International Journal of Multicultural and Multireligious Understanding

http://ijmmu.com
editor@ijmmu.com
ISSN 2364-5369
Volume 7, Issue 6
July, 2020
Pages: 209-216

The Difference of Interests between Host State and Investors Related to Fair and Equitable Treatment in Bilateral Investment Treaty

Ana De Carvalho Maria Soares[1]; Widya Rainnisa Karlina[2]

[1] Faculty of Social and Political Sciences, Airlangga University, Surabaya, Indonesia

[2] Faculty of Law, Airlangga University, Surabaya, Indonesia

http://dx.doi.org/10.18415/ijmmu.v7i6.1656

Abstract

The host state requires a source of funds in its national economic development which requires investors to increase their income to be able to run the national economy which results in people's welfare. However, before investing, the investors consider several factors related to investment, such as low labor costs, abundant natural resources, low production costs, large market share, the existence of supporting facilities, and a consumptive lifestyle. These things are then called the investment climate. On the other hand, developing countries frequently make it difficult for investors who will invest their capital in their countries, such as making it difficult to obtain permits, making changes in legislation due to regime change, changing the way of the government due to changing government structures, and so on. In the international investment, these kind of changes are called the Dynamic Inconsistency Problem (DIP). It then makes the investors feel insecure and not protected by the host state. When the national interests of the host state are confronted with the interests of investors regarding violations of the FET clause, there are many ways that can be done so that the two parties are not disadvantaged in the investment. One of the effective ways that can be done is determining limitations regarding the FET clause and the reasonable expectations of investors with the aim of keeping the investment climate stable.

Keywords: *Host State; Fair and Equitable Treatment; Bilateral Investment Treaty*

Introduction

Almost all countries in the world have adopted an open market economy in this era of economic neo-liberalism. This is because by implementing an open market system, the country will get many benefits that can be used as funds to carry out a country's economic and national development. The open market system adopted by the state can involve a variety of fields, including investment. At present, investment has spread throughout the world when large-scale multinational companies began to expand their company's expansion to other countries as an effort to increase opportunities and profits. Investors usually invest in developing countries since the developing countries generally require a lot of capital in carrying out their national development. In the international investment, the term for the country where investors make investments is called Host State.

The host state requires a source of funds in its national economic development which requires investors to increase their income to be able to run the national economy which results in people's welfare. Developing countries have the expectation that inviting foreign investors can increase the country's foreign exchange, provide plenty of jobs, develop industry and trade, and increase regional development and technology transfer. However, before investing, the investors consider several factors related to investment, such as low labor costs, abundant natural resources, low production costs, large market share, the existence of supporting facilities, and a consumptive lifestyle. These things are then called the investment climate (Margono, 2009).

On the other hand, developing countries frequently make it difficult for investors who will invest their capital in their countries, such as making it difficult to obtain permits, making changes in legislation due to regime change, changing the way of the government due to changing government structures, and so on. In the international investment, these kind of changes are called the Dynamic Inconsistency Problem (DIP). It then makes the investors feel insecure and not protected by the host state.

To improve the investment climate, there needs to be a bilateral agreement between the host state and the home state (the country of origin of investment) related to the investment, called the Bilateral Investment Treaty (BIT) (Margono, 2009). Bilateral agreements are formed to determine what may and may not be done for the investors or host states when they invest. In the development of the history of law and international relations, international agreements agreed between countries can be used as a legal basis for peaceful cooperation regardless of the system and constitution (Suryokusumo, 2008). The authority to form the BIT is an attribute of a sovereign state because the agreement is made in the framework of its sovereignty, by which the states create obligations that are binding on one another and each tries to limit its own actions and the actions of other countries as an embodiment of a sovereign state (Desilta, 2018).

BIT can be interpreted as a legally binding international agreement between two states or countries where each state promises each other to implement the standard of treatment contained in the agreement related to the investment made by each state. In the BIT, investor's rights become more secure and the investors are allowed to sue the host state in an international court if their rights are not fulfilled (Suryokusumo, 2008). The content of BIT generally consists of four things, including (Lambooy & Prihandoko, 2015).

