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Bilateral Investment Treaties

By Eamon Macdonald

|Preamble|

| This paper, “*Bilateral Investment Treaties: Liberal Tools Encouraging Greater Financial Direct Investment or Economic Nationalist Instruments?*” will examine the legal arguments on how best to regulate Foreign Direct Investment, especially exploring the ramifications of the widespread use of Bilateral Investment Treaties (BITs). |

In November 1959, the Federal Republic of Germany and Pakistan signed a ‘Treaty for the Promotion and Protection of Investments’ with the stated intention of establishing ‘favourable conditions for investments by nationals and companies of either State in the territory of the other State’.¹ Developed out of the Friendship, Commerce, and Navigation Treaties which had become commonplace in the 19th century, this seminal treaty between Pakistan and the Federal Republic of Germany came to be known as the world’s first Bilateral Investment Treaty (BIT). The concept of the BIT is simple. Designed to establish and uphold the terms and conditions of Foreign Direct Investment (FDI), BITs are supposed to ensure equitable and fair treatment of investors in a foreign country. One of the key ways in which BITs achieve this is through their distinctive use of international tribunals as dispute resolution mechanisms, which ensure that an investor does not have to sue a host company or state in its own courts. As such, BITs have always seemed to be fundamentally liberal documents which promote international trade with an emphasis on fairness for all parties. Proponents of BITs have even gone as far to argue that they ‘symbolise a commitment to economic liberalism’.²

Sixty years on from the inaugural BIT between Pakistan and Germany, BITs have become a cornerstone of global trade with around 3,300 currently in existence, concerning virtually every country in the world.³ In short, BITs are the primary source of international investment law to protect and promote

¹ Treaty for the Promotion and Protection of Investments (with Protocol and exchange of notes), Germany and Pakistan, 25 November 1959, 457 U.N.T.S. 24 (entered into force 28 November 1962).

² Kenneth J. Vandavelde, “The Political Economy of a Bilateral Investment Treaty” *The American Journal of International Law* 92, no. 4 (October 1996), 628

³ Julia Calvert, “Constructing Investor Rights? Why some states fail to terminate bilateral investment treaties” *Review of International Political Economy* 25, no. 1 (December 2017): 77.

cross-border investment flows.⁴ Despite their prominence in international trade, BITs are becoming an increasingly controversial tool. Recently, two major arguments have been used to cast aspersions on the value of BITs in today's global economy. Firstly, moral criticisms have been levelled against BITs from those concerned about the amount of power such treaties afford to wealthy investors and the ways in which such investors can manipulate BITs to take advantage of less economically developed nations. Further to this, political organisations have begun to question the legitimacy of the international tribunals which BITs employ as arbitrators of disputes. In 2020, these concerns prompted the European Union to terminate all existing intraEU BITs. For some critics, BITs are much more 'useful foreign policy tools'⁵ than treaties protecting capital invested overseas, and BITs have been seen as economic nationalist weapons. This essay seeks to explore the validity of the two central criticisms which have made the future of BITs seem so uncertain.

It will be suggested that an analysis of two key rulings on BITs, *Slovak Republic v Achmea* (2018) and *Phillip Morris v Uruguay* (2016), illuminates the failures and dangers of BITs. Ultimately, it will be argued that whilst not all of the thousands of BITs which constitute FDI are dangerous, BITs afford excessive protection to investors and sometimes facilitate the bullying of developing nations by developed nations or multinational conglomerates. Proponents of BITs argue that the treaties offer vital substantive and procedural guarantees for investors, encouraging FDI without which today's globalised economy would never have materialised. Signatories of BITs, for example, are obliged to ensure that foreign firms are treated in the same way as domestic firms in a process known as 'national treatment'. Moreover, BITs offer genuine protection against expropriation, and massively reduce the frustrating protectionist measures often imposed by nations on foreign firms operating in their jurisdiction. One prime example of this is that, under BITs, governments are unable to force firms to use local materials in their products, and perhaps most importantly under a BIT foreign firms are able to freely

⁴ Eric Neumayer, "Self Interest, Foreign Need, and Governance: Are Bilateral Investment Treaties Programs Similar to Aid Allocation" *Foreign Policy Analysis* 2, vol. 3 (July 2006): 251

⁵ Adam Chilton, "Reconsidering the Motivations of the US Bilateral Investment Treaty Program" *Proceedings of the Annual Meeting (American Society of International Law)* 108, no.1 (July 2014): 374.

move capital in and out of the country in which they are investing without any limits or caps.

