Defendant: Wenhua Shan: 1st: 19 March 2014

IN THE HIGH COURT OF THE REPUBLIC OF SINGAPORE

Originating Summons No. 24 of 2014
Summons No. 884 of 2014

In the Matter of Section 10 of the International Arbitration Act (Cap. 143A)

And

In the Matter of Order 69A of the Rules of Court (Cap. 322, R 5, 2006 Rev Ed)

Between

THE GOVERNMENT OF THE LAO PEOPLE'S DEMOCRATIC REPUBLIC
(No ID exists)

... Plaintiff

And

SANUM INVESTMENTS LIMITED
(ID No. not known)

... Defendant

AFFIDAVIT OF WENHUA SHAN

I, Wenhua Shan of 28 Xianning West Road, Xi'an 710049, Shaanxi Province, People's Republic of China, do solemnly and sincerely make oath / affirm and say as follows:

1. I am the founding Dean and University Chair Professor of International Law at Xi'an Jiaotong University, People's Republic of China ("**PRC**"), and a Senior Fellow of the Lauterpacht Centre for International Law at the

University of Cambridge. I am a "State Specially Recruited Expert", which is "the highest title of honour established by the PRC for the high level experts introduced from overseas". I am also a "Yangtze River Chair Professor", "State Council Special Allowance Expert", Arbitrator of China International Economic and Trade Arbitration Commission (CIETAC), and Legal Advisor of the People's Government of Shaanxi Province.

2. I have been lecturing in and teaching international law since 1996, with a particular focus on international investment, trade and arbitration law. At the same time, I have been practising Chinese and international law since 1994 when I became a fully licensed Attorney-at-Law in the PRC. I am now practising as a Senior Counsel at Beijing Kangda Law Firm (Xi'an Branch). Copies of my *curriculum vitae* and practising certificate are exhibited at Annex 1 and Annex 2 to "**WS-1**", respectively.

3. I have been engaged by the Defendant to prepare an expert report for the purpose of these proceedings. A copy of my report is now shown to me and exhibited as "**WS-1**" ("**Report**").

4. I confirm that I prepared the Report exhibited as "**WS-1**" in my personal capacity as a specialist in the field and I accept full responsibility for the Report. For the reasons explained in the Report, I believe that my opinions

stated therein are correct.

5. I have read and understood the duties of an expert witness set out in Order 40A of the Rules of Court, Singapore. I understand that it is my duty to assist the Court on matters within my expertise, and that this duty overrides any obligation to the person from whom I have received instructions or by whom I am paid. I understand that in giving this Report, my duty is to the Court and I confirm that I have complied with this duty.

AFFIRMED / SWORN by the above named)
Wenhua Shan)
this 18th day of March 2014)
in Abingdon, Oxfordshire, England)

Before me,

Notary Public London, England
(Christopher G. Higgins)

NOTARY PUBLIC

This affidavit is filed on behalf of the Defendant.

SAVILLE & CO

SCRIVENER NOTARIES

One Carey Lane
London EC2V 8AE
Tel: +44 (0)20 7920 0000
Fax: +44 (0)20 7920 0088
www.savillenotaries.com
mail@savillenotaries.com

Richard Saville
Sophie Milburn
Nicholas Thompson
Robert Kerss
Andrew MacNab
Christopher Higgins
(General Notary)

Eleonora Ceolin
(General Notary)

TO ALL TO WHOM THESE PRESENTS SHALL COME, I CHRISTOPHER GERARD HIGGINS of the City of London NOTARY PUBLIC by royal authority duly admitted and sworn and authorised to practise throughout England and Wales DO HEREBY CERTIFY that on the day of the date hereof in Abingdon, Oxfordshire, England before me personally came and appeared **WENHUA SHAN**, holder of Chinese passport number G16647455 and whose personal identity I attest, the deponent named and described in the foregoing **affidavit**, WHO in my presence by solemn affirmation by him taken in due form of law did solemnly and sincerely affirm and depose to the truth of the several matters and things mentioned and contained in the said affidavit.

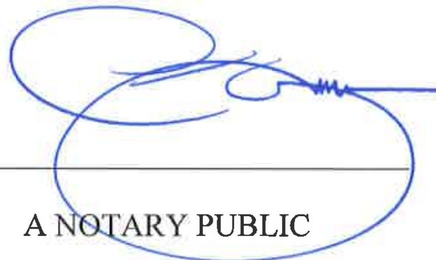
IN WITNESS WHEREOF I have hereunto set my hand and seal of office at London, England this eighteenth day of March two thousand and fourteen.

THIS IS THE EXHIBIT MARKED "**WS-1**"

REFERRED TO IN THE AFFIDAVIT OF WENHUA SHAN

AFFIRMED THIS 18th DAY OF MARCH 2014

BEFORE ME



A NOTARY PUBLIC

Notary Public London, England
(Christopher G. Higgins)

EXPERT REPORT OF PROFESSOR WENHUA SHAN

I. INTRODUCTION

1. I, Wenhua Shan, am the founding Dean and University Chair Professor of International Law at the Law School of Xi'an Jiaotong University, People's Republic of China ("**PRC**"), and a Senior Fellow of the Lauterpacht Centre for International Law ("**LCIL**") at the University of Cambridge. I am a "State Specially Recruited Expert", which is "the highest title of honour established by the PRC for the high level experts introduced from overseas", and the "Yangtze River Chair Professor", which is regarded as "the highest academic honour given by the People's Republic of China" in the legal field.

2. I am a "State Council Special Allowance Expert" awarded by the PRC Government, an arbitrator of the China International Economic and Trade Arbitration Commission ("**CIETAC**"), and Legal Advisor to the People's Government of Shaanxi Province.

3. As described in further detail below, I have been teaching international law since 1996, with a particular focus on international investment, trade and arbitration law. At the same time, I have been practising Chinese and international law since 1994 when I became a fully licensed Attorney-at-Law in the PRC. I am now practising as a Senior Counsel of Beijing Kangda Law Firm (Xi'an Branch). Copies of my detailed curriculum vitae

and practising certificate are annexed hereto as "**Annex 1**" and "**Annex 2**", respectively.

4. I have been approached by the Defendant to act as an expert witness to provide my opinion on certain issues of PRC and international law arising out of Originating Summons 24 of 2014 ("**OS 24**").

5. For the reasons stated herein, I have specific expertise in the issues on which I was asked to opine, and I believe that my opinion is correct.

6. I have read Order 40A of the Rules of Court, Singapore. I understand that it is my duty to assist this Honourable Court on matters within my expertise, and that this duty overrides any obligation to the person from whom I have received instructions or by whom I am paid. I understand that, in giving this report, my duty is to the Honourable Court and I confirm that I have complied with that duty.

II. PROFESSIONAL EXPERIENCE AND QUALIFICATIONS

7. I received my first law degree in 1991 from Zhongshan (Sun Yet-Sen) University. I then received a Masters of Economics from Jinan University in 1994, and a Ph.D. in Law from Xiamen University in 1996. In 2004, I received my second Ph.D. from Trinity College, University of Cambridge.

8. After I completed my first Ph.D. at Xiamen, I started to teach as a Lecturer and then Associate Professor of Law at Xiamen University School of Law. During 1998 and 1999, I was a Visiting Fellow at LCIL at the University of Cambridge, before I embarked on a second Ph.D. at Cambridge in September 1999.

9. I taught at Oxford Brookes University in England, as a Lecturer, Senior Lecturer, Reader and Professor of International Law from 2002 till 2013, when I took up a Senior Fellowship from the LCIL. From 2005 till 2008, I worked at Xi'an Jiaotong University, on secondment from Oxford Brookes, as the Dean of the College of Humanities and Social Sciences and the University Tengfei Chair Professor of International Law. In 2008, I started to work on a full time basis as the founding Dean of the School of Law at Xi'an Jiaotong University. Meanwhile I retained my job in England on a part time basis.

