to the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments."[12] Generally speaking, regulatory measures that favour domestic investors over foreign investors are considered to be inconsistent with national treatment commitments.

Chapter 11 arbitral tribunals have interpreted the national treatment obligation set out in the *NAFTA* as requiring that *NAFTA* investors and their investments be accorded the "best" treatment accorded to domestic investors and their investments in like circumstances.[13]

Critical to the determination of whether a measure complies with the national treatment obligation is the question of whether the foreign investor or its investment is considered to be "in like circumstances" to domestic investors or investments. In other words, in determining whether less favourable treatment is being accorded to *NAFTA* investors, the

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[11] Other significant obligations, although not as broad-ranging as these, include restrictions on the ability of governments to impose requirements regarding the nationality of senior management and boards of directors (for example, see *NAFTA*, *supra* note 1, art. 1107), and the requirement that host governments permit all transfers relating to an investment of an investor to be made freely and without delay (for example, see *NAFTA*, *ibid.*, art. 1109).

[12] For example, *NAFTA*, *ibid.*, art. 1102 (National Treatment) provides as follows:

1. Each Party shall accord to investors of another Party treatment no less favorable 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.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

[13] *Pope & Talbot v. Government of Canada*, Award on the Merits of Phase 2 (10 April 2001) at para. 16 [*Pope & Talbot*, Phase 2 Award].

relevant standard of comparison is the treatment accorded to domestic investors that are "in like circumstances" or "like situations."

The meaning of "in like circumstances" was considered at length by the arbitral tribunal in *Pope & Talbot*.[14] Although the tribunal in that case conceded that the concept was context dependent and had no unalterable meaning across the spectrum of fact situations, it stated that the test required a determination of whether rational host government policies existed to justify any differential treatment between foreign and domestic investments:

> [A]s a first step, the treatment accorded to foreign owned investment protected by Article 1102(2) should be compared with that accorded to domestic investments in the same business or economic sector. However, that first step is not the last one. Differences in treatment will presumptively violate Article 1102(2), unless they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA …
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> [This] formulation focusing on the like circumstances question, on the other hand, will require addressing *any* difference in treatment, demanding that it be justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments. That is, once a difference in treatment between a domestic and a foreign-owned investment is discerned, the question becomes, are they in like circumstances? It is in answering that question that the issue of discrimination may arise.[15]

An example of a successful national treatment claim can be found in *Marvin Roy Feldman Karpa v. United Mexican States*.[16] In that case, the claimant, a U.S. citizen and owner of a Mexican trading company engaged in the export of cigarettes from Mexico, filed a US$50 million claim challenging the Mexican tax authority's denial of value-added tax (VAT) refunds allegedly available to other exporters under Mexican law.

Mexican legislation imposed a tax on the production and sale of cigarettes in the domestic market; however, it also permitted a zero tax rate to be applied to cigarettes that were exported, provided certain conditions were satisfied. Typically when cigarettes were purchased in Mexico at a price that included this tax and then subsequently exported, the tax amount initially paid could be rebated. Feldman alleged that Mexico's refusal to rebate excise taxes applied to cigarettes exported by his company and Mexico's continuing refusal to recognize his company's right to a rebate of such taxes regarding prospective cigarette exports violated, *inter alia*, Mexican national treatment obligations under *NAFTA* art. 1102.

The tribunal agreed with Feldman that this Mexican tax policy had treated his company less favourably than domestic companies in like circumstances and, therefore, failed to comply with national treatment obligations. In making its determination, a majority of the tribunal examined the circumstances of a domestic group of companies, known as the Poblano Group, which was also engaged in the business of purchasing Mexican cigarettes

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[14] *Ibid.*; and *Pope & Talbot v. Government of Canada*, (26 June 2000) [*Pope & Talbot*, Interim Award].

[15] *Pope & Talbot*, Phase 2 Award, *ibid.* at paras. 78-79.

[16] I.C.S.I.D. No. ARB (AF)/99/1, Award (16 December 2002) [*Karpa*].

from volume retailers and marketing those cigarettes abroad.[17] Companies considered by the tribunal to be in like circumstances were those domestic and foreign trading companies that were in the business of purchasing Mexican cigarettes for export. Since Feldman's company had been denied rebates, while at the same time members of the Poblano Group continued to enjoy rebates for the same activity, the majority concluded that there was discrimination in clear conflict with the provisions of art. 1102.

As a result of the tribunal's finding, Feldman was awarded $9.5 million Mexican Pesos (or approximately US$1 million). Shortly after the tribunal's decision, Mexico applied to the Ontario Superior Court of Justice to have the award set aside. On 3 December 2003, the Court rejected Mexico's application.[18]

B. MOST-FAVORED-NATION TREATMENT

The most-favored-nation (MFN) obligation requires host governments to accord to foreign investors and their investments treatment no less favourable than that accorded in like circumstances or situations to investors of other nations.[19] As with the national treatment obligation discussed above, an important issue in determining whether a measure complies with the MFN treatment obligation is whether the foreign investor is considered to be in like circumstances to investors from another country.

Although it is relatively clear that the MFN obligation precludes states from according less favourable treatment to one foreign investor than to an investor from another country, there is currently some controversy as to whether MFN obligations apply to a treaty's dispute settlement provisions. Investor claimants have in some cases been successful in relying on the MFN obligation to incorporate more favourable dispute settlement provisions contained in investment agreements concluded between the host government and other nations.

One of the first cases in which an investor successfully invoked an MFN clause to import more favourable dispute settlement provisions from other investment treaties was *Emilio*

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[17] *Ibid.* Notably, the tribunal rejected a national treatment comparison between Feldman's company and domestic producers of cigarettes, who were clearly in a better position to obtain a VAT rebate on exports. In determining that such producers were not domestic investors "in like circumstances" to Feldman's company, the tribunal found there were at least some rational grounds for treating them differently than resellers, including better control of tax revenues, discouraging smuggling, protecting intellectual property rights, and prohibiting grey market sales, even if some of these grounds were considered to be anti-competitive.

[18] See *Mexico v. Karpa*, [2003] O.T.C. 1070 (Ont. Sup. Ct. J.). In its judgment of 11 January 2005, the Ontario Court of Appeal refused to overturn the lower court's decision, *United Mexican States v. Karpa* (2005), 74 O.R. (3d) 180.

[19] For example, *NAFTA*, *supra* note 1, art. 1103 (Most-Favored-Nation Treatment) provides as follows:

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

Agustin Maffezini v. Kingdom of Spain.[20] In that case, an Argentine investor had sued the Government of Spain in respect of a number of measures allegedly violating the Spanish-Argentine BIT. The BIT contained a requirement that recourse had to be made to domestic courts of the host country for a period of at least 18 months before bringing a claim under the BIT. This is a common provision contained in many of the BITs signed by Argentina and other Latin American countries. The tribunal allowed the Argentine investor to use the MFN provision of the Spanish-Argentine BIT to take advantage of the dispute settlement provisions in the Spanish-Chilean BIT, which did not require prior recourse to domestic proceedings. This latter BIT contained instead a "fork in the road" provision that required the investor to choose between submitting the dispute either to domestic proceedings or to international arbitration proceedings.

The tribunal found, that notwithstanding the fact that the Spanish-Argentine BIT did not refer expressly to dispute settlement being covered by the MFN clause, "there are good reasons to conclude that today dispute settlement arrangements are inextricably related to the protection of foreign investors,"[21] and as such the Argentine investor could benefit from the advantageous dispute settlement provisions contained in the Spanish-Chilean BIT. Accordingly, the Argentine investor was not required to seek recourse in Spanish courts before bringing its claim.

Arbitral tribunals have struggled with applying the *Maffezini* decision in subsequent cases, which are further discussed in Part V below regarding new developments in investment agreements.[22]

C. MINIMUM STANDARD OF TREATMENT — FAIR AND EQUITABLE TREATMENT

Investment agreements also require host governments to extend to investments of investors of other countries the minimum standard of treatment under international law, including fair and equitable treatment.[23] This commitment continues to be one of the most controversial and elastic obligations contained in bilateral investment protection agreements. As one leading commentator has observed, the fair and equitable treatment obligation "has become the alpha and omega of investor-state arbitration under Chapter 11 of NAFTA."[24]

The fair and equitable treatment standard is a difficult one to decipher as its application depends on the circumstances of each case. As noted in *Ronald S. Lauder v. The Czech*

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[20] I.C.S.I.D. No. ARB/97/7, Decision on Jurisdiction (25 January 2000) [*Maffezini*].

[21] *Ibid.* at para. 54.

[22] For further consideration of MFN issues, see also John W. Boscariol & Orlando E. Silva, "New developments in foreign investment protection" (2005) 14 Canadian Corporate Counsel 71; John W. Boscariol & Orlando E. Silva, "The Widening Application of the MFN Obligation and its Impact on Investor Protection" (2005) 11 Int'l Trade L. & Reg. 61; and Rudolf Dolzer & Terry Myers, "After *Tecmed*: Most-Favored-Nation Clauses in Investment Protection Agreements" (2004) 19:1 ICSID Rev. — Foreign Invest. L.J. 49.

[23] For example, *NAFTA*, *supra* note 1, art. 1105 provides as follows:

> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

[24] Charles H. Brower, II, Remarks in "Fair and Equitable Treatment Under NAFTA's Investment Chapter" *Proceedings of the 96th Annual Meeting of the American Society of International Law* (2002) 9 at 9.

Republic, "[i]n the context of bilateral investment treaties, the 'fair and equitable' standard is subjective and depends heavily on a factual context."[25] The standard may also differ greatly among investment agreements. In some agreements, it may be linked by reference to international law or customary international law, while in others there is no such reference.

For example, the *NAFTA*'s fair and equitable treatment clause is apparently governed by the *NAFTA* Free Trade Commission's *Notes of Interpretation of Certain Chapter 11 Provisions*.[26] These notes provide that the concept of "fair and equitable treatment" and "full protection and security" "do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[27] The notes further clarify that the existence of a breach of another provision of the *NAFTA* or of a separate international agreement does not thereby also establish a breach of *NAFTA* art. 1105(1).[28]

One of the better descriptions of the fair and equitable treatment standard can be found in *Waste Management v. United Mexican States*:

> [D]espite certain differences of emphasis a general standard for Article 1105 is emerging. Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest that the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial proprietary — as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process. In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.[29]

Other tribunals considering the fair and equitable treatment standard have emphasized the importance of considering the totality of a number of elements or factors, none of which on its own is determinative of violation.[30] Acts violating this minimum standard would include acts demonstrating a wilful neglect of duty, an insufficiency of action falling far below international standards, or subjective bad faith.[31] Furthermore, a disruption of the legal and business environment in which an investment has been made,[32] conduct affecting the basic expectation of the foreign investor when it made its investment,[33] and lack of due process,

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25 UNCITRAL Final Award (3 September 2001) at para. 292.

26 NAFTA, Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (31 July 2001), online: <www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp> [*Notes of Interpretation*].

27 *Ibid.* at B(2).

28 *Ibid.* at B(3).

29 I.C.S.I.D. No. ARB (AF)/00/3, Award (30 April 2004) at para. 98.

30 *GAMI Investments v. The Government of the United Mexican States*, UNCITRAL Final Award (15 November 2004).

31 *Alex Genin, Eastern Credit Limited & A.S. Baltoil v. The Republic of Estonia*, I.C.S.I.D. No. ARB/99/2, Award (25 June 2001).

32 *Occidental Exploration and Production Company v. The Republic of Ecuador*, London Court of International Arbitration No. UN 3467, Final Award (1 July 2004) [*Occidental*].

33 *Técnicas Medioambientales Tecmed v. United Mexican States*, I.C.S.I.D. No. ARB(AF)/00/2, Award (21 May 2003).

denial of justice, or lack of transparency[34] can lead to a violation of the fair and equitable treatment obligation. Scholars and tribunals alike continue to struggle to define this very flexible and fact-specific obligation.[35]

The potential scope of the fair and equitable treatment obligation is especially broad since bilateral investment treaties do not typically contain any exceptions or reservations in respect of this commitment.