1. Definition of investor and investment

2. Protection Provisions (general treatment)
   a. Fair and equitable treatment (FET Clause)
   b. Most Favored Nation (MFN Treatment)
   c. National Treatment

3. Absolut treatment provisions (specific)
   a. Expropriation + compensation
   b. (Free) export of profits

4. Dispute resolution provision
   a. Investor-State dispute resolution provision
   b. State-to-state dispute resolution provision

The main and real purpose of making BIT is to protect investors from uncertainty that occurs in the state where they are investing. However, it is undeniable that every sovereign state has the right to make various changes related to the law, the government system, or the institution. Besides to develop the state towards a better state, these reforms are also to protect national interests from foreign control in the investment sector. On the other hand, the investors have different expectations and desires from the host state, that when the investors make investments, their rights will always be guaranteed, the investment climate is always stable, and the host state has never made changes related to policies or ways of governance that can detrimental to its investment. The difference of interests between the host state and the investors is what then creates a dilemma when making investments both by the investor and the host state.

Considering that the main purpose of making BIT is to protect investors, the investors often use FET in the Content of BIT to protect the continuity of their investment. This is because the FET is considered as the most effective clause in dealing with DIP by the host state. This then raises a question about the treatment carried out by the state as a reason to protect its national interests whether it can be said to be injuring the fair and equitable treatment clause in a bilateral investment treaty, as well as how the state or investors should do in responding to uncertainty in the unavoidable investment climate. Thus, the authors tried to study this problem based on an analysis of the theory and several investment cases related to the fair and equitable treatment clause.

Fair and Equitable Treatment Clause in Bilateral Investment Treaty

The word 'fair' basically also refers to equity which means fair, impartial, reasonable and in accordance with regulations,[1] meaning that the word fair can be interpreted as a single, equal, fair, and balanced standard. Accordingly, fair is about the government's impartiality. Fair and equitable treatment fundamentally can be said as a general standard in treating foreigners (equality and justice) that exist in customary international law.[2] In terms of the discussion of this paper, the intended foreigners are foreign investors who make investments in the host state.

The FET clause was first used in the Draft Convention on Investment Aboard proposed by Herman Abs and Lord Shawcross in 1959. The FET clause began to be part of international law since 1948 as an effort to establish the International Trade Organization (ITO) contained in Article 11 paragraph (2) of Havana Charter. Although in the end the ITO failed to form, the FET clause was in fact still adopted in bilateral and multilateral investment agreements, for example in the OECD (Organization for Economic Cooperation and Development) which issued the Draft Convention on the Protection of Foreign Property. It includes FET in its first article which explains that FET is a general principle of international law and every country has an obligation to protect and respect the property of foreign nationals.[3] According to the draft, the FET is sourced from the standard treatment of foreigners contained in the international customary law. Based on the First Article of the Draft, the FET then began to be applied by OECD member countries in making bilateral agreements.

The first country to use the concept of the FET clause is the United States, which is the USA wants protection for its investors. America applies FET concept clauses in friendship, commerce, and navigation (FCN) agreements.[4] Until finally such bilateral agreement keeps developing and the FET clause is frequently used until now. However, the minimum standards referred to in the FET clause still have no definite and permanent definitions and limitations. Therefore, this situation is then exploited by investors and investors' legal counsel when they want compensation for DIP due to government actions.

In terms of BIT, the initial purpose of using the FET clause is to protect the investors from some unfair treatments, such as unilaterally canceling licenses, granting tax payments that have no basis, and

[1] Concise Oxford English Dictionary
[2] Organisation for Economic Cooperation and Developement (OECD), Draft Covention on the Protection of Foreign Property, 1960, page 5
[3] Ibid, page 7
[4] Ibid, page 8

granting other obstacles that could harm the investors in conducting their business. Therefore, the investors need some protections outside the other clauses, such as MFN and NT; and the chosen procedure is to include the FET clause. Considering that there are no fixed limitations and standards regarding FET, international arbitration will decide on its case based on its own interpretation which tends to use the notion of legitimate expectations owned by the investors. It will certainly harm the host state as a party sued. The concept of reasonable expectations by the investors principally has been recognized by its existence in the FET, but its application is still immature which can lead to various problems related to the interests of the host state. There are two problems that arise from the FET clause:[5]

1. There is a broad and unpredictable interpretation
   The FET clause in the BIT generally has a very brief and unclear explanation, so it tends to be interpreted broadly by arbitration since there is no further explanation. Since the main purpose of BIT is to protect investors and the reasonable expectations in the FET are as reinforcement of violations, it is often used as a reference by arbitrators in deciding cases.