10. I have been practising Chinese and international law since 1994 when I received a full licence as a PRC attorney. Over the years I have practiced at law firms based in Guangzhou, Xiamen and Shanghai, and I am now practising at Beijing Kangda Law Firm (Xi'an Branch) as a Senior Counsel. I am an appointed arbitrator at CIETAC and the South China International Economic and Trade Arbitration Commission

(SCIA)/Shenzhen Court of International Arbitration, among others. I am also Legal Advisor to the People's Government of Shaanxi Province.

11. I have published more than ten books in international and comparative law by English and PRC publishers, and numerous articles in journals such the European Journal of International Law and the American Journal of Comparative Law. I am the founding Editor-in-Chief of The Chinese Journal of Comparative Law published by the Oxford University Press and Editor-in-General of the "China and International Economic Law Series" and "Silk Road Series on International and Comparative Law".

12. Many of my books and articles concern the PRC and its bilateral investment treaty regime, including "Chinese Investment Treaties: Policy and Practice (OUP 2009)", which I co-authored with Professor Norah Gallagher, formerly Director of the Investment Treaty Forum at the British Institute for International and Comparative Law. I have also given testimony on the EU-China investment treaty before the European Parliament and taught at the UNCTAD-APEC Regional Training Course on Core Elements of International Investment Agreements in the APEC Region.

13. As a "State Specially Recruited Expert" and "State Council Special Allowance Expert", I have led a team of experts to advise and support the

PRC Government on certain key investment treaty negotiations, and have personally participated in some of the negotiations. More generally, I have advised foreign governments, international organizations, and transnational corporations on international investment, trade, arbitration and other legal matters. I should emphasize, however, that I submit this expert report in my personal capacity as an expert in PRC and international law, independent from the PRC or foreign governments to which I have provided professional services.

III. FACTS AND ISSUES

14. I understand that the present proceedings arise out of an investor-state dispute between the Government of the Lao People's Democratic Republic ("**Laos**") and Sanum Investments Limited ("**Sanum**"), an entity incorporated in Macau Special Administrative Region ("**Macau SAR**"). This dispute has been referred to arbitration in PCA Case No. 2013-13 (the "**PCA Arbitration**") and an award on jurisdiction was issued on 13 December 2013 ("**Award**" attached as "**Annex 3**"). In the Award, the international tribunal ruled that it had jurisdiction to arbitrate Sanum's expropriation claims under Article 8(3) of the Agreement between the Government of the People's Republic of China and the Government of the Lao People's Democratic Republic Concerning the Encouragement and Reciprocal Protection of Investments dated 31 January 1993 ("**PRC-Laos BIT**"). The tribunal also ruled that the PRC-Laos BIT extends to Macau

SAR such that the tribunal has jurisdiction over Macau investors such as Sanum under the PRC-Laos BIT.

15. I further understand that Laos now appeals against part of the Award, arguing that the tribunal erred in ruling that it has jurisdiction over Sanum's expropriation claims. Laos also takes the position that the PRC-Laos BIT does not extend to Macau SAR. Sanum, on the other hand, takes the position that the international tribunal was correct and that the PRC-Laos BIT applies to Macau SAR and the tribunal has jurisdiction over Sanum's claims.

16. I understand that after the tribunal issued its Award rejecting Laos's jurisdictional objections, Laos claimed that it wrote a letter to the Embassy of the PRC based in Vientiane, Laos (the "**PRC Embassy**"). In the present appeal, I understand that Laos seeks to admit this correspondence allegedly between the PRC Embassy and Laos, namely:

    a) A letter in English allegedly from the Ministry of Foreign Affairs of Laos to the PRC Embassy dated 7 January 2014 ("**Laos Request**" attached as "**Annex 4**"); and

    b) A letter in Chinese allegedly from the PRC Embassy to the Ministry of Foreign Affairs of Laos dated 9 January 2014 ("**Embassy Letter**" attached as "**Annex 5**")

    (collectively, "**the Embassy-Laos Correspondence**").

17. I have been asked to provide my opinion on the following issues:

    a) Whether the Embassy Letter represents a formal decision or an authoritative interpretation of the PRC Government on the question of whether the PRC-Laos BIT applies to Macau SAR under PRC domestic law; and

    b) Whether the Embassy Letter is relevant to the question of the interpretation of the PRC-Laos BIT under international law

    (collectively, the "**Issues**").

IV. DOCUMENTS REVIEWED

18. For the purposes of preparing my report, I have reviewed the following documents:

    a) The Embassy-Laos Correspondence;

    b) The Award;

    c) OS 24;

    d) Summons No. 884 of 2014;

    e) 1st Affidavit of Chin-Puar Yow Hoy; and

    f) 3rd Affidavit of Outakeo Keodouangsinh.

19. I have also reviewed the relevant legal authorities cited for the purposes of preparing my report.

V. SUMMARY OF CONCLUSIONS

20. The Embassy Letter represents neither a formal decision nor an authoritative interpretation of the Central People's Government ("**CPG**") on the territorial scope of the PRC-Laos BIT and thus has no legally binding force under PRC domestic law. The discussion of domestic law in the Embassy Letter bears no legal effect on the interpretation of the territorial scope of the PRC-Laos BIT, and the Embassy Letter should not be given retroactive effect under international law.

VI. OPINION

21. Set out below is my detailed opinion on the Issues. I shall deal first with the PRC domestic law issue, then the issue under international law.

A. The Embassy Letter Represents Neither a Formal Decision nor an Authoritative Interpretation Taken by the PRC Government as a Matter of PRC Domestic Law

1. The Embassy Letter Does Not Constitute a Formal Decision of the PRC Government Regarding the Question of Whether the PRC-Laos BIT Applies to Macau SAR under PRC Domestic Law

22. It is possible for the CPG to make a decision on whether or not a particular international agreement concluded by the PRC applies to Macau SAR, on the basis of paragraph 1 of Article 138 of the Macau Basic Law (attached as "**Annex 6**"), which stipulates that:

> The Central People's Government may, in accordance with the circumstance and needs of the MCSAR, and after consultation with the government of the MCSAR, decide on whether or not an

international agreement(s) entered into by the People's Republic of China applies to the MCSAR.[1]

23. However, the Embassy Letter may not be considered as representing a formal decision taken by the CPG under this paragraph, for the following three reasons.

24. *First*, the Embassy Letter does not indicate that a formal decision has been made by the CPG and that the letter is based on such a decision. Rather, it bases its reply on an interpretation of relevant provisions of the Basic Law of Macau SAR. Specifically, the Embassy Letter states, in relevant part, that:

> *According to the Basic Law of the Macao Special Administrative Region (Macau SAR),* subject to specific authorization by the Central People's Government, the government of the Macau SAR may by itself enter into and fulfil investment agreements with foreign and regional entities; bilateral investment agreements entered into by the Central People's Government are in principle not applicable to the MCSAR save where otherwise arranged after consultation with the government of the MCSAR and negotiations with the parties to the agreement.[2]

25. Had there been a formal decision made by the CPG, it would have been more straightforward to have referred to such a decision as the legal basis of the Embassy Letter.

[1] Aomen Jiben Fa (澳門基本法) [Basic Law of the Macao Special Administrative Region of the People's Republic of China], adopted by the Eighth National People's Congress at its First Session, art. 138(1) (31 March 1993) ("**Annex 6**").
[2] Embassy Letter ("**Annex 5**").

26. *Second*, the making of such a decision by the CPG is dependent on the fulfilment of a procedural condition, that is, "after consultation with the government of the MCSAR", which does not seem to have been met.[3] A careful reading of the paragraph in the original Chinese version reveals that such a procedural condition has to be met in both cases of the CPG deciding "whether or not" (*shì fǒu*) a particular treaty applies to Macau SAR. In other words, for the CPG to effectively make such a decision, whether it is *for or against* the application of a particular treaty to Macau SAR, it has to consult the SAR Government.