To date, only two challenges based on *NAFTA*'s art. 1105 fair and equitable treatment obligation have been successful.[36] In *S.D. Myers*, a majority of the arbitral tribunal determined that a temporary ban imposed by Canada on exports of PCB waste to the U.S., which it found to be inconsistent with Canada's national treatment obligations under art. 1102, also thereby violated Canada's obligation to extend to investors the minimum standard of treatment required by art. 1105.[37]

In *Pope & Talbot*,[38] the arbitral tribunal determined that Canada had violated its obligations under *NAFTA* art. 1105 in its treatment of an investment under the administration of its softwood lumber export regime. In that case, the tribunal found that the Softwood Lumber Division of Canada's Department of Foreign Affairs and International Trade had violated the fairness obligations under art. 1105 by refusing to conduct verifications outside Canada where there was no basis under Canadian law to refuse to do so, by subjecting the investment to threats, by denying the investment's reasonable request for pertinent information, by forcing it to incur unnecessary expenses, and disruption in meeting the Softwood Lumber Division's requests for information, by forcing it to expend legal fees and by likely causing it to suffer a loss of reputation in government circles.

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[34] *Maffezini*, *supra* note 20 and *The Loewen Group & Raymond L. Loewen v. United States of America*, I.C.S.I.D. No. ARB(AF)/98/3, Award (26 June 2003).

[35] An excellent overview of the fair and equitable treatment standard can be found in OECD, Directorate for Financial and Enterprise Affairs, "Fair and Equitable Standard in International Investment Law," Working Paper No. 2004/3 (September 2004). See also Stephen Vasciannie, "The Fair and Equitable Treatment Standard in International Investment Law and Practice" (1999) 70 Brit. Y.B. Int'l L. 99; and Barnali Choudhury, "Evolution or Devolution? Defining Fair and Equitable Treatment in International Investment Law" (2005) 8:2 Journal of World Investment and Trade 297.

[36] It should be noted that in *Metalclad Corp. v. The United Mexican States*, I.C.S.I.D. No. ARB(AF)/97/1, Award (30 August 2000) [*Metalclad*], the arbitral tribunal concluded that Mexico had violated *NAFTA* art. 1105 on the basis that it failed to ensure a transparent and predictable framework for the investor's business planning and investment. On 2 May 2001, the Supreme Court of British Columbia set aside this aspect of the tribunal's award on the basis that the tribunal had erroneously included transparency obligations within the ambit of art. 1105 ((2001), 89 B.C.L.R. (3d) 359, 2001 BCSC 664).

[37] In light of the subsequent release of the *Notes of Interpretation*, *supra* note 26, discussed above, which provide that a breach of another provision of the *NAFTA* does not thereby establish a breach of art. 1105, it appears unlikely that the approach of the tribunal in *S.D. Myers Inc. v. Government of Canada*, Partial Award (13 November 2000) [*S.D. Myers*], in this regard will be adopted in the future.

[38] *Pope & Talbot*, Phase 2 Award, *supra* note 13.

D. RESTRICTIONS ON THE USE OF PERFORMANCE REQUIREMENTS

Many investment agreements prohibit the use of certain performance requirements, that is, measures imposed on investors, whether domestic or foreign, that encourage exports or favour the sourcing of domestic goods or services.[39]

These provisions are designed to prevent host governments from imposing requirements or eliciting undertakings to achieve a given level of domestic content or to purchase, use, or accord a preference to goods produced or services provided in the host government's territory. These provisions also apply to transfers of technology. For example, host governments are prohibited from requiring transfers of technologies to entities in its territory as a condition of the establishment or operation of an oil and gas project. Further, these commitments prevent governments from conditioning the receipt of an advantage in connection with any investment in its territory on compliance with requirements that favour domestic goods or content.[40]

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[39] For example, *NAFTA*, *supra* note 1, art. 1106 provides as follows:

1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
   (a) to export a given level or percentage of goods or services;
   (b) to achieve a given level or percentage of domestic content;
   (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
   (d) to relate in any way the volume or value of imports to the volume or value of exports or the amount of foreign exchange inflows associated with such investment;
   (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
   (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
   (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

...

3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:
   (a) to achieve a given level or percentage of domestic content;
   (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
   (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investments; or
   (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

[40] *NAFTA*, *ibid.* Chapter 11 arbitral tribunals have ruled that in considering performance requirement claims, they may only consider those requirements specifically enumerated under *NAFTA* arts. 1106(1) and (3): "Although the Tribunal must review the substance of the measure, it cannot take into consideration any limitations or restrictions that do not fall squarely within the 'requirements' listed in Articles 1106(1) and (3)" (*S.D. Myers*, *supra* note 37 at para. 275).

There has yet to be a successful claim under the performance requirement provisions of the *NAFTA*. In *Pope & Talbot*, the investor challenged Canada's system for allocating export permits to softwood lumber producers. The arbitral tribunal held that the investor had not made out a valid claim under art. 1106(1)(a) because Canada's export control regime did not "impose or enforce requirements." The tribunal noted that while Canada's regime "undoubtedly deters increased exports to the U.S., that deterrence is not a 'requirement' for establishing, acquiring, expanding, managing, conducting or operating a foreign owned business in Canada."[41] Unfortunately, the decision in *Pope & Talbot* does not offer much guidance on the meaning of the terms "impose" and "enforce," as the tribunal dismissed the investor's art. 1106 claim primarily on the grounds of the absence of a "requirement."

Jurisprudence under the *General Agreement on Tariffs and Trade*[42] and the agreements of the WTO has considered the term "requirement" and may offer some guidance in this area. Under these decisions, a "requirement" has been considered to exist where there is an undertaking or commitment that is entered into which is legally enforceable or binding,[43] where undertakings or commitments are voluntarily accepted as a condition to the obtaining of an advantage,[44] or where undertakings or commitments are entered into that are not legally enforceable, but due to the extent of government involvement in securing and/or monitoring the commitments, the parties considered them to be binding.[45]

E. EXPROPRIATION AND COMPENSATION

Investment treaties generally prohibit governments from directly or indirectly nationalizing or expropriating investments and from taking measures tantamount to the expropriation of such investments without satisfying certain requirements. Typically such measures must be for a public purpose, non-discriminatory, in accordance with due process of law and fair and equitable treatment obligations, and — most significantly — must be accompanied by payment of adequate compensation.[46]

The expropriation obligation is among the most controversial elements of investment agreements. Scholars and arbitral tribunals continue to struggle to distinguish between measures that are confiscatory or tantamount to expropriation and measures that constitute

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41 *Pope & Talbot*, Interim Award, *supra* note 14 at para. 75.

42 30 October 1947, 58 U.N.T.S. 187, Can T.S. 1947 No. 27 (entered into force 1 January 1948) [*GATT*].

43 *Canada — Administration of Foreign Investment Review Act ("Canada— FIRA")*, GATT Doc. S/140, 30th Supp. B.I.S.D. (1984).

44 *European Economic Community - Regulation on Imports of Parts and Components ("EEC — Parts and Components")*, GATT Doc. S/132, 37th Supp. B.I.S.D. (1990).

45 *Canada — Certain Measures Affecting the Automobile Industry (Complaint by European Communities, Japan* (2000) WTO Doc. WT/DS139/R, WT/DS 142R (Panel Report).

46 For example, *NAFTA*, *supra* note 1, art. 1110 provides that:

> No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
>
> (a) for a public purpose;
>
> (b) on a non-discriminatory basis;
>
> (c) in accordance with due process of law and Article 1105(1); and
>
> (d) on payment of compensation in accordance with paragraphs 2 through 6.

bona fide or legitimate regulation.[47] It is well established in international law that an expropriation can exist short of a formal or legal transfer of title to property, and that such a government taking need not be deliberate or intended. However, not just any kind of interference by a government with the activities or operations of a foreign investor will constitute expropriation requiring compensation. A host government can be considered to have expropriated property when its interference with the use of property is viewed as being unreasonable and has the effect of significantly depriving the owner of the use or expected economic benefit of the property.

Several investment dispute tribunals have dealt with claims of expropriation.[48] Examples of various *NAFTA* and other international tribunal expressions of these principles include the following:

> [E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[49]

> The term "expropriation" in Article 1110 must be interpreted in light of the whole body of state practice, treaties and judicial interpretations of that term in international law cases. In general, the term "expropriation" carries with it the connotation of a "taking" by a governmental-type authority of a person's "property" with a view to transferring ownership of that property to another person, usually the authority that exercised its *de jure* or *de facto* power to do the "taking"... The Tribunal accepts that, in legal theory, rights other than property rights may be "expropriated" and that international law makes it appropriate for tribunals to examine the purpose and effect of governmental measures.[50]

> An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be that, in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.[51]

> While it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that

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[47] Thomas Wälde & Abba Kolo, "Confiscatory Taxation Under Customary International Law and Modern Investment Treaties" (1999) 4 Ctr. En. Petr. & Min. L. & Pol'y J., Article 17; Burns H. Weston, "'Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation'" (1975) 16 Va. J. Int'l L. 103; G.C. Christie, "What Constitutes the Taking of Property Under International Law?" (1962) 38 Brit. Y.B. Int'l L. 307; Guillermo Aguilar Alvarez & William W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11" (2003) 28 Yale J. Int'l L. 365; and E. Gaillard, "Tax Disputes Between States and Foreign Investors" (1997) N.Y.L.J. 3.

[48] For example, see *Karpa*, *supra* note 16; *Metalclad*, *supra* note 36; *S.D. Myers*, *supra* note 37; *Pope & Talbot*, Interim Award, *supra* note 14; *Tippetts v. TAMS-ATTA* (1985), 6 Iran-U.S.C.T.R 219 [*Tippetts*]; and *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica*, I.C.S.I.D. No. ARB/96/1, Final Award (17 February 2000) [*Desarrollo de Santa Elena*].

[49] *Metalclad*, *supra* note 36 at para. 103.

[50] *S.D. Myers*, *supra* note 37 at paras. 280-81.

[51] *Ibid.* at para. 283.

> the property has been "taken" from the owner.... [U]nder international law, expropriation requires a "substantial deprivation."[52]

> A state is responsible as for an expropriation of property under Subsection (1) when it subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory.... A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory.[53]

> While assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral. The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.[54]

> As is well known, there is a wide spectrum of measures that a state may take in asserting control over property, extending from limited regulation of its use to a complete and formal deprivation of the owner's legal title.... There is ample authority for the proposition that a property has been expropriated when the effect of the measures taken by the state has been to deprive the owner of title, possession or access to the benefit and economic use of his property.[55]

The phrase "tantamount to expropriation," which is contained in art. 1110 of the *NAFTA* and many of Canada's FIPAs, has been considered by arbitral tribunals not to expand or extend beyond the term "expropriation," but to encompass what is commonly referred to as "creeping expropriation." In many cases, this includes regulatory measures imposed by host governments. Examples of tribunal expressions of these principles include the following:

> The Tribunal agrees with the conclusion in the Interim Award of the *Pope & Talbot* Arbitral Tribunal that something that is "equivalent" to something else cannot logically encompass more. In common with the *Pope & Talbot* Tribunal, this Tribunal considers that the drafters of the NAFTA intended the word "tantamount" to embrace the concept of so-called "creeping expropriation", rather than to expand the internationally accepted scope of the term expropriation.[56]

> Regulations can indeed be exercised in a way that would constitute creeping expropriation.... Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation.[57]

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52 *Pope & Talbot*, Interim Award, *supra* note 14 at para. 102.

53 *Karpa*, *supra* note 16 at para. 105 (citing with approval this excerpt from *Restatement (Third) of the Foreign Relations Law of the United States* § 712, cmt. g. (1987) [emphasis omitted].

54 *Tippetts*, *supra* note 48 at 225-26.

55 *Desarrollo de Santa Elena*, *supra* note 48 at paras. 76-77.

56 *S.D. Myers*, *supra* note 37 at para. 286 [footnotes omitted].

57 *Pope & Talbot*, Interim Award, *supra* note 14 at para. 99.

Article 1110 deals not only with direct takings, but indirect expropriation and measures "tantamount to expropriation," which potentially encompass a variety of government regulatory activity that may significantly interfere with an investor's property rights. The Tribunal deems the scope of both expressions to be functionally equivalent. Recognizing direct expropriation is relatively easy: governmental authorities take over a mine or factory, depriving the investor of all meaningful benefits of ownership and control. However, it is much less clear when governmental action that interferes with broadly-defined property rights — an "investment" under NAFTA, Article 1139 — crosses the line from valid regulation to a compensable taking, and it is fair to say that no one has come up with a fully satisfactory means of drawing this line.

... The Restatement defines "creeping expropriation" in part as a state seeking "to achieve the same result [as an outright taking] by taxation and regulatory measures designed to make continued operation of a project uneconomical so that it is abandoned" (Restatement, Section 712, Reporter's Note 7). Since the Tribunal believes that creeping expropriation, as defined in the Restatement, noted above, is a form of indirect expropriation, and may accordingly constitute measures "tantamount to expropriation", the Tribunal includes consideration of creeping expropriation along with its consideration of these closely related terms.[58]

Notably, as is the case with respect to the fair and equitable treatment obligation, investment protection treaties do not typically provide for any reservations or exceptions to the expropriation and compensation obligation.