2. There is no limit on the accountability of the host state
   Investors who file a lawsuit in an arbitration regarding the FET clause are certainly related to adverse government actions. The current practice of arbitration tends to show that almost all government actions are deemed to have violated the FET. This is because there is no minimum standard of government responsibility in what fields of action can be categorized as FET. The responsibility can relate to two principles of governance, namely the principle of good governance such as not taking arbitrary actions and how serious the violations committed have violated the FET.

The example of the FET clause in the BIT (Lambooy & Prihandoko, 2015):

1. Article 2.3 in the German BIT, which points out that the FET will be given according to standard and full protection, where the government will not violate or harm investors in an arbitrary manner and discrimination affecting management maintenance and income from the investment.

2. Article 4 of the French BIT clause, which states that the FET standard used is the standard used in the principles of treatment against foreigners.

3. The first paragraph in the Belgian BIT Clause, which states that protection of the FET clause will always be carried out except when it concerns on the public interest, where the investment will also receive continuous protection from arbitrary state acts and discrimination.

Based on the aforementioned examples of FET clauses in the BIT, it is clear that they do not provide exact and precise boundaries in the FET clause. In fact, these limitations are very important to determine what actions are categorized as violating the FET and what types of violations which require the state to be responsible for these actions. Thus, it is not surprising that many investors use the FET clause to hold the state accountable for its investment losses. The FET clause is also often known as '*sapu jagat'* clause since the investors can sue the host state if legitimate expectations are not fulfilled.

National Interests (Host State) and Investor's interests

Because the state is a dynamic organ, there must be a national interest that requires the host state to make inevitable changes to domestic rules. In addition, the Host state is also bound by international legal obligations to form regulations in the state based on international agreements, such as environmental

[5] UNCTAD III, page 9

protection, health, natural resources, and human rights. Therefore, these changes are inevitable not to be made. In the perspective of the host state, this action is an obligation to protect its citizens.

Making domestic regulations is a sovereign right of the host state that cannot be eliminated for the state has full sovereignty over its territory. However, on the other hand, the host state must consider its obligations regarding protection to investors to avoid violating the FET. Considering that there are no specific restrictions regarding FET arrangements, it is possible to be detrimental to the country, because:

1. The implementation of the FET clause can cause uncertainty in terms of its application and limitations

2. FET clause can lead to legal clauses whose application may exceed the limitations

3. The arbitrators' interpretation that is too broad tends to favor foreign investors based on their legitimate expectation.

These three things will later interfere with the interests of the state in implementing its sovereignty and obligations in carrying out the national interests. In fact, state sovereignty is a characteristic of a country. As stated in Opinion number 1 of the European Arbitration Commission in Yugoslavia, the state can be defined as a community or group consisting of populations and territories subject to sovereign political authority characterized by having the sovereignty.[6] Moreover, sovereignty is the highest power owned by a state to freely conduct activities in accordance with its national interests as long as it is not contrary to the international law (Mauna, 2005). Sovereignty covers three aspects, including: external, internal, and territorial (Mauna, 2005).

1. The external aspect of sovereignty is the right of each country to determine its relationship with other countries or groups without the authority, supervision, or pressure from other countries.

2. The internal aspect of sovereignty is the exclusive right or authority of a country to determine the form of its institutions, the way these institutions work, and the right to make the laws they want and the actions to comply with them.

3. The territorial aspect of sovereignty is the full and exclusive power that the state has over individuals and objects within the territory of that country.

Uncertainty and unclear rules in the BIT regarding the limitations of the FET clause will limit the regulatory space of the host state in regulating its internal problems, such as taxes, the environment, and the public interest. The difference of interests between countries and investors is then a problem in the investment sector. One of the examples is the ICSID arbitration that once handled a case between BIT Uruguay and Phillip Morris. Phillip Morris filed a claim of objection to the policies of the Uruguayan government and was considered to have violated the FET clause. It is because Uruguay issued a rule to require 80% of cigarette packets containing warnings of the dangers of smoking and increased cigarette factory taxes. From an investor perspective, this is certainly considered to be very detrimental because if 80% of cigarette packages contain warnings, it will be difficult to distinguish between cigarette brands from one another so that Phillip Morris feels disadvantaged.