27. As noted by the tribunal when citing a statement made by the Respondent[4], no such consultation between the CPG and the SAR Government had actually taken place. Also, it is noted that, the Embassy Letter is dated just two days after Laos's Request was submitted in English. It is therefore highly unlikely that such consultation had actually taken place before the Embassy Letter was issued.

28. *Third*, had a formal decision been taken by the CPG on this matter, it would be expected that the decision should be made public in good time, given the significance of the decision. The significance lies in the fact that such a decision would impact on not only the interests of international

[3] Macau Basic Law, *supra* n. 1, art. 138 ("**Annex 6**").
[4] Award, ¶ 260 ("**Annex 3**").

investors in Macau SAR, but also those in Hong Kong, which itself is the world's third largest capital importer and fourth largest exporter.[5]

29. Indeed, such publication is required under Article 9 of the 2007 Provisions of the People's Republic of China on the Disclosure of Government Information (the "**Provisions**"),[6] which requires administrative organs to disclose on their own initiative government information that involves "immediate interests of citizens, legal persons or other organizations".[7] For international investors in the PRC SARs, whether or not they can benefit from the protection and promotion of the PRC BIT network, which is the second largest such network in the world, should be considered a matter of "immediate interests".

30. Consequently, if any decision on such matters had been made by the executive branch of the CPG in or before early January of this year, one would expect it to have already been made public in accordance with the Regulations.[8] However, so far there has been no evidence or indication that such a decision has been publicised.

---

[5] UNCTAD, WORLD INVESTMENT REPORT 2013, at xiv-xv (figures 2 and 3) ("**Annex 7"**).

[6]Zhonghua Renmin Gongheguo Zhengfu Xinxi Gongkai Tiaolie (中华人民共和国政府信息公开条例) [Provisions of the People's Republic of China on the Disclosure of Government Information], promulgated by Order of the People's Republic of China State Council (No. 492), 5 April 2007, effective 1 May 2008 ("**Annex 8**").

[7] *Id.*, art. 9(1) ("**Annex 8**")

[8] According to Article 18 of the Provisions, information falling within Article 9 shall be disclosed within 20 working days. *Id.* ("**Annex 8**")

31. It can therefore be concluded that no formal decision has been made by the CPG on the application or non-application of the PRC-Laos BIT to Macau SAR and consequently the Embassy Letter cannot be viewed as representing a formal decision of the CPG under PRC domestic law.

2. The Embassy Letter Is Not an Authoritative Interpretation of the Basic Law

32. As noted above, the Embassy Letter appears to have intended to provide an interpretation of the Macau Basic Law on the question of whether or not the PRC-Laos BIT applies to Macau SAR. However, it does not and cannot represent an authoritative interpretation of the Macau Basic Law under PRC domestic law.

33. *First of all*, Article 143 of the Basic Law is clear on this point: authority to issue interpretations of the Law rests exclusively with the Standing Committee of the National People's Congress of the PRC ("**Standing Committee**"):

> *The power of interpretation of this Law shall be vested in the Standing Committee of the National People's Congress.*
>
> The Standing Committee of the National People's Congress shall authorize the courts of the MCSAR to interpret on their own, when adjudicating cases, the provisions of this Law which are within the limits of the autonomy of the MCSAR . . . . However, if the courts of the MCSAR, when adjudicating cases, need to interpret the provisions of this Law concerning affairs which are the responsibility of the Central People's Government, or concerning the relationship between the Central Authorities and the MCSAR, and if such interpretation will affect the judgments in the cases, *the*

> *courts of the MCSAR shall, before making their final judgments which are not appealable, seek an interpretation of the relevant provisions from the Standing Committee of the National People's Congress through the Court of Final Appeal of the MCSAR. When the Standing Committee makes an interpretation of the provisions concerned, the courts of the MCSAR, in applying those provisions, shall follow the interpretation of the Standing Committee.* However, judgments previously rendered shall not be affected.
>
> The Standing Committee of the National People's Congress shall consult its Committee for the Basic Law of the Macau Special Administrative Region before giving an interpretation of this Law.[9]

34. Article 143 exists because under Article 67(4) of the Constitution of the PRC, the authority to interpret PRC law belongs exclusively to the Standing Committee. Article 67(4) provides:

> The Standing Committee of the National People's Congress exercises the following functions and powers:
>
> […]
>
> (4) to interpret laws[.][10]

35. As a matter of fact, the Standing Committee has, on a number of occasions, issued interpretations of the Basic Laws of both Macau and Hong Kong Chinese SARs.[11] However, there is no record of any interpretation issued by the Standing Committee on the question of whether PRC BITs apply to Macau or Hong Kong SARs. Accordingly, the Embassy Letter cannot

---

[9] Macau Basic Law, *supra* n. 1, Art. 143 ("**Annex 6**").

[10] Xianfa (中华人民共和国宪法) [Constitution of the People's Republic of China], art. 67 (1982) ("**Annex 9**").

[11] *See, e.g.*, The Interpretation by the Standing Committee of the National People's Congress of Articles 22(4) and 24(2)(3) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, L.N. 167 of 1999 (H.K.) ("**Annex 10**"); *see also Interpretation on Macao Basic Law Adopted*, CHINA DAILY, 31 December 2011 ("**Annex 11**").

purport to set forth the position of the Standing Committee as an authoritative interpretation of the Basic Law of Macau SAR on this matter.

36. *Moreover*, the Embassy Letter, in its interpretation of the Macau Basic Law, errs in that it presumes that the PRC-Laos BIT, in principle, does not apply to Macau SAR, unless certain procedural conditions have been met. In other words, it considers that the Macau Basic Law has established a default position of non-application, and that a decision of the CPG is required only when the CPG intends to extend it to Macau SAR.

37. The presumption that such PRC treaties do not apply to Macau SAR is not supported by the language adopted by Article 138 of the Macau Basic Law, particularly in the original Chinese version. A careful reading of the Article demonstrates that: a) the CPG may or may not make a decision on such an issue of application or non-application; and b) in case the CPG intends to make such a decision, either *for or against (shì fǒu)* such application of an international agreement concluded by the CPG to Macau SAR, the SAR Government must be consulted in advance.[12] Until a decision has been thus made the matter is undecided as a matter of PRC domestic law.

[12] Macau Basic Law, *supra* n. 1, art. 138 ("**Annex 6**").

38. Such a presumption is also not supported by the stated purposes of the Basic Law of Macau SAR. The Preamble of the Basic Law stipulates that:

> *Upholding national unity and territorial integrity, contributing to social stability and economic development*, and taking account of its history and realities, the People's Republic of China has decided that upon China's resumption of the exercise of sovereignty over Macau, a Macau Special Administrative Region will be established in accordance with the provisions of Article 31 of the Constitution of the People's Republic of China, and that under the principle of "one country, two systems", the socialist system and policies will not be practiced in Macau.[13]

39. It can be seen that the fundamental purposes of the Macau Basic Law are to uphold national unity and territorial integrity on the one hand, and to contribute to social stability and economic development on the other. It would indeed be difficult to see how excluding Macau (and potentially Hong Kong) SAR from the territorial scope of the PRC-Laos BIT (and potentially all PRC BITs) in principle might help to maintain the national unity and territorial integrity of China, or to promote social stability or economic development of either the SAR or the country as a whole. The opposite seems to be more likely: by depriving foreign investors in Macau (and potentially Hong Kong) the protection offered by the PRC BITs, this interpretation has the potential to undermine both the national unity and territorial integrity of PRC and the social stability and economic development of Macau SAR.

[13] *Id.*, Preamble ("**Annex 6**").

40. In sum, for the reasons stated above, the Embassy Letter represents neither a formal decision nor an authoritative interpretation on the territorial scope of the PRC-Laos BIT, and is therefore not legally binding under PRC domestic law. Consequently the question of whether the PRC-Laos BIT applies to Macau SAR remains undecided as a matter of PRC domestic law.