An example of a tribunal considering the principles of expropriation in the petroleum sector can be found in *Occidental Exploration and Production Co. v. The Republic of Ecuador*,[59] which is further discussed in Part IV below. In that case, the tribunal dismissed Occidental's claim that Ecuador's refusal to refund value-added tax constituted an expropriation of its investment in Ecuador. The tribunal found, in those circumstances, there was no deprivation of the use or reasonably expected economic benefit of Occidental's investment.

F. BREACH OF CONTRACT — UMBRELLA CLAUSES

Umbrella clauses are of particular significance to investors in the oil and gas sector that enter into agreements, including concession agreements, with host governments. Generally speaking, the umbrella clause provides that host governments must comply with investment contracts or other undertakings provided to foreign investors. In effect, the umbrella clause transforms breaches of obligations that the host state has undertaken with respect to foreign investors and investments into breaches of the investment treaty. Such a provision is of particular advantage to investors who may challenge a breach of contract before independent arbitral tribunals under the auspices of a bilateral investment agreement rather than within the domestic courts of the host country.

As noted above, *NAFTA* Chapter 11 does not contain an umbrella clause. Accordingly, a simple breach of contract between an investor and host government which does not constitute a violation of other Chapter 11 obligations is not a sufficient basis upon which to

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58 *Karpa*, *supra* note 16 at paras. 100-101.

59 *Occidental*, *supra* note 32.

sue a *NAFTA* government.[60] Many other investment treaties, however, including to a limited extent Canada's FIPAs, contain umbrella clauses in one form or another.

There is no one standard umbrella clause. Some cover only specific types of contract breaches, such as when a change in the host state's taxation regime contravenes an investment contract. Other umbrella clauses are broadly worded and cover a wider range of obligations. For example, some BITs contain clauses that require the host state to "'observe any obligation it may have entered into,' 'constantly guarantee the observance of the commitments it has entered into,' or 'observe any obligation it has assumed' with certain investors or in respect of their investments.'"[61]

None of Canada's 23 FIPAs contains a general umbrella clause. However, Canada's *NAFTA*-based FIPAs, as well as its 2004 Model FIPA, provide that a tax measure that breaches an agreement between the host government and the investor constitutes a breach of the FIPA provided certain conditions are satisfied. Specifically, the investor must refer the claim to the taxation authorities of both the host country and the investor's country, who may block the claim if they jointly determine that the tax measure does not violate the FIPA. If the tax authorities agree that the measure contravenes the investor-state contract, or if they cannot come to an agreement on this point within six months, the investor can submit the claim to arbitration.[62]

Some of Canada's earlier FIPAs, which are based on an OECD model for BITs, have widely drafted investor dispute settlement provisions that could be interpreted to permit

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60 See *e.g.*, *Azinian et al v. The United Mexican States*, I.C.S.I.D. No. ARB(AF)/97/2, Award (1 November 1999): "NAFTA does not ... allow investors to seek international arbitration for mere contractual breaches" (at para. 87).

61 Anthony C. Sinclair, "The Origins of the Umbrella Clause in the International Law of Investment Protection" (2004) 20 Arb. Int'l 411 at 412.

62 This provision is contained in all of Canada's *NAFTA*-based FIPAs, other than its treaty with Thailand. Included in this group are the FIPAs Canada has signed with Ukraine, Latvia, Philippines, Trinidad and Tobago, Barbados, Ecuador, Venezuela, Panama, Egypt, Armenia, Uruguay, Lebanon, Costa Rica, and Croatia. The relevant clauses, as they appear in art. 16 of Canada's Model FIPA (online: Canada, Department of Foreign Affairs and International Trade <www.dfait-maeci-gc.ca/tna-nac/documents/2004-FIPA-model-en.pdf>), are as follows:

3. A claim by an investor that a tax measure of a Party is in breach of an agreement between the central government authorities of a Party and the investor concerning an investment shall be considered a claim for breach of this Agreement unless the taxation authorities of the Parties, no later than six months after being notified by the investor of its intention to submit the claim to arbitration, jointly determine that the measure does not contravene such agreement. The investor shall refer the issue of whether a taxation measure does not contravene an agreement for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).
4. The provisions of Article 13 shall apply to taxation measures unless the taxation authorities of the Parties, no later than six months after being notified by an investor that the investor disputes a taxation measure, jointly determine that the measure in question is not an expropriation. The investor shall refer the issue of whether a taxation measure is an expropriation for a determination to the taxation authorities of the Parties at the same time that it gives notice under Article 24 (Notice of Intent to Submit a Claim to Arbitration).
5. An investor may submit a claim relating to taxation measures covered by this Agreement to arbitration under Section C only if the taxation authorities of the Parties fail to reach the joint determinations specified in paragraph 3 and paragraph 4 of this Article within six months of being notified in accordance with the provisions of this Article.

investors to bring contract-based investment disputes to international arbitration. For example, the Canada-Poland FIPA[63] allows an investor to bring "[a]ny dispute between one Contracting Party and an investor of the other Contracting Party relating to the effects of a measure taken by the former Contracting Party with respect to the essential aspects pertaining to the conduct of business" to international arbitration if the investor and the Contracting Party are unable to reach an amicable settlement.[64] The Canada-Russia FIPA and the Canada-Czech and Slovak Federal Republic FIPAs also contain similarly wide definitions of what type of dispute investors are permitted to submit to international arbitration: "Any dispute between one Contracting Party and an investor of the other Contracting Party relating to the effects of a measure taken by the former Contracting Party on the management, use, enjoyment or disposal of an investment made by the investor, and in particular, but not exclusively, relating to the effects of a measure" may be submitted to arbitration if the Parties are unable to come to an amicable settlement.[65] None of Canada's other OECD-based FIPAs contains similar provisions.[66]

Although the inclusion of umbrella clauses in international investment treaties can be traced back to the 1950s,[67] it was not until recently that this obligation was carefully considered and applied by arbitral tribunals. In one of the first cases to consider the umbrella obligation thoroughly, a tribunal took a very narrow view of its scope.[68] However, recent decisions have taken a broader approach, noting that the failure of a state to observe its binding commitments is a violation of the general umbrella clauses found in investment treaties.[69]

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63 *Agreement Between the Government of Canada and the Government of the Republic of Poland for the Promotion and Reciprocal Protection of Investments*, 22 November 1990, Can. T.S. 1990 No. 43.

64 *Ibid.*, art. IX.

65 *Agreement Between the Government of Canada and the Government of the Union of Soviet Socialist Republics for the Promotion and Reciprocal Protection of Investments*, 27 June 1991, Can. T.S. 1991 No. 31 (further to the dissolution of the USSR, the FIPA now binds Russia as the continuing state), art. IX and *Agreement Between the Government of Canada and the Government of the Czech and Slovak Federal Republic for the Promotion and Protection of Investments*, 9 March 1992, Can. T.S. 1992 No. 10 (further to the dissolution of Czech and Slovak Federal Republic, the FIPA currently binds both the Czech Republic and the Slovak Republic, and is considered to be two agreements), art. IX.

66 The remaining OECD-model FIPAs that Canada has signed are with Hungary and Argentina.

67 The first umbrella clause appeared in the 1959 German-Pakistan bilateral investment treaty (Thomas W. Wälde, "The 'Umbrella' Clause in Investment Arbitration: A Comment on Original Intentions and Recent Cases" (2005) 6 Journal of World Investment and Trade 183 at 185).

68 *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, I.C.S.I.D. No. ARB/01/13, Decision on Jurisdiction (6 August 2003) [*SGS*]. The tribunal was asked to consider whether the following clause elevated Pakistan's breach of a service contract to a breach of the Pakistan-Switzerland BIT: "Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party" (*SGS*, *ibid.* at para. 163). The tribunal rejected the investor's claim, expressing concern that the clause appeared "susceptible of almost indefinite expansion" (at para. 166). Because the legal consequences of reading the umbrella clause as guaranteeing all commitments would have such a burdensome impact on the host state, the tribunal wanted to see clear and convincing evidence that the intention of the signatories was to have such an inclusive umbrella clause. In the tribunal's view, there was no such evidence. Instead of transforming contractual claims into treaty claims, the tribunal was of the view that the umbrella clause provided a general pledge on the part of the host state to ensure the effectiveness of state contracts.

69 In *Société Générale de Surveillance S.A. v. Republic of the Philippines*, I.C.S.I.D. No. ARB/02/06, Decision on Jurisdiction (29 January 2004), an arbitral tribunal reached the opposite conclusion on the impact of the relevant BIT's umbrella clause. The tribunal held that the umbrella clause in the

Since the *SGS* decisions,[70] there have been at least seven subsequent cases in which arbitral tribunals have considered umbrella clauses in the context of BITs.[71] Investors have come away with mixed results from these arbitrations.

In the most recent case, *CMS Gas Transmission Company v. The Argentine Republic*,[72] the claimant successfully relied upon an umbrella clause to elevate contractual breaches to a breach of the BIT. In this case, the U.S. investor with an interest in an operator of Argentina's northern gas pipeline sued the Argentinean government under the Argentina-U.S. BIT[73] because of Argentina's refusal to allow the operator to increase its tariffs. The public utility licence issued to the operator permitted it to adjust its tariffs based on fluctuations in the U.S. Producer Price Index (PPI) and to calculate the tariffs in U.S. dollars and convert them to pesos at the time of billing. Tariffs were to be adjusted every six months in accordance with the U.S. PPI. During Argentina's economic crisis in 2001, the Argentinean government suspended and subsequently terminated the operator's rights to make these adjustments.

Among its claims, CMS argued that the Argentinean government's actions breached the BIT's umbrella clause which provides that each party "shall observe any obligation it may have entered into with regard to investments."[74] The arbitral tribunal awarded CMS US$133.2 million, ruling that Argentina had violated this umbrella clause as well as the BIT's guarantees of fair and equitable treatment. With respect to the umbrella clause, the tribunal noted that there were two stabilization clauses contained in the licence that were breached: the first was the obligation not to freeze the tariff regime or subject it to price controls; and the second was the obligation not to alter the basic rules governing the licence without the operator's written consent.

Philippines-Switzerland BIT, which stated that "[e]ach Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party" (art. X(2)), made it a "breach of the BIT for the host State to fail to observe binding commitments, including contractual commitments, which it has assumed with regard to specific investments" (at para. 128).

70 *Ibid.* and *SGS*, *supra* note 68. For a further analysis of umbrella clauses, and in particular the *SGS* decisions, see Stanimir A. Alexandrov, "Breaches of Contract and Breaches of Treaty — The Jurisdiction of Treaty-Based Arbitration Tribunals to Decide Breach of Contract Claims in *SGS v. Pakistan* and *SGS v. Philippines*" (2004) 5 Journal of World Investment and Trade 555; and Judith Gill, Matthew Gearing & Gemma Birt, "Contractual Claims and Bilateral Investment Treaties: A Comparative Review of the SGS Cases" (2004) 21 J. Int'l Arb. 397.

71 *CMS Gas Transmission Company v. The Argentine Republic*, I.C.S.I.D. No. ARB/01/8, Final Award (12 May 2005) [*CMS*]; *Sempra Energy Int'l v. The Argentine Republic*, I.C.S.I.D. No. ARB/02/16, Decision on Jurisdiction (11 May 2005) [*Sempra*]; *Camuzzi Int'l v. The Argentine Republic*, I.C.S.I.D. No. ARB/03/2, Decision on Jurisdiction (11 May 2005) [*Camuzzi*]; *Impregilo S.p.A. v. Islamic Republic of Pakistan*, I.C.S.I.D. No. ARB/03/3, Decision on Jurisdiction (22 April 2005) [*Impregilo*]; *Salini Costrutorri S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan*, I.C.S.I.D. No. ARB/02/13, Decision on Jurisdiction (29 November 2004) [*Salini*]; *Joy Mining Machinery Ltd. v. The Arab Republic of Egypt*, I.C.S.I.D. No. ARB/03/11, Award on Jurisdiction (30 July 2004); and *Occidental*, *supra* note 32.

72 *CMS*, *ibid.*

73 *Treaty Between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment*, 14 November 1991, U.N.T.S. (entered in force 20 October 1994).

74 *Ibid.*, art. II(2)(c).