Supporters suggest that BITs do not simply facilitate international trade and advance the liberal economic agenda in theory but point to the broader history of global economic growth as evidence of BITs practical and significant impact on world's economy.⁶ Although BITs can trace their early developments to the late 1950s, they were not utilised as a major tool of international trade until the 1990s. Indeed, from 1959 to 1969 a mere seventy-four BITs were signed (this is around eight a year), with approximately half of these being concluded by Germany.⁷ In the 1970s, there was a significant increase of nations signing initial BITs, with the UK, US, France, and Japan developing their inaugural BITs in the mid-70s. Between 1977 and 1986 153 BITs were agreed, doubling the rate witnessed a decade prior.⁸ It was only in the 1990s, however, that BITs began to become the commonplace and mainstream international trade agreement that they are today. In 1996 alone 196 BITs were negotiated, more than in the entire sum of the previous decade and much more than the eight per year concluded in the 1960s.⁹ The rise of BITs in the 1990s prompted contemporary commentators to acknowledge the treaties as 'one of the more remarkable developments of international law in the mid-1990s'. The 1990s not only witnessed the rise of the BIT, but also saw one of the most remarkable periods of economic growth in global history. Between 1991 and 2001 the US recorded its largest period of economic expansions ever, with 120 months of consecutive growth.¹⁰ Looking at the economy from a more global perspective, the 1990s saw the ratio of assets owned by foreign residents to world GDP rise from 48.6 per cent in 1990 and 92.0 per cent in 2000, which represents around 5 times the peak reached earlier in the century.¹¹ It is no coincidence that the sudden proliferation of the BIT occurred at the same time as extraordinary global economic growth and a dramatic increase in international investing. As

⁶ Sabine Selchow, "The Globalisation Discourse and the New World," in *Negotiations of the New World*, ed. Sabine Selchow (New York: Columbia University Press, 2017), 69–95

⁷ See Vandeveld, "The Political Economy of a Bilateral Investment Treaty", 630.

⁸ Ibid

⁹ Ibid

¹⁰ Nicholas Crafts, "*The World Economy in the 1990s: a Long Run Perspective*" (Working Paper 87/04, London School of Economics, 2004) 1.

¹¹ Ibid

the USSR and its satellite states collapsed and opened up their markets it was the BIT which enabled Western countries to trade with these formerly communist states: without the BIT's insistence upon the use of international tribunals to resolve trade disputes, for example, it is difficult to imagine the US trading on a large scale with the Russian Federation out of fear of its allegedly corrupt legal system. Ultimately, the BIT played an integral role in the rapid globalisation and growth of the 1990s and was heralded as the document which allowed liberal economic policies of free trade and globalisation to occur.

More recently, however, this notion of the BIT as an intrinsically liberal tool has come under fire from liberalism's fiercest defenders. The European Union is widely acknowledged as one of the world's most dedicated supporters of liberal economic policy¹², and yet in 2020 the EU took the radical step of banning intra-EU BITs.¹³ As previously mentioned, there are two mainstream arguments deployed by those who seek to see the decline of BITs. The first accusation is that Bilateral Investment Treaties frequently employ vague terms such as 'fair and equitable treatment', 'indirect expropriation', and 'umbrella clause', which are then exploited by wealthy investors to prevent less economically developed nations exercising regulatory control. This issue is exacerbated by BIT's insistence on using arbitral tribunals which are biased towards investors and which often adopt fairly expansive interpretations of the aforementioned vague terms. This, suggests Richard Chen, contributes 'to a jurisprudence skewed in favour of investors, as such arbitrators would naturally be more sympathetic to investor claims and have less appreciation for the regulatory needs of states'.¹⁴

The ability for wealthy investors to use BITs as vehicles through which to intimidate smaller nations was perhaps most shockingly exposed when Philip Morris International (PMI)– a globally renowned cigarette manufacturer – attempted to initiate litigation against Uruguay. In February 2010 the Uruguayan government introduced two new laws regulating the sale of tobacco

¹² Hubert Zimmerman, "Brexit and the External Trade Policy of the EU" *European Review of International Studies* 6, no. 1 (September 2019), 30.

¹³ Julien Berger, *International Investment Protection within Europe: The EU's Assertion of Control* (London: Routledge, 2020), 1.

¹⁴ Bruce Love, "Battle Royal Over EU's Bilateral Investment Treaties," *Financial Times*, September 13, 2019, 24.