B. The Relevance of the Embassy Letter to the Question of Interpretation of the PRC-Laos BIT as A Matter of International Law

1. The Embassy Letter's Discussion of Domestic Law Is Irrelevant to the Territorial Scope of the Treaty under International Law

41. It is of course the case that the question before the tribunal was one of interpretation of the PRC-Laos BIT, which is governed by international law, not domestic law in the form of PRC law.

42. The relevant international law provisions governing the territorial scope of a treaty are Article 15 of the 1978 Vienna Convention on Succession of States in Respect of Treaties ("**VCST**") (attached as "**Annex 12**") and Article 29 of the 1969 Vienna Convention on the Law of Treaties ("**VCLT**") (attached as "**Annex 13**"). Those provisions dictate that a treaty applies to the entire sovereign territory of a State "[u]nless a different intention appears from the treaty or is otherwise established" (VCST, art. 29) or "unless it appears from the treaty or is otherwise established that the application of the treaty to that territory would be

incompatible with the object and purpose of the treaty or would radically change the conditions for its operation" (VCLT, art. 15). These provisions are referred to as the "moving treaty frontiers" rule of international law.

43. In other words, the default position under international law is that the PRC-Laos BIT shall apply to Macau SAR since it was handed over to China in 1999. There are two types of exception to such a norm. The first type is an "explicit exception" found in the treaty text. The second type is an "implied exception", which has to be "otherwise established".

44. The Embassy Letter is entirely without legal effect on this question of the territorial scope of the Treaty as a matter of international law, for the simple reason that it purports to relate only to the status of the Treaty under domestic PRC law and not under international law. Article 27 of the VCLT, which codifies a well established principle of customary international law, stipulates that "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty". The tribunal also noted in the Award that "[i]t is well known that "the binding character of treaties is determined by international law, which on this point takes precedence over internal law".[14] On this basis alone, the Embassy Letter has no relevance to the question of jurisdiction before the tribunal or this Honourable Court.

---

[14] Award, ¶ 257 ("**Annex 3**").

45. In any event, the Embassy Letter also cannot satisfy the "explicit exception" under either Article 29 of the VCLT or Article 15 of the VCST or the "implied exception" under Article 15 of the VCST. The PRC-Laos BIT is silent on this matter. Neither does the Embassy Letter purport to interpret the terms of the PRC-Laos BIT.

46. In addition, the implied exception established under Article 15 of the VCST provides for objective tests: is the application of the PRC-Laos BIT to Macau SAR incompatible with the object and purpose of the treaty or would it radically change the conditions for its operation? The PRC's subjective intent with regard to the territorial scope of the Treaty is irrelevant to these questions. The International Law Commission, which drafted the VCST, described the implied exception in its Commentary on the Treaty as follows: "by such a formula, the Commission intends to lay down an <u>international objective legal test of compatibility</u> which, if applied in good faith, should provide a reasonable, flexible and practical rule".[15]

47. It therefore follows that the Embassy Letter is irrelevant to the question of the Treaty's interpretation as a matter of international law (including with respect to attempting to establish an exception to the general rule of

[15] 2 YEARBOOK OF THE INTERNATIONAL LAW COMMISSION 1974 at 210 (United Nations, 1975) (Part I) (emphasis in original) (internal quotation omitted) ("**Annex 14**").

territorial scope of treaty application). As a result, the PRC-Laos BIT should follow the general rule and apply to the entire territory of the PRC, including Macau SAR.

2. The Embassy Letter Does Not Apply Retroactively to Establish the PRC's Intent with Respect to the PRC-Laos BIT under International Law

48. Even if the Embassy Letter could be construed as a statement of PRC intent regarding the territorial scope of the Treaty for the purposes of Article 29 of the VCLT, it does not purport to be a statement of the PRC's intent at the time of the handover of Macau SAR.

49. To the extent that the Embassy Letter purports to establish the PRC's intent today, it is irrelevant. Because no contrary statement of intent was issued at the time of the handover, the Treaty automatically extended to Macau SAR as a matter of customary international law. Therefore, when Sanum first invested in Laos in 2007, Macau SAR was included within the territorial scope of the PRC.

50. There are no grounds for granting the statement in the Embassy Letter retroactive effect. Basic considerations of fairness and due process dictate against such a conclusion, especially where Laos took steps to solicit the Embassy Letter in order to assist its attempt to defeat jurisdiction before this Honourable Court after the tribunal has made its ruling in the Award.

As international law scholars Rudolf Dolzer and Christoph Schreuer have observed:

> [A] mechanism whereby a party to a dispute is able to influence the outcome of judicial proceedings---by issuing an official interpretation to the detriment of the other party---is incompatible with the principles of fair procedure and is hence undesirable.[16]

51. Indeed, since the Embassy Letter expresses an intent that would deprive international investors in Macau SAR of the protection of the PRC-Laos BIT that they otherwise would enjoy, it amounts to an amendment of the existing treaty language. Such an amendment to a treaty, even if it is agreed between the contracting parties, does not have retroactive effect.[17] In more than one treaty-based investment arbitration case, tribunals have held that such interpretations given to a treaty provision after the treaty has been signed and entered into force do not necessarily govern the treaty.[18] The *Enron v Argentina* tribunal, for instance, succinctly ruled that:

> Not even if this was the interpretation given to the clause today by the United States would this necessarily mean that such interpretation governs the Treaty. What is relevant is the intention the parties had in signing the Treaty and this does not confirm the selfjudging interpretation. Even if this interpretation were shared today by both parties to the Treaty, it would still not result in a change of its terms. States are of course free to amend the Treaty

---

[16] Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW, 35 (2nd ed. 2012) (internal citations omitted) (quoting the United States Model BIT of 2004) ("**Annex 15**").

[17] Mark E. Villiger, COMMENTARY ON THE 1969 VIENNA CONVENTION ON THE LAW OF TREATIES 513 (2009) ("**Annex 16**").

[18] *See e.g., Enron v. Argentina*, ICSID Case No. ARB/01/3, Award, ¶¶ 337-38 (22 May 2007) ("**Annex 17**"); *Sempra v. Argentina*, ICSID Case No. ARB/02/16, Award, ¶¶ 382-87 (28 Sept. 2007) ("**Annex 18**"). Other discussions on the legal effect of interpretation given by contracting parties can be seen in *Aguas del Tunari v. Bolivia*, Decision on Respondent's Objections to Jurisdiction, ¶¶ 47, 249-63 (21 Oct. 2005) ("**Annex 19**"), and *National Grid v. Argentina*, UNCITRAL, Decision on Jurisdiction, ¶ 85 (20 June 2006) ("**Annex 20**") (noting that the intent of both parties is necessary to interpret a treaty).

> by consenting to another text, but this would not affect rights acquired under the Treaty by investors or other beneficiaries.[19]

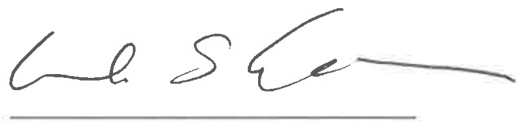
52. For the aforementioned reasons, and given the circumstances under which the Embassy Letter was issued and its shaky foundation under PRC domestic law, as observed above, it is beyond doubt that no retroactive effect should be given to the interpretation contained in the Embassy Letter.

VII. CONCLUSION

53. Based on the reasons stated above, it is my considered view that the Embassy Letter does not represent competent evidence under either PRC or international law for overturning the tribunal's decision with respect to the application of the Laos-PRC BIT to Macau SAR.

[19] *Enron v. Argentina*, *supra* note 18, ¶ 337 ("**Annex 17**").