Of particular interest to Canadian-based investors who bring claims under the *NAFTA* or FIPAs that have little or no specific protection in respect of state contracts or commitments is the ability to import umbrella clauses from other more generous investment treaties. For example, in *Impregilo S.p.A. v. Islamic Republic of Pakistan*,[75] the claimant attempted to import an umbrella clause from other BITs to which Pakistan was a party. Impregilo relied on the most-favored-nation (MFN) clause in the Italian-Pakistan BIT[76] to argue that Pakistan was obliged to extend the umbrella clause from other BITs. The arbitral tribunal dismissed this argument on the ground that the contract at issue in the dispute was not actually made with the government of Pakistan and thus the breach of contract did not engage the BIT. However, the tribunal did not dismiss the possibility of this argument succeeding under different circumstances. This suggests that it may be possible for a Canadian investor suing under a FIPA to rely on the FIPA's MFN obligation to import an umbrella clause from the host country's other foreign investment treaties.[77]

Despite the wide variety of umbrella clauses found in investment agreements and the varied success investors are having arguing these clauses in international arbitration, the umbrella clause can be a very powerful tool for foreign investors seeking redress against host governments that fail to abide by their contractual commitments.

G. RESERVATIONS AND EXCEPTIONS

No review of investment protection treaties would be complete without considering the reservations and exceptions that derogate from the substantive obligations contained in these agreements. Although these exceptions differ from one investment treaty to another, the *NAFTA* contains significant exceptions particularly relevant to the oil and gas sector, which are considered below. These include certain measures related to oil and gas development, Aboriginal affairs, minority affairs, provincial measures, and tax measures.[78]

1. SPECIFIC OIL AND GAS RESERVATIONS

Under the *NAFTA*, Canada has taken three reservations with respect to measures specific to oil and gas development and in existence at the time of the *NAFTA*'s coming into force. Some of these reservations are also included in certain FIPAs. The *NAFTA* includes: a reservation from the national treatment obligation with respect to existing measures requiring that only Canadian citizens ordinarily resident in Canada and corporations incorporated in Canada may hold production licences issued for frontier lands and offshore areas; a reservation from the prohibition against performance requirements in respect of benefits plans in the Hibernia project for the achievement of specific Canadian and Newfoundland

[75] *Impregilo*, *supra* note 71.

[76] *Agreement Between the Government of the Italian Republic and the Government of the Islamic Republic of Pakistan on the Promotion and Protection of Investments*, 19 July 1997, U.N.T.S.

[77] See discussion in Part V below regarding recent developments in MFN jurisprudence.

[78] Although not reviewed in detail here, other reservations of potential significance to the oil and gas sector include those regarding acquisition and investment approvals under the *Investment Canada Act*, R.S.C. 1985, c. 28 (1st Supp.), and its regulations. Canada has taken specific reservations regarding the application of national treatment, performance requirement, and senior management and boards of directors' obligations to these measures, including "net benefit" determinations under this legislation.

target levels and commitments regarding the transfer of technology; and a reservation in respect of benefits plans regarding certain oil and gas developments in Nova Scotia, Newfoundland, Yukon, and the Northwest Territories.

All three *NAFTA* reservations apply to Standard Industrial Classification (SIC) 071, "Crude Petroleum and Natural Gas Industries."[79] The third reservation referred to above allows Canada to implement benefit plans that may favour local products and services or ensure that disadvantaged groups have access to training and employment opportunities or can participate in the supply of goods or services in connection with the particular oil and gas development. This reservation provides as follows:[80]

Sector:	Energy
Sub-Sector:	Oil and Gas
Industry Classification:	SIC 071 Crude Petroleum and Natural Gas Industries
Type of Reservation:	Performance Requirements (Article 1106) Local Presence (Article 1205)
Level of Government:	Federal
Measures:	*Canada Oil and Gas Production and Conservation Act*, R.S.C. 1985, c. O-7, as amended by *Canada Oil and Gas Operations Act*, S.C. 1992, c. 35 *Canada - Nova Scotia Offshore Petroleum Resources Accord Implementation Act*, S.C. 1988, c. 28 *Canada - Newfoundland Atlantic Accord Implementation Act*, S.C. 1987, c. 3 Measures implementing Yukon Oil and Gas Accord Measures implementing Northwest Territories Oil and Gas Accord
Description:	Cross-Border Services and Investment

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79 SIC 071 provides:

Establishments primarily engaged in the exploration for and/or production of crude oil and natural gas whether by conventional or non-conventional methods.

Since the coming into force of the *NAFTA*, the SIC system was replaced by the North American Industry Classification System (NAICS). Equivalent NAICS Canada classification is as follows:

21111 Oil and Gas Extraction

This industry comprises establishments primarily engaged in operating oil and gas field properties. Such activities may include exploration for crude petroleum and natural gas; drilling, completing and equipping wells; operating separators, emulsion breakers, desilting equipment and field gathering lines for crude petroleum; and all other activities in the preparation of oil and gas up to the point of shipment from the producing property. This industry includes the production of oil, the mining and extraction of oil from oil shale and oil sands, and the production of gas and hydrocarbon liquids, through gasification, liquefaction and pyrolysis of coal at the mine site.
Exclusion(s): Establishments primarily engaged in:

- performing oil field services for operators, on a contract or fee basis (21311, Support Activities for Mining and Oil and Gas Extraction)
- recovering liquefied petroleum gases incidental to petroleum refining (32411, Petroleum Refineries)
- recovering helium from natural gas (32512, Industrial Gas Manufacturing).

80 *NAFTA*, *supra* note 1, Annex I — Canada, I-C-25 (Energy).

1. Under the *Canada Oil and Gas Operations Act*, the approval of the Minister of Energy, Mines and Resources of a "benefits plan" is required to receive authorization to proceed with any oil and gas development project.

2. A "benefits plan" is a plan for the employment of Canadians and for providing Canadian manufacturers, consultants, contractors and service companies with a full and fair opportunity to participate on a competitive basis in the supply of goods and services used in any proposed work or activity referred to in the benefits plan. The Act permits the Minister to impose an additional requirement on the applicant, as part of the benefits plan, to ensure that disadvantaged individuals or groups have access to training and employment opportunities or can participate in the supply of goods and services used in any proposed work referred to in the benefits plan.

3. The *Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act* and the *Canada-Newfoundland Atlantic Accord Implementation Act* have the same requirement for a benefits plan but also require that the benefits plan ensure that:

(a) prior to carrying out any work or activity in the offshore area, the corporation or other body submitting the plan establish in the applicable province an office where appropriate levels of decision-making are to take place;

(b) expenditures be made for research and development to be carried out in the province, and for education and training to be provided in the province; and

(c) first consideration be given to goods produced or services provided from within the province, where those goods or services are competitive in terms of fair market price, quality and delivery.

4. The Boards administering the benefits plan under these Acts may also require that the plan include provisions to ensure that disadvantaged individuals or groups, or corporations owned or cooperatives operated by them, participate in the supply of goods and services used in any proposed work or activity referred to in the plan.

5. In addition, Canada may impose any requirement or enforce any commitment or undertaking for the transfer of technology, a production process or other proprietary knowledge to a person of Canada in connection with the approval of development projects under the applicable Acts.

	6. Provisions similar to those set out above will be included in laws or regulations to implement the Yukon Oil and Gas Accord and Northwest Territories Oil and Gas Accord which for purposes of this reservation shall be deemed, once concluded, to be existing measures.
Phase-Out:	None

Provided that the oil and gas measures in question fall within the benefits plan described in the reservation set out above, they will not be considered to violate the *NAFTA*'s prohibitions against the use of performance requirements set out in art. 1106. Furthermore, Canada may amend any such non-conforming measures in the future, provided that the amendment does not decrease the conformity of the measure with the *NAFTA*.[81]

In addition to the existing measures discussed above, Canada has also taken a number of reservations for future measures which permit it to maintain existing or adopt new or more restrictive measures that do not conform with the *NAFTA*'s investment obligations. One example particularly relevant to the petroleum industry is Canada's reservation regarding Aboriginal peoples. Canada may adopt or maintain any measure denying investors of another *NAFTA* party and their investments any rights or preferences that have been provided to Aboriginal peoples in light of their participation in oil and gas development. This relieves Canada of compliance with investment obligations regarding national treatment, MFN treatment, performance requirements, and nationality measures regarding senior management and board of directors. Similarly, Canada has taken a reservation for the right to adopt or maintain any measure according rights or preferences to socially or economically disadvantaged minorities. As far as these measures are concerned, they need not comply with the *NAFTA*'s national treatment, performance requirement, and senior management and board of directors obligations.

Both the U.S. and Mexico have also taken reservations for existing and future measures, and these should be carefully considered by potential claimants before pursuing any case against these governments under the investment dispute settlement mechanisms of *NAFTA*. In particular, it should be noted that Mexico, because of the political sensitivities in these areas, was very aggressive in taking extensive *NAFTA* reservations regarding its energy sector. This reflects the Mexican government's participation in the oil and gas industry and the importance of this economic sector in the Mexican constitution.[82]

2. NON-CONFORMING PROVINCIAL MEASURES

In addition to reservations specific to the oil and gas sector, there are other reservations and exceptions in investment treaties that apply across all industries and sectors. These include exceptions for non-conforming sub-federal measures that may violate investment agreement obligations.

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81 *NAFTA*, *ibid.*, art. 1108(1)(c).

82 For discussion of the importance of the oil and gas sector to Mexico and the application of *NAFTA* investment obligations in this regard, see Jon Ragnar Johnson, *The North American Free Trade Agreement: A Comprehensive Guide* (Aurora, Ont.: Canada Law Book, 1994) at 201-202, 311-13.

Under the *NAFTA*, it was initially intended that each *NAFTA* party would, within two years of the date of entry into force of the *NAFTA*, identify its existing non-conforming measures maintained by states or provinces and seek reservations for such measures under *NAFTA* Annex I. On 29 March 1996, the three *NAFTA* parties exchanged letters setting out reservations with respect to sub-federal measures and included reservations from the obligations of national treatment, MFN treatment, performance requirements, and nationality of senior management and board of directors. These blanket reservations apply to all existing (as of 1 January 1994) non-conforming measures of all provinces, states, and territories.

Accordingly, a measure of the Province of Alberta that existed as of 1 January 1994, and that discriminates against foreign investors in the oil and gas sector, would be exempt from challenge under the national treatment provisions of the *NAFTA*. To the extent that there are any *NAFTA*-inconsistent measures introduced by a province subsequent to the coming into force of the *NAFTA*, these would be covered by *NAFTA* obligations and not subject to this sub-federal reservation.

The treatment of sub-federal measures may differ between various investment treaties, so it is important to review these agreements closely before bringing challenges against discriminatory measures maintained by provincial or local governments.

3. TAXATION MEASURES

Taxation measures are of particular concern to the oil and gas industry as they are sometimes used by host governments to discriminate against foreign investors. Although the treatment of taxation measures can differ from one investment treaty to another, a review of the *NAFTA*'s taxation provisions is instructive.

Article 2103 of the *NAFTA* addresses taxation and begins by noting that nothing in the *NAFTA* applies to taxation measures other than set out in that particular article.[83] Article 2103 also provides that nothing in the *NAFTA* shall affect the rights and obligations of any of the *NAFTA* parties under any tax convention and that in the event of any inconsistency between the *NAFTA* and a tax convention, the tax convention prevails. Nonetheless, the *NAFTA* does apply, albeit in a somewhat limited manner, to taxation measures.

The *NAFTA*'s national treatment and MFN treatment obligations, which require that *NAFTA* investors and their investments be accorded treatment no less favourable than that accorded to domestic investors or investors of non-*NAFTA* parties, apply only to sales tax measures (that is, taxation measures other than taxes on income, capital gains, or the taxable capital of corporations and taxes on estates, inheritances, gifts, *etc.*). In contrast, the *NAFTA*'s prohibition against the use of performance requirements applies to all taxation

[83] *NAFTA*, *supra* note 1, art. 2107 defines taxes and taxation measures (for the purposes of Chapter 21) as excluding customs duties, anti-dumping or countervailing duties, fees or other charges in connection with importation commensurate with the cost of services rendered, premiums offered or collected on imported goods arising out of any tendering system in respect of the administration of quarantine and import restrictions, tariff quotas or tariff preference levels, and fees applied under the U.S. *Agricultural Adjustment Act* (7 U.S.C., c. 26, § 601 (2005)).

measures. The *NAFTA*'s compensation and expropriation obligations apply to all taxation measures, subject to the following procedures.