due to public health concerns. First, the Uruguayan government banned the practice of selling one type of cigarette under multiple different packaging (a technique by cigarette companies designed to target a range of demographics), instead adopting the ‘Single Presentation Requirement’, whereby Article 3 of Ordinance NO.514, of the Constitution of the Republic, requires cigarette companies to sell only one unique presentation of each cigarette brand as of February 2009¹⁵ Second, by Presidential decree, Uruguay forced tobacco companies to display graphic health warnings covering 80% of cigarette packaging. The response to this legislation from the health authorities was overwhelmingly positive and the legislation was widely considered to be a good faith policy aimed at improving the life expectancy of Uruguayans. Philip Morris International, however, was badly affected by these policies, and were forced to withdraw 7 out of its 12 product brands from the Uruguayan market. Subsequently, PMI engaged the Uruguayan government in a six-year legal battle, beginning a long-drawn out suit before the World Bank’s International Centre for Settlement of Investment Disputes (ICSID), in a move which can be interpreted as more of an attempt to intimidate other countries than as a genuine attempt to win compensation for lost income: the Action on Smoking and Health (ASH), the oldest anti-tobacco organisation in the United States, said Philip Morris “had accomplished its primary goal... in launching the suit... six years and millions of dollars have been spent [by Uruguay] defending a non-discriminatory law that was intended purely to protect public health”.¹⁶ Philip Morris International was able to take advantage of the ambiguities of the Switzerland-Uruguay BIT to mount a legitimate legal challenge against the government of the Republic of Uruguay. The global tobacco group argued that the ‘Single Presentation Requirement’, and the 80% regulation, were violating the fair and equitable treatment clause of the Swiss-Uruguayan BIT. Philip Morris claimed the group ‘never questioned Uruguay’s authority to protect public health’¹⁷, but there was no evidence that they would lead to a decrease in ill-health caused by smoking. Without a legal consensus on the facts of the

¹⁵ DeAtley, Bianco,, Welding, Cohen, *Compliance with Uruguay’s single presentation requirement*.

¹⁶ Casaldi and Eposito, *Philip Morris loses tough-on-tobacco lawsuit in Uruguay*.

¹⁷ Mander, *Uruguay defeats Philip Morris test case lawsuit*.

policies, Philip Morris suggested the decision was essentially an arbitrary one and thus by logical extension an unfair one. Moreover, Philip Morris further argued that the 80% legislation did not leave sufficient space on a cigarette packet for the intended branding, PMI argued the Uruguayan government had essentially expropriated the firm's Intellectual property rights, specifically its trademark branding, thus violating the investment protection agreement between Uruguay and Switzerland, signed in 1991.¹⁸ Finally, the Switzerland-Uruguay BIT confirmed that each state should provide a stable regulatory environment in which firms are able to trade. Philip Morris argued that these arbitrary legislations implemented by Presidential decree were not in keeping with the stable regulatory environment clause.

After six years of legal battles, and over \$38 million cumulatively spent on legal fees by both parties, a single vote won the case for Uruguay. This does not, however, represent a victory for BITs. Philip Morris spent \$28 million dollars on legal fees but only sued for \$25 million worth of damages.¹⁹ Additionally, it is worth noting PMI's annual revenues exceed 80 billion dollars (USD) across 180 countries – far greater than the Constitutional Republic of Uruguay's 50 billion-dollar (USD) GDP.²⁰ Philip Morris never sought to use the case to genuinely seek compensation for the potential lost income caused by Uruguay's legislation as the case would have lost them millions of dollars either way. Instead, this case was used as a means of discouraging other, less wealthy nations from enacting anti-smoking legislation – for, despite its victory in the courts, the Uruguayan government was forced to pay millions of dollars in legal fees. Moreover, that this wasn't a unanimous decision from the arbitral tribunal: a dissenting opinion was expressed by an arbitrator, and that only a single vote won the case for Uruguay, both demonstrate the extent to which this was an exceptionally close call. It is extremely likely that PMI considered this ruling a significant victory in that it may well have deterred other small nations from enacting legislation.²¹

¹⁸ Tobacco Tactics: from the University of Bath, Latin America and Caribbean Region

¹⁹ Olivet and Villareal, *Who Really Won the Legal Battle Between Phillip Morris and Uruguay?*,

²⁰ Mander, *Uruguay defeats Philip Morris test case lawsuit.*

²¹ Olivet and Villareal, *Who Really Won the Legal Battle Between Philip Morris and Uruguay?*

The Philip Morris v Uruguay (2016) case makes the pitfalls of BITs abundantly clear. Philip Morris' case was only made possible through the ambiguous and abstract terms of a BIT. Beyond this, the case was initially considered in a court of law in Uruguay but quickly thrown out. Only because of BIT's insistence upon the use of tribunals (in which the claimant appoints one third of the arbitrators), which are often biased towards firms did this case become so closely fought. Even if Philip Morris did not win the case on a technical level it is interesting to note that as of 2020 no other Latin American country, and very few other developing nation states, have implemented progressive tobacco control policies to the degree as Uruguay, which surely represents a victory for PMI. Nonetheless, in 2017, Uruguay's President Tabaré Vázquez announced his government would introduce 'Plain Packaging' legislation – whereby all unique branding material (logos, colours, or promotional text) is removed save from text-name alone – joining only 6 other countries to do so – being Australia, the United Kingdom, Ireland, France, Norway, and Hungary.²²