Dated: 18th March 2014



Professor Wenhua Shan

List of Annexures

1. Wenhua Shan, Curriculum Vitae

2. Wenhua Shan, Lawyer's License, People's Republic of China

3. *Sanum Investments Ltd. v. Lao People's Democratic Republic*, UNCITRAL, Award on Jurisdiction (13 Dec. 2013)

4. Letter from Ministry of Foreign Affairs of Lao People's Democratic Republic to the Embassy of the People's Republic of China, Vientiane, Laos (7 Jan. 2014)

5. Letter from the Embassy of the People's Republic of China, Vientiane, Laos, to Ministry of Foreign Affairs, of Lao People's Democratic Republic (9 Jan. 2014)

6. Aomen Jiben Fa (澳門基本法) [Basic Law of the Macao Special Administrative Region of the People's Republic of China], adopted by the Eighth National People's Congress at its First Session (31 March 1993)

7. UNCTAD, WORLD INVESTMENT REPORT 2013

8. Zhonghua Renmin Gongheguo Zhengfu Xinxi Gongkai Tiaolie (中华人民共和国政府信息公开条例) [Provisions of the People's Republic of China on the Disclosure of Government Information], promulgated by Order of the People's Republic of China State Council (No. 492), 5 April 2007, effective 1 May 2008

9. Xianfa (中华人民共和国宪法) [Constitution of the People's Republic of China] (1982)

10. The Interpretation by the Standing Committee of the National People's Congress of Articles 22(4) and 24(2)(3) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, L.N. 167 of 1999 (H.K.)

11. *Interpretation on Macao Basic Law Adopted*, CHINA DAILY, 31 December 2011

12. 1978 Vienna Convention on Succession of States in Respect of Treaties

13. 1969 Vienna Convention on the Law of Treaties

14. 2 YEARBOOK OF THE INTERNATIONAL LAW COMMISSION 1974 (United Nations, 1975)

15. Rudolf Dolzer & Christoph Schreuer, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW (2nd ed. 2012)

16. Mark E. Villiger, COMMENTARY ON THE 1969 VIENNA CONVENTION ON THE LAW OF TREATIES 513 (2009)

17. *Enron v. Argentina*, ICSID Case No. ARB/01/3, Award (May 22, 2007)

18. *Sempra v. Argentina*, ICSID Case No. ARB/02/16, Award (Sep. 28 2007)

19. *Aguas del Tunari v. Bolivia*, Decision on Respondent's Objections to Jurisdiction (Oct. 21, 2005)

20. *National Grid v. Argentina*, UNCITRAL, Decision on Jurisdiction (June 20, 2006)

ANNEX 1

WENHUA SHAN

School of Law
Xi'an Jiaotong University, Xi'an 710049, China

Lauterpacht Centre of International Law
University of Cambridge, 5 Cranmer Road, Cambridge CB3 9BL, UK
E-Mail: wenhuashan@gmail.com

I. ACADEMIC EXPERIENCE

2013-present	Senior Fellow, Lauterpacht Centre for International Law, University of Cambridge
2008-present	Founding Dean and University Chair Professor of International Law, Xi'an Jiaotong University School of Law
	"State Specially Recruited Expert" ("the highest title of honor established by the State for the high level experts introduced from overseas", selected and awarded by the Chinese Central Government under the national "1000 Talents Scheme")
	"Yangtze River Chair Professor" (the highest academic honor in China selected and awarded by the Ministry of Education under the national "Yangtze River Scholarship Scheme")
2005-2007	Dean of the College of Humanities and Social Sciences and University Tengfei Chair Professor of International Law, Xi'an Jiaotong University
2004-2005	Visiting Research Fellow, East Asia Institute (EAI), National University of Singapore
2003-2006	Visiting Lecturer and Examiner of M.Phil Dissertations, Institute of Chinese Studies, Faculty of Oriental Studies, University of Cambridge
2003-2004	Visiting Lecturer, School of African and Oriental Studies (SOAS), University of London
2002-2013	Professor of International Law, Oxford Brookes University (since October 2007, Reader 2006-2007, Senior Lecturer 2004-2006, Lecturer 2002-2003, part-time since 2011).
1998-1999	Visiting Fellow, Lauterpacht Research Centre for International Law, University of Cambridge
1998-1999	Associate Professor of Law, Xiamen University School of Law

1996-1998	Lecturer of Law, Xiamen University School of Law

II. PROFESSIONAL EXPERIENCE

2014-present	Senior Counsel, Beijing Kangda Law Firm (Xi'an Branch), Xi'an, China
2012-present	Arbitrator, South China International Economic and Trade Arbitration Commission (SCIA)/Shenzhen Court of International Arbitration, Shenzhen
2011-present	Legal Advisor, The People's Government of Shaanxi Province, Xi'an
2011-present	Arbitrator, China International Economic and Trade Arbitration Commission (CIETAC), Beijing
2005-2013	Senior Consultant, HaoLiWen PRC Attorneys, Shanghai
2004.6-present	Arbitrator, Xiamen Arbitration Commission (XMAC), Xiamen
2004-present	Arbitrator, Guangzhou Arbitration Commission (GZAC), Guangzhou
1994-2005	PRC Attorney-at-Law, Xiamen University Scholars Law Firm (latter Fujian Lianhexinshi Law Firm), Xiamen

III. EDUCATION AND TRAINING

University Degrees

1999-2004	Ph.D. Candidate, Trinity College, University of Cambridge Holder of "*Trinity External Research Studentship" (full cost), "Honorary Cambridge Overseas Trust Scholarship*" and "*Overseas Research Scholarship*". Ph.D. in Law received in March 2004
1993-1996	Ph.D. Candidate, Xiamen University, China Holder of "*Tan Kah Kee Award*", "*Guanghua Award (First Prize)"* and *"Excellent Graduate Student Award*". Ph.D. in Law received in July 1996
1991-1993	Research Student in Law & Economics, Jinan University, China Holder of "*NanYue Award*" and "*Excellent Graduate Student Award*". Master of Economics (M. Econ.) received in June 1994
1987-1991	Undergraduate in Law, Zhongshan (Sun Yet-Sen) University

	Holder of "*Morally and Academically Excellent Graduate Award*" BA in Law received in July 1991.

Professional Qualifications

1992-present	Qualification for the Chinese Bar obtained after passing the National Bar Examination. Fully licensed of Chinese Attorney-at-Law (Barrister and Solicitor) received in 1994.
2002-2003	The Postgraduate Certificate in Teaching in Higher Education, the Oxford Centre for Staff and Learning Development (OCSLD). Certificate in Teaching in Higher Education received in May 2004
1998-1998	China International Economic and Trade Arbitration Commission (CIETAC) Commercial Arbitration Training, Xiamen. Certificate of Training received in June 1998.

IV. MAIN PUBLICATIONS

1. MONOGRAPH

Peter Van den Bossche & Wenhua Shan, *The Law and Policy of the World Trade Organization* (Chinese edition, Law Press China 2014)

Wenhua Shan, *Chinese Investment Treaties: Policy and Practice,* (with Norah Gallagher, Oxford University Press, 602 pages, March 2009)

Wenhua Shan, *The Legal Framework of EU-China Investment Relations: A Critical Appraisal*, Hart Publishing (Oxford), October 2005, 377 pages excluding preliminaries.

Wenhua Shan, *Legal_Issues of EU Investment in China: Deconstruction and Reconstruction,* Law Press, China, 2007, 335 pages. (in Chinese)

Wenhua Shan, *International Trade Law*, Volumes I and II, Peking University Press, 2000, 1147 pages excluding preliminaries (in Chinese).

2. EDITED COLLECTION

Wenhua Shan (ed), *China and International Investment Treaty Arbitration: The 20th Anniversary of China in the ICSID* (Vol. 1 of the Silk Road Series on International and Comparative Law), Brill (Martinus Nijhoff）2014.

Wenhua Shan (ed), *Legal Protection of Foreign Investment: A Comparative Study*, Hart Publishing (2012).