Based on the differences of interests between the host state and investors in the interpretation of the FET clause, further action is needed to minimize international investment disputes between the two parties, such as (Islamy, 2016).

---

[6] Opinion No. 1, Arbitration Commission, Europian Community Conference on Yugoslavia, 92, 1991, 165, http://orjil.org.pdf, accessed on October 31, 2019, page 5.

1. Making agreements regarding the regulation related to the type of government action to be considered as a violation in the FET clause. Furthermore, criteria regarding how seriously host state actions have violated the FET clause also need to be set. Thus, there will be clear limitations on how much compensation which needs to be paid by the host state.

2. Making agreements related to adjustments regarding clauses in the BIT based on the host state development approach. In this case, the states of the parties in the BIT conduct negotiation and agreement and standard obligations of each based on different situations, conditions, and capabilities of the country. This implementation was carried out in accordance with the 2007 Common Investment Area investment agreement.

3. Another alternative to avoid disputes regarding the FET clause is not including the FET clause in the BIT. Thus, the state responsibility on an international scale can be reduced and future losses due to FET inclusion can be avoided. One of the examples is the Australia-Singapore BIT which does not include FET.

These alternatives really need to be put into considerations and implemented in making BIT. The absence of rules can lead to disputes related to host states with foreign investors. Following are some examples of cases between host state and investors regarding FET clause issues:

1. Tecmed vs. Mexico

Tecmed (Spain) sued the Mexican government for not granting a new permit for leasing land for waste management and ordered to close the facility, arguing that the waste contained in the land had exceeded the maximum limit. There were also hazardous biological and liquid wastes while Tecmed did not have a permit for the disposal of biological and hazardous waste. As a result, Tecmed argued that the Mexican government had violated BIT related to FET obligations. In its decision, the panel of judges argued that BIT required the parties to act consistently, transparently, and without ambiguity to foreign investors and their investments. The Arbitrator decided that the Mexican government had violated the FET because the licensing body did not provide clear information regarding the extension of the permit and had used environmental and health reasons to make the decision to revoke permits and facilities against Tecmed which was actually triggered by social and political issues.[7]

2. Continental Casualty vs. Argentina

Continental sued Argentina with the reason that stable legal conditions were a basic element of the FET and investors had reasonable expectations that the Argentina regime would not make changes to investment policies. However, Argentina at that time issued a number of policies and revolutions which according to Continental undermined the legal protection of Continental industries. On the other hand, this policy was taken by Argentina because at that time there was undergoing devaluation of the Argentine Peso, Continental then demanded that Argentina violate the FET clause. The international arbitration award stated that the situation experienced by Continental was very different from other claims against Argentina regarding the policies adopted during the financial crisis. The arbiter considered that Argentina's actions were aimed at the entire population of Argentina including investors without exception. Moreover, it turned out that Continental did not have a legal guarantee on the investment in Argentina because Continental's investment was entered before the guarantee agreement was made.

[7] Tecmed vs. Mexico, Paragraf 210, IISD II, ICSID Case No. ARB (AF)/00/2. http://iisd.org, accessed on October 29, 2019, page 140

3. Churchill Mining Plc vs. Indonesia

Churchill sued Indonesia for the revocation of the Ridlatama Group's Mining Business License (IUP). The alleged violations by Churchill were originated from the existence of a dynamic inconsistency problem with mining laws that differed between 2005 and 2009. There was initially a mining permit, then the permit was revoked and Churchill's investment was indirectly taken over. Churchill considered Indonesia to have violated the guarantee and protection standards that applied in the bilateral investment agreements regarding FET in the BIT of UK-Indonesia (Mangube, 2016). The tribunal arbitration award stated that Indonesia did not violate the FET because the revocation of IUP was carried out for obvious reasons and was in accordance with the provisions of the applicable laws and regulations in Indonesia. Furthermore, Churchill apparently had carried out various falsifications of the illegality of mining permit documents. In addition, the General Survey License and Exploration License, as well as other supporting documents issued by various government institutions, were fabricated using mechanical machines (autopen). The tribunal considered that the falsification of documents indicated violations of the law regarding the authenticity and licensing of documents and pointed out that investments that violated the law did not deserve protection in the international law.