In recognition of the sensitivities with regard to taxation and expropriation, the *NAFTA* provides that an investor cannot initiate a claim that a *NAFTA* party's taxation measure constitutes a compensable expropriation if the *NAFTA* authorities agree that the tax measure in question is not an expropriation. Accordingly, the *NAFTA* requires that an investor refer its challenge of taxation measures to appropriate competent authorities[84] for a determination as to whether or not the measure is an expropriation. If the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is an expropriation within six months of the referral, the investor may proceed with its expropriation claim.

The treatment of tax measures under Canada's FIPAs differ, depending on whether the challenge is being brought under Canada's older OECD-model FIPAs or its newer *NAFTA*-model investment agreements.

The older OECD-model treaties, which Canada has concluded with Argentina, Poland, Russia, Hungary, and the Czech and Slovak Republics, appear to provide investors with a broader basis for challenging taxation measures. The only exception that may apply in respect of taxation measures is contained in art. IV of each of these agreements, which provides that their provisions should not be construed so as to require one contracting party to extend to the investors of the other the benefits of any treatment, preference, or privilege resulting from existing and future conventions relating to double taxation or other fiscal matters. Accordingly, and in contrast to *NAFTA* Chapter 11, all taxation measures, including sales taxes and income taxes, are subject to these FIPA obligations concerning fair and equitable treatment, national treatment, and MFN treatment, in addition to the expropriation and compensation requirements.[85]

Canada's newer FIPAs, which are based on the *NAFTA*, significantly limit the grounds upon which investors can challenge tax measures. In each of these FIPAs, taxation measures, including both sales tax and income tax measures, are exempt from challenge by private investors in all but two instances. The first arises where there is a claim that a tax measure breaches an agreement between central government authorities and the investor concerning an investment. This serves to protect an investor's pre-investment expectations where, for example, a tax is imposed or increased contrary to the host country's contractual commitments to the investor. A claim for breach of such contracts is considered to be a claim for breach of the FIPA unless the taxation authorities of each contracting party, no later than

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[84] The Assistant Deputy Minister for Tax Policy, Department of Finance (Canada); the Deputy Minister of Revenue of the Ministry of Finance and Public Credit (Mexico); and the Assistant Secretary of the Treasury (Tax Policy), Department of the Treasury (U.S.) (*NAFTA*, *supra* note 1, Annex 2103.6).

[85] It should be noted, however, that the OECD-model FIPA investment obligations themselves may not provide as much protection to investors as the obligations under the *NAFTA*. For example, under these FIPAs, a government is required to accord national treatment only "to the extent possible and in accordance with its laws and regulations" (see art. IV of the *Agreement Between the Government of Canada and the Government of the Republic of Argentina for the Promotion and Protection of Investments*, 5 November 1991, Can. T.S. 1993 No. 11).

six months after having been notified of the claim by the investor, jointly determine that the measure does not contravene the contract.[86] The second instance arises where a claim is made that a taxation measure constitutes expropriation or a measure equivalent to expropriation. In these circumstances, as is also required under the *NAFTA*, the investor must notify the taxation authorities of the contracting parties who may block the claim if, no later than six months after being notified by the investor, they jointly determine that the measure is not an expropriation. Otherwise, the investor may submit its expropriation claim for resolution under the dispute provisions of the particular FIPA.[87]

From a foreign investor's perspective, these particular FIPA provisions are far more restrictive than the *NAFTA*. For example, if Canada were to impose a sales tax measure favouring domestic or third-country investors over a FIPA investor, the investor would have no recourse under the national treatment obligation contained in the FIPA. In the same scenario under the *NAFTA*, the *NAFTA* investor would be able to challenge the measure. This would also be the case where a taxation measure was inconsistent with obligations concerning the use of performance requirements.

III. LAUNCHING AN INVESTOR-STATE CLAIM

For companies with foreign operations, one of the primary attractions of a bilateral investment protection agreement is its dispute resolution mechanism. In addition to government-to-government procedures, these agreements also contain a private investor-state dispute mechanism enabling private foreign entities to sue host governments for damages arising out of the governments' failure to comply with the investment obligations discussed in Part II above. This mechanism is available regardless of whether the investor already has a contractual or arbitration arrangement with the host state or with one of its governmental entities.[88]

A. THE DISPUTE SETTLEMENT MECHANISM

Under most investment treaties, the foreign investor has the option of bringing its claim before an *ad hoc* arbitral panel established under the Rules of the United Nations Commission on International Trade Law (UNCITRAL) or proceeding with an institutional alternative, such as an arbitral panel established under the World Bank's International Centre for the Settlement of Investment Disputes (ICSID). Most investment agreements provide for

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[86] See *e.g.*, art. XII(14)(a) of the *Agreement Between the Government of Canada and the Government of the Republic of Venezuela for the Promotion and Protection of Investments*, 1 July 1996, Can. T.S. 1998 No. 20.

[87] *Ibid.*, art. XII(14)(b).

[88] For example, in *SGS*, *supra* note 68, the service contract at issue between the investor and Pakistan contained an arbitration clause requiring the parties first to attempt to settle amicably any dispute that arose between them, and if unsuccessful, to enter into arbitration under the legislation of Pakistan. SGS sued unsuccessfully under the contract in the Swiss courts. At the same time, Pakistan invoked the arbitration clause and sought an order from the Pakistani courts to compel arbitration under the contract. SGS then brought the case under the Pakistan-Switzerland BIT. Pakistan was successful in convincing the Supreme Court of Pakistan to issue an injunction purporting to restrain SGS from participating further in the BIT arbitration and the court ordered that domestic arbitration begin. Despite the existence of the forum selection clause in the service contract, and ongoing proceedings in Pakistan under the contract, the tribunal determined that it had jurisdiction to hear SGS's claim under the BIT.

the host government's consent to the submission of a foreign investor's claim to arbitration in accordance with the requirements of international conventions on arbitral awards, including the *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, also referred to as the *New York Convention*.[89]

Generally, investment agreements require that the arbitral proceedings be brought in a state that is party to the *New York Convention*. Under the *New York Convention*, contracting parties are required to enforce arbitral awards made in the territory of other state parties. The procedure for obtaining the enforcement of an arbitral award under the *New York Convention* can be relatively straightforward. The arbitral award does not have to be confirmed by the courts in the jurisdiction of the legal place or seat of arbitration. An investor seeking enforcement of an arbitral award is only required to supply the court in the enforcing jurisdiction with a duly authenticated original award and the relevant investment treaty.[90]

Under Section B of *NAFTA* Chapter 11, an investor of a *NAFTA* party[91] may submit to arbitration a claim that another *NAFTA* party has breached its obligations under Chapter 11 and that, as a result, the investor has incurred loss or damage by reason of or arising out of the breach.[92] Such a claim may also be brought by investors of a *NAFTA* party on behalf of an enterprise of another *NAFTA* party that it owns or controls directly or indirectly in respect of any loss or damage incurred by that enterprise that arises out of the other *NAFTA* party's breach of its Chapter 11 obligations.[93] In other words, the U.S. parent of a Canadian subsidiary involved in an oil and gas project in Canada may sue the Canadian government on behalf of its subsidiary for any loss or damage caused to the Canadian subsidiary arising out of the Canadian government's breach of its Chapter 11 obligations. Significantly, a *NAFTA* investor may only challenge measures of another *NAFTA* government, not its own government.

A *NAFTA* investor may submit its claim to arbitration under: (i) the *ICSID Convention*,[94] provided that the investor's government and the government being sued are both parties to the *Convention*; (ii) the *ICSID Additional Facility Rules*,[95] provided that either the disputing party or the party of the investor, but not both, is a party to the *ICSID Convention*; or (iii) the *UNCITRAL Arbitration Rules*.[96] Because Canada is not a party to the *ICSID Convention*,

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89 *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 3 (entered into force 7 June 1959) [*New York Convention*].

90 *Ibid.*, art. IV.

91 *NAFTA*, *supra* note 1, art. 1139 provides that an "investor of a Party" means "a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment." Article 1139 also provides that an "investment of an investor of a Party" means "an investment owned or controlled directly or indirectly by an investor of such Party."

92 *Ibid.*, art. 1116.

93 *Ibid.*, art. 1117.

94 *Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, submitted 18 March 1965, ICSID/15/Rev.1 (January 2003) (entered into force 14 October 1966) [*ICSID Convention*].

95 *ICSID Additional Facility Rules*, 27 September 1978, ICSID/11/Rev.1 (as am. January 2003).

96 *UNCITRAL Arbitration Rules*, GA Res. 31/98, UNGAOR, 31st Sess., Supp. No. 17, UN Doc. A/31/17 (15 December 1976). This limitation is found at *NAFTA*, *supra* note 1, art. 1120. The applicable arbitration rules govern the arbitration except to the extent modified under *NAFTA* Chapter 11.

claims against the Canadian government are pursued either under the *Additional Facility Rules* or the *UNCITRAL Arbitration Rules*.

Under the *NAFTA*, an arbitral tribunal may order an interim measure of protection to preserve the rights of either the investor or host government in order to ensure that the tribunal's jurisdiction "is made fully effective." This includes an order to preserve evidence in the possession or control of either the investor or government or to protect the tribunal's jurisdiction. A tribunal cannot, however, order attachment or enjoin the application of the measure alleged to constitute the breach for which the claim is being made.[97]

An arbitral tribunal appointed under these rules will hear the arbitration and may make a final award against the government for monetary damages and any applicable interest or costs in accordance with the arbitration rules.[98] Notably, a *NAFTA* government cannot be ordered to pay punitive damages nor can it be forced to remove or amend an offending measure. Such tribunals cannot issue damages awards against private parties or sub-federal entities.

NAFTA Chapter 11 tribunal decisions are subject to the *New York Convention*, which provides for the enforcement of an arbitral award in member states, including Canada. Canada, with the consent of the provinces, ratified the *New York Convention* in 1986 and implemented it through the enactment of the *United Nations Foreign Arbitral Awards Convention Act*.[99] It has also been implemented under legislation in a number of provinces.[100]

B. KEY JURISDICTIONAL AND PROCEDURAL CONSIDERATIONS

Once a foreign investor has come to the view that the host government's actions have been unfair, discriminatory, or expropriatory, it must consider several procedural and jurisdictional issues to determine whether the applicable investment treaty provides an effective means of addressing the offensive government measures. In some cases, these issues may be so significant as to prevent the bringing of a claim against the host government, while in other cases, properly addressing these issues can provide a strategic advantage in the dispute.

1. EXISTENCE OF AN INVESTOR AND INVESTMENT

In order to bring a claim under most investment agreements, the claimant must be considered an investor under the agreement. An "investor" is typically defined as a national or enterprise of one of the parties to the agreement that is making or has made an investment. Some investment agreements have a more narrow definition of investment than others. For example, Canada's FIPA with Barbados defines investment as "any kind of asset owned or controlled either directly, or indirectly through an investor of a third State, by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the

97 *NAFTA*, *ibid.*, art. 1134.

98 *Ibid.*, art. 1135.

99 R.S.C., 1985, c. 16 (2nd Supp.).

100 See *e.g.*, in Alberta, the *International Commercial Arbitration Act*, R.S.A. 2000, C. I-5, and in Ontario, the *International Commercial Arbitration Act*, R.S.O. 1990, c. I-9.

latter's laws."[101] The FIPA provides examples of what is included in the definition and specifically excludes real estate or other property that is not acquired in the expectation or used for the purpose of economic benefit or other business purposes. The *NAFTA*'s investment definition, on the other hand, appears to be less broad. It lists a number of interests considered to be investments for purposes of Chapter 11, but excludes a number of interests, including debt securities of and loans to an enterprise where the maturity is less than three years and certain claims to money.[102]

2. NATIONALITY OF THE INVESTOR

In order to bring a claim under an investment agreement, the investor must qualify as a national or an enterprise of a country that is party to the agreement other than the country the investor intends to sue. Generally speaking, in the case of an enterprise, this means the investor must be constituted or organized under the law of the other government. Under the *NAFTA*, it can also include a branch located in the territory of the *NAFTA* party that is carrying on business activities there.[103] Investment treaties may also deny standing to an investor that otherwise qualifies as a national depending on the nationality of those who own or control it. For example, *NAFTA* art. 1113 provides that a *NAFTA* country can deny the benefits of Chapter 11 to an enterprise of another party and to its investments if investors of a non-*NAFTA* party own or control the enterprise and the particular *NAFTA* government does not maintain diplomatic relations with that non-party or adopts or maintains measures with respect to that non-party that prohibit transactions with the enterprise.