Wenhua Shan, Penelope Simons and Dalvinder Singh (ed.), *Redefining Sovereignty in International Economic Law*, Hart Publishing (480 pages, 2008).

3. TRANSLATION (English to Chinese)

Wenhua Shan et al, *Lawless World* (by Philippe Sands, 324 pages, published by Penguin), People's Press, 2011.

Wenhua Shan & CAI Congyan, *EC Commercial Law* (by A. Santa-Maria, originally published by Kluwer Law International), Peking University Press, 490 pages (book proof) in press, Sept. 2007.

Wenhua Shan et al, *The World Trade Organization (WTO)----Trading into Future* (edited by the WTO Secretariat), Peking University Press, 1997, 308 pages.

4. MAJOR REFERRED ARTICLES

Wenhua Shan, *Legal Education in China: The New "Outstanding Legal Personnel Education Scheme" and Its Implications*, Legal Information Management (Cambridge University Press), Vol 13 No 1, 2013 at pp. 10- 25.

Wenhua Shan, *National Treatment and the Foreign Investment Strategy of Shaanxi Province*, Journal of Xi'an Jiaotong University (Social Sciences Edition), 2013 No 2.

Wenhua Shan, Norah Gallagher, Sheng Zhang, N*ational Treatment and Foreign Investment in China: A Changing Landscape,* ICSID Review: Foreign Investment Law Journal (OUP), Spring 2012.

Wenhua Shan, Sheng Zhang, *FDI in China and the Role of Law: An Empirical Approach,* The Journal of World Investment and Trade, Vol 12, August 2011, NO 4, pp. 457-486.

Wenhua Shan, *Towards a Balanced Liberal Investment Regime: General Report on the Protection of Investment for the International Congress of Comparative Law 2010 Washington DC*, ICSID Review: Foreign Investment Law Journal, Fall 2010, pp. 421-497.

Wenhua Shan, Sheng Zhang, *The Treaty of Lisbon: Halfway toward a Common Investment Policy*, European Journal of International Law, 2010 No. 4.

Wenhua Shan, *Umbrella Clause and Investment Contracts under Chinese BITs: Are the Later Covered by the Former*? Journal of World Investment and Trade, 2010, No. 2.

Wenhua Shan, *Towards a Harmonious Chinese Model BIT,* Chinese Journal of International Economic Law (in Chinese), 2010, No.1.

Wenhua Shan, *Commentary on Metalclad Corp v Mexico, Award*, Ad hoc—ICSID Additional Facility Rules; ICSID Case No ARB(AF)/97/1; Oxford University Press (OUP) Oxford Reports on International Law- IIC 161 (2000); Investment Claims- IIC 161 (2000).

Wenhua Shan, *Commentary on Metalclad Corp v Mexico, Review by the supreme court of British Columbia*, ICSID Case No ARB(AF)/97/1; Oxford University Press (OUP) Oxford Reports on International Law- IIC 162 (2001); Investment Claims- IIC 162 (2001).

Wenhua Shan, *Commentary on Metalclad Corp v Mexico, Supplementary reasons for judgment*, 2001 BCSC 1529; Oxford University Press (OUP) Oxford Reports on International Law- IIC 163 (2001); Investment Claims- IIC 163 (2001).

Wenhua Shan, N Gallagher and S Zhang, *Overview of Bilateral Investment Treaties: China* (including over 100 Commentaries on each BIT), Oxford University Press (OUP) Investment Claims: IC-OV 6 CN (2008).

Wenhua Shan, *Is Calvo Dead*? 55 American Journal of Comparative Law 123, May 2007.

Wenhua Shan, *From "North-South Divide" to "Private-Public Debate"*, 27 Northwestern Journal of International Law and Business, No. 3 (Spring 2007).

Wenhua Shan, *The 'Death' and 'Rebirth' of the Doctrine: The Changing Attitude toward Foreign Investment in Latin America and Its Implications for China*, Chinese Journal of International Economic Law (the journal of the Chinese Society of International Economic Law), Vol.9, No.1, 2006, pp. 183-206. (in Chinese)

Wenhua Shan, *Law and Foreign Investment in China: Effectiveness of the Legal System*, Manchester Journal of International Economic Law (University of Manchester), Vol. 3, No.1, 2006, pp. 51-67.

Wenhua Shan, *Law and Foreign Investment in China: General Role of Law and Substantive Issues*, Manchester Journal of International Economic Law, Vol. 2 No. 3, 2005. pp. 1-41.

Wenhua Shan, *EU Enlargement and the Legal Framework of EU-China Investment Relations,* 6 The Journal of World Investment & Trade (formerly known as The Journal of World Investment, Geneva) 2, April 2005, pp. 237-262.

Wenhua Shan, *The International Law of EU Investment in China*, Chinese Journal of International Law (an OUP journal in association with the Chinese Society of International Law, Oxford), 2002, Vol.1, No. 2, pp. 555-614.

Wenhua Shan, *Towards a Level Playing Field of Foreign Investment in China*, 3 The Journal of World Investment (Geneva) 2, April 2002, pp. 327-344.

Wenhua Shan, *Towards a Common European Community Policy on Investment Issues,* 2 The Journal of World Investment (Geneva) 3, September 2001, pp. 603-625.

Wenhua Shan, *Towards a New Legal Framework for EU-China Investment Relations*, 34 Journal of World Trade 5, October 2000, pp. 137-179.

Wenhua Shan, *National Treatment and the Transformation of FDI Laws and Policies in China*, International Trade Law and Regulation (London), Vol. 6 No. 1, 2000, pp. 21-27.

Wenhua Shan, *Legal Issues of Electronic Commerce*, Civil & Commercial Law Review (Ming Shang Fa Lun Cong), Vol.10, Law Press, 1998, pp. 1-71 *(about 50,000 words*). (in Chinese)

Wenhua Shan, *National Treatment for Foreign-funded Enterprises and the Conditions of its Implementation*, 5 Social Sciences in China (Zhongguo Shehui Kexue) (the journal of the Chinese Academy of Social Sciences, CASS, the top Chinese journal in social sciences including law), 1998, pp. 128-145. (in Chinese)

Wenhua Shan, *Some Problems Concerning Legal Education in China*, 5 Social Science Research (Shehui Kexue Yanjiu) (the journal of the Academy of Social Sciences of Shichun Province), 1998, pp. 66-70. (in Chinese)

Wenhua Shan & ZENG Huaqun, *The Foundation and Development of Studies on International Economic Law in China*, 5 Chinese Legal Science (Zhongguo Faxue) (the journal of the Chinese Law Society), 1998, pp. 28-33. (in Chinese)

Wenhua Shan, *Analysis of and Comments on Chinese Laws Concerning International Customs*, 3 Chinese Legal Science (Zhongguo Faxue), 1997, pp. 47-57. (in Chinese)

Wenhua Shan, *The Fundamental Theoretical Problems of International Trade Usage (my first doctoral dissertation)*, Civil and Commercial Law Review (Ming Shang fa Lun Cong), Vol.7, pp.583-716 (*about 100,000 words),* Law Press, 1997. (in Chinese)

Wenhua Shan, *Differences and Interaction between "International Custom" and "International usage"*, Journal of Xiamen University (social science edition) (Xiamen Daxue Xuebao---Zheshe Ban), special issue of law, 1997. (in Chinese)

Wenhua Shan, *Fundamental Legal Issues in Transnational Economic Zones*, 6 International Trade Journal (Guoji Maoyi Wenti), 1996, pp. 45-48. (in Chinese)

Wenhua Shan, *Comments on the Regulations Concerning International Investment in the WTO Agreements*, 2 CASS Journal of Law (Faxue Yanjiu, the law journal of the Chinese Academy of Social Sciences, formerly translated as Studies in Law), 1996, pp. 135-143. (in Chinese)

Wenhua Shan, *The Development and Completion of National Treatment System for foreign Investments in China*, 6 Studies in Law (Faxue Yanjiu, now the CASS Journal of Law), 1995, pp. 52-59. (in Chinese)