Based on the explanation above, it is very necessary to arrange the FET limitations in the BIT. According to the tribunal arbitrators, there are several standards that can be carried out by the state when its national interests confront legitimate investor expectations, for example if there is a violation of reasonable expectations, the reason must be rational to be recognized by the tribunal arbitration. It must be in accordance with the situation in the host state at that time. To prove that the country has not violated the FET, the host state may ask the tribunal arbitrator to measure the stability and consistency of the recipient country in the investment that the change in the host state policy is in line with legal procedures and notifies the interested parties (investors) and has given permission to the investor to deliver it through due process. As in other cases, such as Parkerings (US) vs. Lithuania, the tribunal arbitrators stated that the investors should be able to know and accept that the law in a country will certainly change if it is not in accordance with the conditions of the people and the country (Lambooy & Prihandoko, 2015).

Conclusion

The initial purpose of the Bilateral Investment Treaty was to protect investments from violations of the investment rights. Fair and Equitable Treatment is a clause that is often used to protect the investors' rights. It is usually utilized by the investors to sue particular state to meet the reasonable expectations. However, in the FET clause, there are no specific restrictions on the limitations of state actions that can be categorized as violating the FET and what types of violations which require the state to be responsible for these actions. Therefore, it is not surprising that many investors use the FET clause to hold the state responsible for its investment losses. Without regulations, it will greatly limit the sovereignty of the state to make regulations in the country related to the national interests.

When the national interests of the host state are confronted with the interests of investors regarding violations of the FET clause, there are many ways that can be done so that the two parties are not disadvantaged in the investment. One of the effective ways that can be done is determining limitations regarding the FET clause and the reasonable expectations of investors with the aim of keeping the investment climate stable.

Reference

Books

Margono, S. (2009). *Hukum Investasi Asing Cetakan Pertama*. Jakarta: CV. Novindo Pustaka Mandiri.

Mauna, B. (2005). *Hukum Internasional:Pengertian Peranan dan Fungsi Dalam Era Dinamika Global*, Bandung: PT. Alumni.

Suryokusumo, S. (2008). *Hukum Perjanjian internasional Cetakan ke-1,* Jakarta:PT. Tatanusa.

Journals

Desilta, P.G. (2018). *Analisis Hukum Atas Konsep Investasi Yang Dilindungi Oleh Perjanjian Bilateral Investasi (Bilateral Investment Treaty). Studi Kasus: Perjanjian Bilateral Investasi Antara Inggris Indonesia 1976,* Thesis Journal of Legal Studies Program, University of Indonesia, West Java, www.lib.ui.ac.id/naskahringkas/2018-10-Desilta, accessed on October 29. 2019.

Islamy, F. N. (2016). *Relasi Fair and Equitable Treatment dalam Bilateral Investment Treaty dengan Kedaulatan Negara atas Sumber Daya Alam. Skripsi,* Program Sarjana Universitas Airlangga, Surabaya.

Islamy, F. N. (2016). *Relasi Klausula Fair and Equitable Treatment Dalam Bilateral Investment Treaty Dengan Kedaulatan Negara Atas Sumber Daya Alam* (Doctoral dissertation, Universitas Airlangga).

Lambooy, T., & Prihandoko, I. (2015). *International Investment Law,* Universiteit-Utrecht-Universitas Airlangga, Surabaya, Lecture material in the 6th Power Point Slide, taught on February 22, 2019.

Mangube, J. R. (2016). *Analisis Terhadap Prinsip Fair and Equitable Treatment Dalam Bilateral Investment Treaty (Studi Kasus Churchill Mining Plc Melawan Republik Indonesia)* (Doctoral dissertation, Universitas Pelita Harapan Surabaya-Faculty of Law-Department of Law).

Internet

Opinion No. 1, Arbitration Commission, Europian Community Conference on Yugoslavia, 92, 1991, 165, http://orjil.org.pdf, accessed on October 31, 2019.

Tecmed vs. Mexico, Paragraf 210, IISD II, ICSID Case No. ARB (AF)/00/2. http://iisd.org, accessed on October 29, 2019.

Other References

Organisation for Economic Cooperation and Developement (OECD), Draft Covention on the Protection of Foreign Property, 1960.