There may also exist opportunities for an investor to change its nationality in order to rely upon the provisions of investment agreements between other countries. In one instance, Bechtel Corp., in order to claim for certain losses incurred in Bolivia by its consortium, shifted the consortium's registration from the Cayman Islands (which did not have a BIT with Bolivia) to the Netherlands and then filed the claim under the Netherlands-Bolivia BIT.[104]

3. SELECTION OF RULES OF ARBITRATION

The rules of arbitration can be an important strategic factor in the litigation of an investment dispute as they govern pleadings, the appointment of arbitrators, witnesses, the awarding of costs, rights to discovery, and interim measures, among other issues. As noted above, under *NAFTA* Chapter 11 and Canada's FIPAs, Canadian investors usually have a choice between the *UNCITRAL Arbitration Rules* and the *ICSID Additional Facility Rules*. Although the selection of the rules of arbitration is largely dependent on the specific facts and circumstances of each case, some Canadian investors have found that the *UNCITRAL*

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101 *Agreement Between the Government of Canada and the Government of Barbados for the Reciprocal Promotion and Protection of Investments*, Can. T.S. 1997/4 (entered into force 29 May 1996), art. I(f).

102 *NAFTA*, *supra* note 1, art. 1139.

103 *Ibid.*

104 For a discussion of the *Aguas del Tunari S.A. v. Republic of Bolivia*, I.C.S.I.D. No. ARB/02/3, case, see Geroge M. von Mehren, Claudia T. Salomon & Aspasia A. Paroutsas, "Navigating Through Investor-State Arbitrations – An Overview of Bilateral Investment Treaty Claims" (2004) 59:1 Disp. Resol. J. 69.

Arbitration Rules are preferable to the *ICSID Additional Facility Rules* in terms of expedited proceedings and a streamlined selection of arbitrators.

4. SEAT OF ARBITRATION

The place or seat of the arbitration may impact the procedural rules of the arbitration as well as the law governing subsequent challenge of any award that may be issued by the arbitral tribunal. Some arbitration rules provide that unless the parties to the dispute agree on the place of arbitration, this will be decided by the tribunal "having regard to the circumstances of the arbitration."[105] Some tribunals have considered the United States to be more desirable than Canada as a place of arbitration because of the position taken by the Canadian government in litigation regarding the standard of review to be employed by Canadian courts reviewing arbitral tribunal awards.[106]

5. TIMING

There are a number of limitation periods to keep in mind when filing a claim under an investment agreement. Under the *NAFTA* and many of Canada's FIPAs, claims cannot be filed more than three years after the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor incurred loss or damage arising from that breach.[107]

6. WAIVER OR RECOURSE TO LOCAL REMEDIES

Some investment agreements provide that an investor cannot bring a claim until it has exhausted its remedies in the local court system of the host government. For example, Canada's FIPA with Argentina requires prior recourse to local remedies for an 18-month period before a claim may be launched.[108] Such provisions are often contained in certain older BITs signed by Argentina or other Latin American countries, in accordance with the so-called Calvo Doctrine.[109]

Other investment treaties may contain what is referred to as a "fork in the road" provision, which requires that the investor choose between submitting its dispute to domestic proceedings or to international arbitration proceedings. The choice of one venue excludes recourse to the other. Certain agreements, such as the *NAFTA* and many of Canada's FIPAs,

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[105] *UNCITRAL Arbitration Rules*, *supra* note 96, art. 16. It should be noted that the place of arbitration is distinct from the geographical location of hearings. Different aspects of the arbitral tribunal's work may be carried out at locations other than the place of arbitration.

[106] *United Parcel Service of America v. Government of Canada*, Award on Place of Arbitration (17 October 2001) at paras. 8, 9.

[107] *NAFTA*, *supra* note 1, art. 1116(2). Article 1117(2) provides that "[a]n investor cannot make a claim on behalf of an enterprise ... if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage."

[108] *Supra* note 85, art. 10(1).

[109] The Calvo Doctrine was named after the Argentine legal scholar and diplomat Carlos Calvo and was intended to limit foreign interference in Latin American affairs. A "Calvo clause" was developed pursuant to the doctrine whereby foreign investors were required to submit any disputes to local courts. Other Argentine BITs require the complete exhaustion of local remedies.

require that before bringing a claim, the investor must waive its right to initiate or continue any proceedings with respect to the measure being challenged in any administrative tribunal or court or other dispute settlement procedure.[110]

7. GOVERNING LAW OF THE DISPUTE

Some investment agreements provide that the governing law of the investment dispute is to be the law of jurisdiction in which the investment was made. Others, such as the *NAFTA*, are more general and refer to the particular investment treaty and "applicable rules of international law."[111]

IV. AN INVESTMENT DISPUTE IN THE PETROLEUM SECTOR: *OCCIDENTAL V. ECUADOR*

The table at Appendix II sets out a brief description of recent cases in which investors in the oil and gas sector challenged government measures under mechanisms available in investment treaties.

One of the most recent oil and gas cases in which an award on the merits has been issued is *Occidental Exploration and Production Co. v. The Republic of Ecuador*.[112] The case is an excellent example of how investors in the oil and gas sector can exercise their rights under these agreements and challenge host governments that undertake measures that are harmful to foreign investment. In this case, damages in the amount of US$75 million were awarded to Occidental in respect of Ecuador's breaches of the BIT between the U.S. and Ecuador.[113]

A. BACKGROUND

In 1999, Occidental, a U.S. company, entered into a participation contract with Petroecuador, an Ecuadorian state-owned corporation, to undertake the exploration and production of oil in Ecuador. Up until 2001, Ecuador's tax authority, the Servicio de Rentas Internas (SRI), reimbursed value-added tax (VAT) paid by Occidental on its purchases required for oil exploration and production activities and the ultimate exportation of the oil. Beginning in 2001, however, SRI took the position that these reimbursements were already accounted for in the participation formula set out in the contract with Petroecuador whereby Occidental was allocated a portion of the volume of oil it discovered and exploited in Ecuador. SRI issued resolutions denying reimbursements of VAT, in response to which Occidental filed lawsuits in the tax courts of Ecuador on the basis that SRI's refusal to reimburse VAT was inconsistent with Ecuador's legislation governing VAT.

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110 *NAFTA*, *supra* note 1, art. 1121.

111 *NAFTA*, *ibid.*, art. 1131(1) provides that the arbitral tribunal must "decide the issues in dispute in accordance with this Agreement and applicable rules of international law."

112 *Occidental*, *supra* note 32.

113 *Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment*, 27 August 1993, U.S. Treaty Doc. 103-15 (entered into force 11 May 1997) [U.S.-Ecuador BIT].

In November 2002, Occidental commenced arbitration proceedings under the U.S.-Ecuador BIT in the London Court of Arbitration, claiming that Ecuador had violated its obligations to protect Occidental's investment. Occidental initiated its proceedings under the *UNCITRAL Arbitration Rules*. Occidental claimed four breaches of the BIT, including: failure to accord fair and equitable treatment and treatment no less favourable than that required by international law; failure to treat Occidental's investment on a basis no less favourable than that accorded to investments of Ecuador's own nationals or nationals of third countries; impairment by arbitrary and discriminatory measures of the management, operation, maintenance, use, and enjoyment of Occidental's investment; and expropriation without providing compensation and satisfying other requirements.[114]

B. JURISDICTIONAL OBJECTIONS

At the outset, as tends to be the situation in many of these cases, Ecuador made a number of jurisdictional objections in an effort to defeat the case in its early stages.

1. FORK IN THE ROAD

The most significant objection involved the "fork in the road" provision of the BIT, which requires investors to resolve their particular dispute with the courts of the host government, with any applicable previously agreed dispute settlement procedure, or under binding international arbitration pursuant to such rules as those of UNCITRAL. Under these provisions, recourse to one avenue precludes recourse to any other.[115] It was the Ecuadorian government's position that because Occidental was challenging SRI decisions in the Ecuadorian courts, it was precluded from challenging the measures at issue under the BIT. In dismissing this jurisdictional objection, the arbitral tribunal distinguished between the treaty-based issues it was considering in the case before it and the non-contractual domestic law questions that were being addressed by the local courts in Ecuador, namely, matters of interpretation of Ecuadorian tax law. In the tribunal's view, the investment dispute could therefore be distinguished from the matters before the Ecuadorian courts.

The tribunal also relied on the test of triple identity, noting that to the extent that the dispute might involve the same parties, object, and cause of action, it might be considered as the same dispute and the fork in the road mechanism would preclude its submission to concurrent tribunals. In the tribunal's view, however, the fundamental legal basis of the claim in this case was the investment treaty and to the extent that the nature of the dispute

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[114] *Occidental*, *supra* note 32.

[115] Article VI(2) of the U.S.-Ecuador BIT, *supra* note 113, provides as follows:

> In the event of an investment dispute, the parties to the dispute should initially seek a resolution through consultation and negotiation. If the dispute cannot be settled amicably, the national or company concerned may choose to submit the dispute, under one of the following alternatives, for resolution:
>
> (a) to the courts or administrative tribunals of the Party that is a party to the dispute; or
> (b) in accordance with any applicable, previously agreed dispute-settlement procedures; or
> (c) in accordance with the terms of paragraph 3 [settlement by binding arbitration before ICSID, the Additional Facility of ICSID, UNCITRAL, or another mutually agreed upon arbitration institute].

submitted to arbitration is principally, albeit not exclusively, treaty based, the jurisdiction of the tribunal was correctly invoked.

The tribunal further supported its finding by noting that the fork in the road mechanism contained in the BIT assumed that investors would make a choice between alternative avenues, a choice to be made entirely free from any form of duress. Ecuadorian law required Occidental to apply to courts within a brief period following the issuance of any resolution that could affect it and barring such application, the resolution would become final and binding. In the tribunal's view, the investor did not have a real choice between alternatives since, even if it took the matter instantly to arbitration, protection of its right to object to the decision would have been considered forfeited if it had not applied to the local courts within the short time frame required under Ecuadorian law.

The tribunal also found support for its rejection of Ecuador's arguments in the text of the BIT regarding arbitrary and discriminatory measures, challenges to which are allowed even where a claimant has previously resorted to local courts seeking review of such measures.[116]

2. TAXATION MEASURES

In the second of its jurisdictional objections, Ecuador argued that Occidental's claim involved a matter of taxation, which is excluded from dispute resolution under the Ecuador-U.S. BIT.[117] Ecuador argued that the issue of VAT reimbursements was clearly a matter of taxation subject to the exclusion. In particular, Ecuador pointed to the fact that Occidental's claims were in respect of obligations regarding no less favourable treatment, fair and equitable treatment, and arbitrary and discriminatory measures, none of which apply to taxation matters under the BIT. In response, Occidental argued that the BIT's tax exclusion only applied to direct taxation and not indirect taxation such as VAT.

Although the tribunal rejected Occidental's argument distinguishing the treatment of direct and indirect taxes under the BIT, they did find that certain taxation measures were covered by the obligations cited by Occidental in its claim. Regarding fair and equitable treatment, the tribunal noted the BIT's reference to "strive to accord fairness and equity"[118] with respect to tax policies and, despite its non-mandatory language, was of the view that this imposed an obligation on the host government that was not different from the independent obligation of fair and equitable treatment contained elsewhere in the BIT.

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116 *Ibid.*, art. II(3)(b).

117 *Ibid.*, art. X provides as follows:

1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investments of nationals and companies of the other Party.
2. Nevertheless, the provisions of this Treaty, and in particular Articles VI and VII, shall apply to matters of taxation only with respect to the following:
   (a) expropriation, pursuant to Article III;
   (b) transfers, pursuant to Article IV; or
   (c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VI(1)(a) or (b), to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.

118 *Ibid.*, art. X(1).

The main basis for its acceptance of jurisdiction over such taxation matters was the tribunal's interpretation of art. X(2)(c) of the BIT, which provides that the BIT applies to matters of taxation with respect to the "observance and enforcement of terms of an investment agreement or authorization" between the investor and the government. Although Occidental did not invoke any of its rights under its contract with Petroecuador in this proceeding, the tribunal still found that the dispute found its origins in that contract — specifically, the issue of whether the VAT reimbursement was included in the participation formula for allocations made under that contract. The tribunal made a very broad finding to the effect that the BIT dispute concerned the observance and enforcement of the contract, which in its view brought it squarely within the exceptions of art. X and, therefore, the jurisdiction of the tribunal.

3. ADMISSIBILITY OF EXPROPRIATION CLAIM

The tribunal also made an interesting and somewhat surprising preliminary finding regarding Occidental's claims of expropriation, which Ecuador had argued were inadmissible. Occidental had claimed that there was an expropriation of its investment as a result of Ecuador's refusal to refund VAT to which it was entitled under Ecuadorian law.