Wenhua Shan, *The Legal Problems and Countermeasures of Multi-Level Marketing*, 5 Journal of Law (Faxue Zhazhi, the journal of Beijing Law Society), 1995, pp. 20-21. (in Chinese)

Wenhua Shan, *The Development of the Theories and Practices of Nationalization Compensation and the Countermeasures of China*, 4 Law Science (Falu Kexue, the

journal of North-Western University of Law and Political Science), 1995, pp. 45-73. This Article was listed on Xinhua Digest (Xinhua Wenzhai), 1995(10), as one of the most important articles published in China in that month. (in Chinese)

Wenhua Shan, *Market Economy and National Treatment for foreign Invested Enterprises*, 5 Chinese Legal Science (Zhongguo Faxue), 1995, pp. 23-30. (in Chinese)

Wenhua Shan, *Legal Considerations of Anti-dumping in China*, Journal of Xiamen University (social science edition) (Xiamen Daxue Xuebao---Zheshe Ban), special issue of graduate students, 1994. (in Chinese)

5. BOOK CHAPTERS

Wenhua Shan and Sheng Zhang, *The Potential EU-China BIT: Issues and Implications*, in Marc Bungengerg et al (eds.), European Union and Investment Agreements: Open Questions and Remaining Challenges, Hart/NOMOS, 2013.

Wenhua Shan, *China and International Investment Law*, in Leon Trakman and Nicola Ranieri (eds.), Regionalism in International Investment Law, OUP, 2013.

Wenhua Shan, Norah Gallagher, *Chinese Model BITs*, in Chester Brown et al (eds), Commentaries on Selected Model Investment Treaties, OUP 2013.

Wenhua Shan, "*Redefining the Chinese Concept of Sovereignty*", in Wang Gungwu and Zheng Yongnian (eds.), China and the New International Order (Routledge, 2008).

Wenhua Shan, "Calvo Doctrine, State Sovereignty and the Changing Landscape of International Investment Law ", in Wenhua Shan et al (ed.), Redefining Sovereignty in International Economic Law, Oxford hart Publishing 2008.

Wenhua Shan, "*Latin American States and International Investment Arbitration*", in CHEN An (ed.), New Frontier in International Investment Law and China's BIT Practice, Peking University Press, forthcoming 2006. (in Chinese)

Wenhua Shan, "*International Technology Transfer" (Chapter 4),* and "*International Trade Regulation" (Chapter 5),* in CHEN An (ed.), International Economic Law, Law Press 2006 (2nd edition, forthcoming), about 65,000 words. (in Chinese)

Wenhua Shan, "*National Treatment*" (Chapter 7), and "*Expropriation and Compensation*" (Chapter 8), in Prof. ZHU Chongshi (ed.), Studies on Chinese Foreign Investment Law: In the Context of WTO Accession, Xiamen University Press, 2005, about 50,000 words. (in Chinese)

Wenhua Shan, *Commercial Arbitration* (Part 5), in Qi Shujie (ed.), Civil Procedural Law, Xiamen University Press, 2002 (2nd edition), about 60,000 words. (in Chinese)

Wenhua Shan, *"Compensation for Nationalization" (Chapter 7),* in LU Joingxing (ed.), Studies on Chinese Investment Law for Foreign Merchants, Law Press, 2001, pp. 216-242. (in Chinese)

Wenhua Shan, *"International Technology Transfer" (Chapter 4),* and *"International Trade Regulation" (Chapter 5),* in CHEN An (ed.), International Economic Law, Law Press 1999 (1st edition), about 60,000 words. (in Chinese)

Wenhua Shan, *Commercial Arbitration* (Part 5), in Qi Shujie (ed.), Civil Procedural Law, Xiamen University Press, 1998 (1st edition), about 60, 000 words. (in Chinese)

Wenhua Shan, *The Investment Promotion Operations and Incidental Powers of MIGA (Chapter 10),* in CHEN An (ed.), MIGA and China: the Introduction and Comments on the Multilateral Investment Guarantee Agency, Fujian People's Press, 1995, pp. 408-448. (in Chinese)

Wenhua Shan, *The Legal System of the Economy & Technology Development Zones (Chapter 11), The Legal Problems of the Border Economic Cooperation Zones (Chapter 15)* and *The Legal System of Special Economic Zones in Other Countries (Chapter 17)*, in LI Xueling (ed.), The Laws of Special Economic Zones (a nationally adopted law textbook), Law Press, 1996, about 60,000 words. (in Chinese)

Wenhua Shan, *The Law of Professions in Taiwan (Chapter 14) & The Law of Public Services in Taiwan (Chapter 15),* in CHEN An (ed.), A Complete Introduction to the Laws of Taiwan, China Great Encyclopedia Press, 1997, about 70,000 words. (in Chinese)

6. CONFERENCE PAPERS

A. Major Invited Conference Papers:

"Reform of the Investor-State Dispute Settlement Mechanism: A Matrix Analysis", presented at the "15 Years of Energy Investment Promotion and Protection under the Energy Charter Treaty" Ministerial Conference of the Energy Charter Treaty in Nicosia, Cyprus, on 5 December 2013

"Market Access Provisions in the Potential EU Model BIT", International Conference on "The Anatomy of the (Invisible) EU Model BIT", by University of Siegen & University of Vienna, Vienna, 25-26 November 2013

"Key Provisions in China-US BIT Negotiations", Keynote speaker at the "China-US BIT Forum" as part of the Annual Conference on Commercial Law organised by MOFCOM, 26 November 2012, Beijing.

"Towards an EU-China Bilateral Investment Treaty", presentation at the European Parliament Hearing on EU-China Investment Policy organised by the International Trade Committee of the European Parliament, 6 November 2012.

"China, WTO and the New World Economic Order", presentation at the "China and the WTO High-Level Strategic Colloquium", Tsinghua University Law School, 3 November 2012, Beijing.

"New Aspects of International Economic Law" (5 sessions 10 hours), Xiamen Academy of International Law 2011 Summer Programme, 2011 年 7 月 4-22 日, Xiamen, PR China.

General Report for the theme entitled *"Protection of Foreign Investment"* presented at the International Congress of Comparative Law (organised by the International Academy of Comparative Law and American Society of Comparative Law), July/August 2010, Washington DC, as the General Reporter (chaired by Ms Meg Kinnear, Secretary-General of the ICSID Secretariat).

"*National Treatment*", presented at the UNCTAD-APEC Regional Training Course: Core Elements of International Investment Agreements in the APEC Region, 15–19 June 2009, Kuala Lumpur, Malaysia, co-organized by UNCTAD, APEC and the Ministry of International Trade and Industry, Government of Malaysia.

"Fair and Equitable Treatment", presented at the UNCTAD-APEC Regional Training Course: Core Elements of International Investment Agreements in the APEC Region, 15–19 June 2009, Kuala Lumpur, Malaysia, co-organized by UNCTAD, APEC and the Ministry of International Trade and Industry, Government of Malaysia.

"Chinese Investment Treaty Policy: Recent Changes and Future Direction", presented at Twelfth ITF Public Conference "Investment Treaties at 50: Host State Perspectives", 15 May 2009, BIICL, London.

"*Financial Crisis and Treaty Protection of International Investment*", presented at the Western Returned Scholars Association (WRSA) 2008 High-Level Economic Forum "Conference on Financial Crisis and Its Countermeasures", 18 December 2008, Beijing.

"A Double-Payer Approach to the Concept of Sovereignty", presented at the "Governance of a Globalising World: Whither Asia and the West?" conference organised by the Lee Kuan Yee School of Public Policy, National University of Singapore, 3-6 December 2008.

"EU-China Investment Relations: A Critical Appraisal", lecture given at the Max Planck Institute for Comparative and International Private Law, 10 April 2007, Hamburg.