The first major criticism of BITs explored in this essay has proved a solid foundation for further investigation. There is justification to suggest BITs can be weaponised by large firms to attack nation states' attempts to enact regulatory public policy. Crucially, it is not this flaw of BITs which has prompted the EU to take action against them, and which thus threatens their status as the major means of conducting international trade. Instead, the EU's concern with BITs is more political and revolves around the use of international tribunals as dispute resolution mechanisms. The EU's decision to terminate all intra-EU BITs was made following the European Court of Justice's decision on the Slovak Republic v Achmea case (2018).²³ In 2006 the Slovak government began the process of de-liberalising its health care market and in doing so prevented Dutch insurer Achmea – who had only invested in the Slovak Republic because of its liberalised healthcare market – from distributing the profits it made whilst providing healthcare insurance in Slovakia. Following this, Achmea began proceedings against the Slovak

²² Tobacco Tactics: from the University of Bath, *Philip Morris vs the Government of Uruguay*

²³ International Institute for Sustainable Development (IISD), *EU Member States Sign Agreement to Terminate Intra-EU BITs*

Republic, arguing that the state had violated article 4 of the Dutch-Slovak BIT which allows firms the right to the ‘free transfer of profit and dividends’.

Originally, an international tribunal agreed with the Dutch Insurer that the Slovak Republic had violated its BIT and ordered the state to pay €22.1 million in compensation.²⁴ The Slovak Republic, however, appealed the decision, not by disagreeing with the final judgement, but by challenging the tribunal’s very power to make such a judgement, suggesting that the use of an external international arbitration tribunal to decide legal matters between two EU member states represented a breach of EU law. The European Court of Justice’s judgement ‘addressed three key features of the arbitration clause in the BIT that made it incompatible with the European Union’s judicial system and the autonomy of EU law’: ‘disputes an arbitration tribunal may be called to resolve “are liable to relate to the interpretation or application of EU law (para.39.)”’; investment tribunals were not internationally independent alternatives to domestic judiciary systems, but part of them (though not, however, part of the judicial system of the Netherlands or Slovakia); and finally, awards issued by investment tribunals must be addressed ‘by means of a reference for a preliminary ruling’, subject to review by an EU member state court.²⁵ From the perspective of the EU – and the European Court of Justice – BITs are means through which member states can create deals which the EU cannot rule on, primarily due to the incorporation of arbitration clauses in BIT agreements which necessitate cases be heard, per the New York Convention, 1958. The ‘Preliminary Reference System’ is thus the solution whereby the ECJ operates to preserve the integrity of the application of EU law to cases – in member-state judiciaries – where International Investment Law takes precedent over EU law. In the case of the Case C-284/16 *Achmea/Dutch-Slovak BIT*, the ECJ could not – at the time – invalidate the proceedings, however they could stem the enforcement of awards produced from the tribunal at the ICSID. . The European Court of Justice ruled in favour of the Slovak Republic. In doing so, the EU essentially declared the intra-EU BIT null

²⁴ Ankersmit, *Achmea: The Beginning of the End for ISDS in and with Europe?*

²⁵ Ibid

and void, a decision reflected to a greater scale months later when 22 member-states agreed to the termination of all 196 intra-EU BITs.

The EU's position on Intra-EU BITs demonstrates the seriousness of the threat they believe BITs pose to judicial superiority over its member states. Indeed, a BIT may appear to promote liberal economic policy, but until they are regulated by well-established courts, rather than inconsistent and unpredictable international tribunals, states may see them as easier to break than other forms of trade agreement. It is important to note that BITs are often disputed: by 2015, 3,300 BITs had been signed, and 696 disputes surrounding BITs had been brought to tribunals (roughly 20% of all BITs are disputed).²⁶ BITs were developed in the wake of decolonisation and were designed to protect developed nations' investment in countries who had demonstrated economic nationalist tendencies, especially in terms of expropriation following independence. It is therefore ironic that the very same states (consider Germany's role in the EU and in the founding of BITs) have begun to be concerned that BITs are themselves furthering economic nationalist interests. BITs are not themselves inherently nationalist instruments, however; rather, they are open-ended agreements which can be easily interpreted and utilised by economic nationalists. As such, it is true that BITs played a powerful role in liberalising the global economy in the 1990s. This was mainly driven by the liberalising instincts of the political powers of that era. Now, a resurgence of economic nationalism has led to BITs being used for economic nationalist purposes. BITs are neither economic nationalist instruments nor vehicles through which liberal economic policies can be achieved, but poorly regulated, open-ended treaties through which economic actors of all persuasions hope to achieve their end goals.

²⁶ Raphael Lencucha, "Is It Time to Say Farewell to the ISDS System" in *International Journal of Health Policy Management* 6, no. 5 (May 2017): 290.

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