The tribunal determined that no expropriation had taken place in this case, addressing it as a question of admissibility and refusing to consider it on the merits of the case. The tribunal expressed doubt that a refund claim could be considered an investment despite that term's very broad definition contained in the BIT which includes tangible and intangible property, rights, a claim to money associated with an investment, and any rights conferred by law.[119]

In the tribunal's view, however broad the definition of investment might be under the BIT, "it would be quite extraordinary for a company to invest in a refund claim."[120] The tribunal found that Ecuador did not adopt measures that could be considered as amounting to direct or indirect expropriation since there was no deprivation of the use or reasonably expected economic benefit of the investment, let alone measures affecting a significant part of Occidental's investment. In the tribunal's view, there was no substantial deprivation even under the broadest definitions of expropriation in international law. Accordingly, the tribunal concluded that Occidental's claim concerning expropriation was inadmissible.

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119 *Ibid.*, art. I(1)(a) provides that:

"investment" means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes:

(i) tangible and intangible property, including rights, such as mortgages, liens and pledges;
(ii) a company or share of stock or other interests in a company or interests in the assets thereof;
(iii) a claim to money or a claim to performance having economic value, and associated with an investment;
(iv) intellectual property which includes ...; and
(v) any right conferred by law or contract, and any license and permits pursuant to law.

120 *Occidental*, *supra* note 32 at para. 86.

C. OCCIDENTAL'S SUBSTANTIVE CLAIMS

After reviewing the contract between Occidental and Petroecuador, the tribunal ruled that the participation formula did not take into account amounts for VAT refunds to be accorded to Occidental. The tribunal also found that Occidental had a right to such reimbursements under Ecuadorian law as well as under Andean community law. The tribunal, however, did not consider that there was an international law obligation to accord VAT refunds in these circumstances.

1. IMPAIRMENT BY ARBITRARY AND DISCRIMINATORY MEASURES

Regarding Occidental's first claim concerning impairment by means of arbitrary and discriminatory measures,[121] the tribunal found that the Ecuadorian tax authorities did not act with prejudice but out of confusion and with lack of clarity. In the tribunal's view, this was insufficient to establish that Ecuador had acted in an arbitrary or discriminatory manner so as to impair Occidental's use or enjoyment of its investment.

2. FAILURE TO ACCORD NATIONAL AND MFN TREATMENT

The tribunal did, however, find a violation of the national and MFN treatment provisions of the BIT.[122] Ecuador had argued that the phrase "in like situations" contained in the national treatment provision only allowed a comparison between the treatment accorded to Occidental and the treatment of other oil exporters. In this case, other oil exporters were also denied VAT reimbursements; therefore, on the basis of this comparison there could be no violation of this obligation. The tribunal disagreed and adopted a very broad definition of the phrase "in like situations" and noted that the comparison should not be made by evaluating only the sector in which the particular activity was undertaken. The tribunal compared the treatment with other businesses in non-oil economic sectors such as flowers, mining, and seafood products, and concluded that Occidental had been accorded less favourable treatment than domestic investors in like situations.

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[121] U.S.-Ecuador BIT, *supra* note 113, art. II(3)(b) provides as follows:

> Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purposes of dispute resolution under Articles VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a party has had or has exercised the opportunity to review such measures in the courts or administrative tribunals of a Party.

[122] *Ibid.*, art. II(1) provides as follows:

> Each Party shall permit and treat investment, and activities associated therewith, on a basis no less favorable than that accorded in like situations to investments or associated activities of its own nationals or companies, or of nationals or companies of any third country, whichever is the most favorable, subject to the right of each Party to make or maintain exceptions falling within one of the sectors or matters listed in the Protocol to this Treaty. Each Party agrees to notify the other Party before or on the date of entry into force of this Treaty of all such laws and regulations of which it is aware concerning the sectors or matters listed in the Protocol. Moreover, each Party agrees to notify the other of any future exception with respect to the sectors or matters listed in the Protocol, and to limit such exceptions to a minimum. Any future exception by either Party shall not apply to investment existing in that sector or matter at the time the exception becomes effective. The treatment accorded pursuant to any exceptions shall, unless specified otherwise in the Protocol, be not less favorable than that accorded in like situations to investments and associated activities of nationals or companies of any third country.

3. FAILURE TO ACCORD FAIR AND EQUITABLE TREATMENT

The tribunal also found that Ecuador had violated the fair and equitable treatment provisions of art. II(3)(a) of the BIT.[123] The tribunal found that Occidental was faced with a situation where "[t]he tax law was changed without providing any clarity about its meaning and extent and the practice and regulations were also inconsistent with such changes."[124] The tribunal referred to other cases in which the lack of orderly process and timely disposition was viewed as undermining the expectation of investors that they will be treated fairly and justly, and thereby violated the fair and equitable treatment obligation. The tribunal also noted that the fair and equitable treatment standard set out in the BIT was not different from that required under international law concerning both the stability and predictability of the legal and business framework of the investment.

Although the tribunal had concluded there was no specific obligation under international law to refund VAT, in its view, there was an obligation on the part of Ecuador not to alter the legal and business environment in which Occidental had made its investment. It was on this issue that Ecuador had fallen short in its fair and equitable treatment commitments.

D. AWARD TO OCCIDENTAL

In delivering its award, the tribunal ruled that the VAT amounts already refunded to Occidental were entitled to be retained by Occidental and any SRI resolutions requiring returns of those amounts were without legal effect. In terms of amounts of VAT for which Occidental requested refund and was denied, Occidental was awarded US$71,533,649. The tribunal also held that Occidental could not benefit from any additional recovery and had to cease and desist from its local court actions seeking refund of the VAT.

With respect to VAT that was not yet due or paid by Occidental, the tribunal noted that it would not order the payment of compensation or refund of these future amounts. It therefore rejected Occidental's claim for US$121 million in this regard. Including interest, the total amount awarded to Occidental was US$75 million. Costs of the arbitration were split 55 percent on the part of Ecuador and 45 percent on the part of Occidental, and each party was to bear its own legal expenses.

V. LEADING ISSUES FOR THE FUTURE OF INVESTMENT DISPUTES

There are a number of new and ongoing developments with respect to investment agreements that will be of particular interest to those investors active in the oil and gas industry that may be facing harmful action from host governments.

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[123] *Ibid.*, art. II(3)(a) provides as follows:

> Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law.

[124] *Occidental*, *supra* note 32 at para. 184.

A. MOST-FAVORED-NATION TREATMENT OBLIGATIONS

As discussed above, evolving jurisprudence in the area of MFN treatment is of particular importance to investment claims. In *Maffezini v. Spain*,[125] referred to in Part II above, an arbitral tribunal permitted an investor to rely upon certain favourable elements of the dispute settlement mechanism of another BIT to avoid recourse to domestic proceedings in Spain.

In 2004, in *Siemens AG v. Argentine Republic*,[126] an arbitral tribunal relied on the *Maffezini* decision and allowed the investor Siemens to avoid exhausting an 18-month period set out in the BIT for prior recourse to local courts. Together, both the *Siemens* and *Maffezini* decisions appeared to provide significant comfort to investors enabling them to take advantage of more favourable dispute settlement provisions contained in other investment treaties entered into by the host government. Two decisions since then, however, have introduced some uncertainty into the application of the MFN clause, and have given investors cause for concern.

In *Salini Construttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan*,[127] a dispute between an Italian investor and the Jordanian Valley Authority, the arbitral tribunal refused to apply the MFN clause contained in the Jordanian-Italian BIT to enable the claimants to benefit from more favourable dispute settlement provisions under Jordan's BITs with the U.S. and the U.K. The *Salini* tribunal was clearly concerned about the impact of the *Maffezini* decision, noting that "the precautions taken by authors of the award may in practice prove difficult to apply," resulting in treaty shopping.[128]

In February of 2005, another decision was released that also considered the incorporation of dispute settlement provisions from third party BITs — *Plama Consortium Ltd. v. Republic of Bulgaria*.[129] In this case, a Cypriot investor had filed a request for arbitration against Bulgaria, invoking the *Energy Charter Treaty*[130] and the MFN provision of the Bulgarian-Cypriot BIT in an attempt to import the ICSID arbitration provisions of other BITs entered into by Bulgaria. The tribunal rejected the investor's argument that Bulgaria also consented to ICSID arbitration of the dispute at issue by virtue of the MFN provision of the Bulgarian-Cypriot BIT.

The *Plama* tribunal ruled that in order to allow such an MFN claim, the intention to import the arbitration provisions of another investment treaty must be "clear and unambiguous." The tribunal was of the view that the Bulgarian-Cypriot BIT's MFN clause created doubt as to whether reference to the other documents (other investment treaties concluded by Bulgaria) clearly and unambiguously included a reference to the dispute settlement provisions contained in those BITs. The tribunal further noted, as did the *Maffezini* and *Salini* tribunals, that many U.K. BITs, including the U.K. Model BIT, expressly extend MFN treatment to dispute settlement. According to the tribunal, the MFN provision of the governing treaty

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[125] *Maffezini*, *supra* note 20.
[126] I.C.S.I.D. No. ARB/02/8, Decision on Jurisdiction (3 August 2004) [*Siemens*].
[127] *Salini*, *supra* note 71.
[128] *Ibid.* at para. 115.
[129] I.C.S.I.D. No. ARB/03/24, Decision on Jurisdiction (8 February 2005) [*Plama*].
[130] *Energy Charter Treaty*, 1995, WL 312823, 34 I.L.M. 382.

cannot incorporate by reference dispute settlement provisions from other BITs, "unless the MFN provision in the basic treaty leaves no doubt that the Contracting Parties intended to incorporate them."[131] This is the most demanding test articulated to date in this series of cases that have considered this issue.

One cannot help but conclude that irreconcilable differences remain between the reasoning in *Maffezini/Siemens* and *Salini/Plama*. In particular, a conclusion by the *Salini* tribunal that the BIT's MFN clause "does not apply insofar as dispute settlement clauses are concerned"[132] appears to foreclose the application of MFN principles to any aspect of dispute settlement procedures. The principle expressed in *Plama* that the MFN clause must be "clear and unambiguous" in its intention to import dispute settlement procedures from other BITs suggests that MFN treatment must be expressly extended to dispute settlement in the investment treaty at issue. Both results would appear to be inconsistent with the decisions in *Maffezini* and *Siemens*.

It will be interesting to observe how future cases deal with such MFN claims on the part of investors seeking the benefits of more favourable dispute settlement procedures in other investment treaties. More recent decisions, at least with respect to the exhaustion of an 18-month period for prior recourse in local courts before bringing a BIT claim, indicate that arbitral tribunals are leaning in favour of investors and applying a broad interpretation of the MFN clause.[133]

B. GOVERNMENTS' ATTEMPTS TO LIMIT THE IMPACT OF INVESTMENT AGREEMENTS

Host governments have been particularly aggressive in trying to limit the application of BITs, as is evidenced by the many jurisdictional challenges launched by host governments against investors when a claim is brought under these investment agreements. Oil and gas operators in foreign markets should also be aware that governments have been considering means of changing the protections contained in these agreements.

For example, as mentioned above, in 2001 the *NAFTA* governments released an interpretation of the fair and equitable treatment obligation in art. 1105 of the *NAFTA*.[134] This interpretation clearly attempted to limit the scope of the obligation to the standard of treatment that existed in respect of aliens under customary international law and foreclose the ability of investors to claim that violations of other trade agreement obligations or other actions could constitute a violation of this minimum standard of protection. Some

[131] *Plama*, *supra* note 129 at para. 223.

[132] *Salini*, *supra* note 71 at para. 119.

[133] See *Camuzzi*, *supra* note 71 and *Gas Natural SDG, S.A. v. Argentine Republic*, I.C.S.I.D. No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction (17 June 2005), in which arbitral tribunals, relying on the MFN clause, permitted the claimants to avail themselves of more favourable dispute settlement provisions in other BITs signed by Argentina. In both cases, the investors were not required to have recourse to Argentine courts for an 18-month waiting period prior to bringing their claim under the BIT.

[134] *Notes of Interpretation*, *supra* note 26.

commentators have questioned the impact of these interpretation notes and whether the Free Trade Commission exceeded its mandate in issuing this "interpretation."[135]

Another example can be found in the recently released model investment treaties of both Canada and the United States. The MFN clause under Canada's Model FIPA (2004) has been modified, apparently in response to the *Maffezini* decision discussed above. The MFN provision under Canada's Model FIPA now limits MFN treatment to "the establishment, acquisition, expansion, management, conduct, operation and sale or other disposition of investments in its territory"[136] and further provides that the MFN clause "shall not apply to treatment accorded under all bilateral and multilateral international agreements in force or signed prior to the date of entry into force of this Agreement."[137]

Furthermore, the emergence of BITs has not been without controversy, particularly regarding the obligation to provide compensation for expropriation or measures equivalent to expropriation. Arbitral tribunals continue to struggle in distinguishing legitimate regulatory measures from compensable expropriation. The new U.S. Model BIT (2004) and the Canadian Model FIPA, both of which seek to limit the scope of expropriation provisions as well as other elements of BITs, may give rise to additional uncertainties for investor-claimants seeking protection under these obligations.

C. CONTINUED EXPANSION OF INVESTMENT TREATIES

Despite the recent controversy and concerns associated with investment agreements, countries continue to negotiate them in increasing numbers. Failed attempts to negotiate a Multilateral Agreement on Investment at the OECD during the late 1990s have highlighted the difficulty of reaching these agreements among a large number of industrialized countries. Nonetheless, efforts continue to develop additional investment obligations under the auspices of the WTO, and in particular, in the current Doha Round of negotiations. The WTO's *General Agreement on Trade in Services*[138] already contains a number of obligations regarding the treatment of commercial presence (although there is little indication that an investor-state dispute mechanism will be included in any of these agreements in the near future).

Canadian initiatives on investment agreements with developing countries will be of particular interest to oil and gas producers. Recent reports indicate that Canada is now in the process of negotiating bilateral investment agreements with China, India, and Peru.[139] It appears that Canada intends to wrap up these negotiations before the end of 2006.

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[135] See *e.g.*, Brower, *supra* note 24.
[136] Canada's Model FIPA, *supra* note 62, art. 4(1).
[137] *Ibid.*, Annex III, s. 1.
[138] *Supra* note 3.
[139] Luke Eric Peterson, "Canada Negotiating BITs with China, India and Peru" *INVEST-SD: Investment Law and Policy Weekly News Bulletin* (18 November 2004).

VI. CONCLUSION

The increasing impact of investment and trade agreements on the day-to-day operations of Canadian and foreign businesses demands that organizations develop internal mechanisms to ensure that this information is taken into account in strategic decision-making processes.

Investment protection treaties should be viewed as a tool available to investors in the oil and gas sector that are faced with discriminatory, unfair, or expropriatory measures undertaken by host governments. As discussed above, these treaties present many emerging and unresolved issues. However, as decisions are issued on the growing number of claims submitted under these treaties, one expects that further clarity will be brought to the analysis. Foreign investors in the oil and gas sector facing adverse host government measures are strongly encouraged to consider their options under any available investment treaties.

APPENDIX I
CANADA'S FOREIGN INVESTMENT PROMOTION AND PROTECTION AGREEMENTS

Country	Date Signed
Poland	22 November 1990
USSR[140]	27 June 1991
Czech and Slovak Republic[141]	9 March 1992
Argentina	29 April 1993
Hungary	21 November 1993
Ukraine	24 July 1995
Latvia	27 July 1995
South Africa	27 November 1995 (not yet in force)
Trinidad and Tobago	8 July 1996
Philippines	13 November 1996
Barbados	17 January 1997
Romania	11 February 1997
Chile (Chapter G of the *Canada-Chile Free Trade Agreement*)	6 June 1997
Ecuador	6 June 1997
Egypt	3 November 1997
Venezuela	28 January 1998
Panama	13 February 1998
Thailand	24 September 1998
Armenia	29 March 1999
El Salvador	31 May 1999 (not yet in force)
Uruguay	2 June 1999
Lebanon	19 June 1999
Costa Rica	29 September 1999
Croatia	30 January 2001

140 Russia is now bound as the continuing State.

141 The FIPA currently binds both the Czech Republic and the Slovak Republic and is considered to be two agreements.

APPENDIX II
SELECTED OIL AND GAS INVESTMENT DISPUTES

Case	Date	Status	Subject Matter
AGIP S.p.A. v. People's Republic of the Congo, No. ARB/77/1	4 November 1977	Award rendered on 30 November 1979.	Oil products distribution venture: Congolese government violated agreement entered into with AGIP following nationalization of oil companies, in which it promised to favour AGIP.
Guadalupe Gas Products Corporation v. Nigeria, No. ARB/78/1	20 March 1978	Settlement recorded at parties' request in form of an award.	Production and marketing of liquefied natural gas.
Tesoro Petroleum Corporation v. Trinidad and Tobago, No. CONC/83/1	26 August 1983	Settlement agreed by parties and proceedings closed.	Oil exploitation and exploration: dispute arose out of a joint venture that the two sides established in 1968, each with a 50 percent interest, to develop and manage oil fields in Trinidad. Due to problems in the region, Tesoro wanted to sell its shares, and pursuant to their agreement offered them first to the Trinidad and Tobago government when they were unable to come to an agreement. Tesoro filed a request for conciliation with the ICSID Secretary-General.
Mobil Oil Corporation and other v. New Zealand, No. ARB/87/2	15 April 1987	Settlement agreed by parties and proceedings discontinued.	Synthetic fuels project: Mobil and New Zealand Government had entered into a participation agreement for the erection of a synthetic gasoline manufacturing plant; a new government introduced legislation designed to promote competition which did not take the most favoured purchaser clause into account.

Case	Date	Status	Subject Matter
Occidental of Pakistan, Inc. v. Islamic Republic of Pakistan, No. ARB/87/4	7 October 1987	Settlement agreed by parties and proceedings discontinued.	Petroleum concession.
Scimitar Exploration Limited v. Bangladesh and Bangladesh Oil, Gas and Mineral Corporation, No. ARB/92/2	3 November 1992	Award declining jurisdiction rendered 4 May 1994.	Oil exploration and development: request for arbitration was instituted by persons not competent to act for claimant.
Société Kufpec (Congo) Limited v. Republic of Congo, No. ARB/97/2	27 January 1997	Proceeding discontinued at request of claimant.	Petroleum exploration and exploitation agreement.
Mobil Argentina S.A. v. Argentine Republic, No. ARB/99/1	9 April 1999	Proceeding discontinued at request of claimant.	Petroleum exploration and production venture: involved a gross income tax assessment by the Province of Salta.
Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, No ARB/01/3	11 April 2001	Pending (decisions on jurisdiction rendered on 14 January 2004 and 2 August 2004).	Natural gas transportation company: concerns tax assessments allegedly imposed by Argentinean provinces contrary to the United States-Argentina BIT.
CMS Gas Transmission Company v. Argentine Republic, No. ARB/01/8	24 August 2001	Award rendered (complainant awarded US$132.2 million on 12 May 2005).	Gas transmission enterprise: concerned suspension by Argentina of a tariff adjustment formula for gas transportation contrary to the United States-Argentina BIT.
F-W Oil Interests, Inc. v. Republic of Trinidad & Tobago, No. ARB/01/14	29 November 2001	Pending (second round of post-hearing submissions filed 2 April 2004).	Oil and gas development contract: concerns bidding process for oil and gas development contracts.
LG&E Energy Corp., LG&E Capital Corp and LG&E International Inc. v. Argentine Republic, No. ARB/02/1	31 January 2002	Pending (decision on jurisdiction rendered on 30 April 2004).	Gas distribution enterprise: alleges Argentina unilaterally froze certain automatic semi-annual adjustments, based on changes to US PPI, to tariffs for the distribution of natural gas, contrary to the United States-Argentina BIT.

Case	Date	Status	Subject Matter
Occidental Exploration and Production Company v. Republic of Ecuador LCIAA, No. UN 3467	11 November 2002	Award rendered (complainant awarded US$75 million on 1 July 2004).	Oil exploration and production: involved resolutions denying OEPC reimbursements of VAT contrary to the United States-Ecuador BIT.
Sempra Energy International v. Argentine Republic, No. ARB/02/16	6 December 2002	Pending (decision on jurisdiction rendered 11 May 2005).	Gas supply and distribution enterprise: concerns shareholdings in two gas distribution firms based in Argentina that jointly supply natural gas to 45 percent of the Argentine market.
Camuzzi International S.A. v. Argentine Republic, No. ARB/03/2	27 February 2003	Pending (decision on jurisdiction rendered 11 May 2005).	Gas supply and distribution enterprise: concerns shareholdings in two gas distribution firms based in Argentina which jointly supply natural gas to 45 percent of the Argentine market.
EnCana Corporation v. Government of Ecuador LCIAA, No. UN3481	14 March 2003	On 3 February 2006, majority of tribunal issued a formal award dismissing investor's claims.	Oil production enterprise: claimant alleged that Ecuador's action in denying certain VAT relief to its subsidiaries breached the Canada-Ecuador FIPA.
Gas Natural SDG, S.A. v. Argentine Republic, No. ARB/03/10	29 May 2003	Pending (decision on jurisdiction rendered 17 June 2005).	Gas supply and distribution enterprise: arising from the same facts as the *LG&E* case, above.
Pioneer Natural Resources Company, Pioneer Natural Resources (Argentina) S.A. and Pioneer Natural Resources (Tierra del Fuego) S.A. v. Argentine Republic, No. ARB/03/12	5 June 2003	Pending (tribunal not yet constituted).	Hydrocarbon and electricity concessions dispute arising out of Argentine currency crisis.
Pan American Energy LLC and BP Argentina Exploration Company v. Argentine Republic, No. ARB/03/13	6 June 2003	Pending (hearing on jurisdiction held on 18 March 2005).	Hydrocarbon and electricity concessions dispute arising out of Argentine currency crisis.

Case	Date	Status	Subject Matter
El Paso Energy International Company v. Argentine Republic, No. ARB/03/15	12 June 2003	Pending (decision on jurisdiction rendered on 27 April 2006).	Hydrocarbon and electricity concessions dispute arising out of Argentine currency crisis.
Plama Consortium Limited v. Republic of Bulgaria, No. ARB/03/24	19 August 2003	Pending (decision on jurisdiction rendered 8 February 2005).	Oil refinery: claimant alleges Bulgaria created numerous problems and refused or unreasonably delayed the adoption of adequate corrective measures, violating the *Energy Charter Treaty*.
TG World Petroleum Limited v. Republic of Niger, I.C.S.I.D. No. CONC/03/1	8 December 2003	Pending (Tribunal not yet constituted).	Oil exploration concession.
Total S.A. v. Argentine Republic, No. ARB/04/1	22 January 2004	Pending (hearing on jurisdiction held 15 September 2005).	Gas production and distribution/power generation project.
BP America Production Company and others v. Argentine Republic, No. ARB/04/8	27 February 2004	Pending (respondent filed memorial on jurisdiction 20 September 2004).	Hydrocarbon concession and electricity generation project.
Wintershall Aktiengesellschaft v. Argentine Republic, No. ARB/04/14	15 July 2004	Pending (Tribunal not yet constituted; claimant filed memorial on the merits 10 March 2006).	Gas and oil production.
Mobil Exploration and Development Inc. Suc. Argentina and Mobil Argentina S.A. v. Argentine Republic, No. ARB/04/16	5 August 2004	Pending (Tribunal not yet constituted).	Gas production concessions.
Occidental Petroleum Corporation v. The Republic of Ecuador, no arbitration number assigned as of publication	17 May 2006	Request for arbitration filed by claimant.	Claimant seeking in excess of US$1 billion in damages arising out of Ecuador's annulment of participation contracts and operating agreements with state-owned oil company Petroecuador.

OIL AND GAS CLAIMS UNDER NAFTA CHAPTER 11

Case	Notice of Intent Date	Status	Subject Matter
Ethyl Corporation and Canada	10 September 1997	Parties settled the claim (ban on import repealed, CDN$19.3 million paid to cover Ethyl's expenses and lost profits).	Ethyl's subsidiary was the only importer of the gasoline additive MMT used in unleaded gasoline. The Canadian government banned the import and interprovincial trade of MMT, ostensibly for health reasons. Ethyl claimed that this breached Canada's obligations under Chapter 11 relating to national treatment, expropriation, and the prohibition of performance requirements. Ethyl claimed damages of US$201 million.
Methanex Corporation and the United States of America	2 July 1999	On 9 August 2005, tribunal released final award dismissing all claims and ordering Methanex to pay United States' legal fees and arbitral expenses in the amount of approx. US$4 million.	Methanex, a Canadian distributor of methanol, submitted a claim under the UNCITRAL Rules against the United States. Methanex is challenging an Executive Order by the Governor of the State of California which required the removal of MTBE, a gasoline additive, from gasoline by no later than the end of 2002 in the interests of protecting health and the environment. Methanex claimed breaches of obligations relating to expropriation, national treatment and minimum standard of treatment under international law. Methanex claimed damages of US$970 million.