"*The New Generation of Chinese BITs and Investment Arbitration*", the first and main presentation at the British Institute of International and Comparative Law (BIICL) Investment Treaty Forum Seminar "China and International Investment Law: Trends and Prospects', 2 April 2007, London.

"Redefining Chinese Sovereignty', paper presented at International Conference on "China and the International Order: Integrating Views from Outside-In and Inside-Out', 18-19 September 2006, University of Nottingham, UK.

"*The 'Death' and 'Revival' of the Calvo Doctrine: Sovereignty and Investment Dispute Settlement in Latin America*", presented at the SLS 2006 Symposium "Redefining Sovereignty: an international debate on sovereignty and international economic law", held in May 2006 at Oxford.

"*EU Enlargement and the Law of EU-China Investment Relations*", paper presented at "Chinese Society of International Economic Law Annual Conference 2005" held in November 2005 in Changsha, Hunan, China.

"*Non-Tariff Measures and Trade Disputes*", paper presented at "Chinese Society of International Law Annual Conference 2005", held in Beijing in September 2005. (in Chinese)

"*Law and FDI in China: An Empirical Approach*", paper presented at an International Conference entitled International Economic Law and China in Its Economic Transition , sponsored by The Chinese Society of International Economic Law (CSIEL), held in November 2004 at Xiamen, China.

"*EU-China Relations after WTO Accession*", paper presented at international conference entitled China After WTO Accession organised by the Chinese Economics Association in the UK, etc, April 2004, Shanghai, China.

"*The Chinese Accession to the WTO and the Chinese Rule of Law*" , paper presented WTO and China: The Next Decade Conference, sponsored by Chinese Students and Scholars Association in the UK (CSSA-UK), 2000.

"*Legal Treatment for Foreign Investments in China*", paper presented the Programme entitled World Legal Problems, jointly organized by St Mary's University, USA and the University of Innsbruck, Austria, July 1999.

7. OTHER ARTICLES

Wenhua Shan, *Settlement of Disputes*, Oil, Gas, Energy and Law Intelligence (The Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee), Vol. 4, No. 1 (May 2006), pp. 205-244.

Wenhua Shan, *Foreign Investment in China and the Role of Law: Empirical Evidence from EU Investors*, Transnational Dispute Management (The Centre for Energy, Petroleum and Mineral Law and Policy, University of Dundee) Volume 2, No. 03 - June 2005, pp. 1-74.

Wenhua Shan, *Between Freedom and Order* (in Chinese), Hua Xia Wen Zhai (HXWZ, the oldest online journal in Chinese) No. 554, November 19 2001.

Wenhua Shan, *Xu Zhimo's Cambridge* (in Chinese), Hua Xia Wen Zhai (HXWZ) No. 518, March 2 2001.

Wenhua Shan, *The Problems and Prospects of the EU-China WTO Negotiations*, Ta Kung Pao (Hong Kong), 23 March 2000, p. A4. (in Chinese)

Wenhua Shan, *The Reform of Chinese FDI Law,* Company Secretary (Hong Kong), No. 2, 2000, pp.40-43.

Wenhua Shan & LI Guoan et al, *The Development of Studies on International Economic Law in 1997,* Yearbook of Chinese Law (Zhonguo Falu Nianjian, Yearbook of the Chinese Law Society), 1998. (in Chinese)

Wenhua Shan & XU Chongli et al, *The Development of Studies on International Economic Law in 1996,* Yearbook of Chinese Law (Zhonguo Falu Nianjian), 1997. (in Chinese)

Wenhua Shan & XU Chongli et al, *The Development of Studies on International Economic Law in 1995,* Yearbook of Chinese Law (Zhonguo Falu Nianjian), 1996. (in Chinese)

Wenhua Shan, *Anti-dumping in China: Is It Necessary?* 4 International Markets (Guoji Shichang), 1994. (in Chinese)

Wenhua Shan, *Protecting National Industry and Defending Fair Competition,* 3 Economics and Law (Jingji Yu Fa), 1994. (in Chinese)

V. TEACHING

1. SUPERVISING PHD STUDENTS: 18

2. COURSES FOR GRADUATE STUDENTS:

1) International Investment Law
2) International Commercial Arbitration
3) International Trade Law
4) International Banking and Financial Regulations
5) Core Module on Public International Law
6) Advanced Legal Research Methodology
7) The Law of World Trade Organization (WTO)
8) Foreign Investment Law
9) EU Law (SOAS, London)

3 COURSES FOR UNDERGRADUATE STUDENTS:

1) Commercial Law Part II/International Trade Law
2) Commercial Arbitration Law
3) International Trade Law
4) The Law of International Technology Transfer
5) Rule of Law in China

4. OTHER TEACHING ACTIVITIES

1) Personal tutor to undergraduate, LLM and CPE students.

2) Supervisor of undergraduate, LLM dissertations and CPE research projects.

VI. EDITORSHIP

Chinese Journal of Comparative Law (since 2012), founding Editor-in-Chief, Oxford University Press (OUP).

Silk Road Series on International and Comparative Law (2012-), General Editor, Brill (Martinus Nijhoff).

ICSID Review-Foreign Investment Law Journal (2011-), Member of the Advisory Editorial Board, Oxford University Press

China & International Economic Law Series (2003-), (Principal) Co-General-Editor, Hart Publishing, Oxford.

Chinese Journal of International Law, Member of the Editorial Board (since April 2005), published by Oxford University Press (OUP).

*Selected Monographs by Overseas Legal Scholars (*2003-), Co-Editor-in-Chief, Law Press, China.

Chinese Review of Common Law (CRCL) (in Chinese), Founder and Co-General-Editor (2003-2006), Law Press, China

European Law Review (in Chinese), Member of the Editorial Board, Law Press China

Reviewer, for ESRC (research projects)
ARC (research projects)
OUP/CUP/Hart (book proposals)
Various journals (articles)

VII. LEARNT SOCIETIES

2014-present Member, American Law Institute (ALI)

2008-present Member, Executive Committee of the Chinese Society of International Law (CSIL)

2007-present Member, International Academy of Comparative Law (IACL, The Hague); Titular Member (since 2011)

2007-present Member, Executive Committee of the Chinese Society of Legal Education (formerly as the Legal Education Association of the China Law Society)

2007-present Member, Executive Committee, Chinese Society of International Economic Law (CSIEL)

2007-present	Vice-President, Chinese Society of European Law (CSEL)
2001-present	Founding President and then Advisor, United Kingdom Chinese Law Association (UKCLA)
2004-2007	Director of the Law Commission, the Federation of Chinese Professional Societies in the UK (FCPS-UK)
2002-2004	Member, Board of Executive Directors, the Federation of Chinese Professional Societies in the UK (FCPS-UK)
2006-present	Member, The Founding Council of Directors, The Association of Social Science Experts (ASSE) of the All-China Youth Federation
2005-present	Member, Advisory Committee of the Chinese Journal of International Law Research Group
2000-2001	Member, Executive Board of the UK Chinese Student and Scholar Association (CSSA-UK)
2000-2001	President, Cambridge Chinese Students and Scholars Association (CSSA-CAM)
2000-present	Fellow, Cambridge Overseas Society (COS)
Also Membership of:	British Institute of International and Comparative Law (BIICL) The Society of Legal Scholars (SLS, UK) International Law Association (ILA, British Branch)

VIII. AWARDS & HONOURS

"*State Specially Recruited Expert*", by the Chinese Central Government under the "1000 Talents Scheme".

"*Yangtze River Chair Professor*", by the Ministry of Education of the PR China, 2009.

"Shaanxi Province 100 Talents Scheme" (Shaanxi Sheng Bairen Jihua), awarded by the People's Government of Shaanxi Province.

"State Council Special Allowance Expert", selected and conferred by the State Council (the Executive branch of the Chinese Government), 2008.

"Top-Ten Outstanding Young Persons in Shaanxi Province", awarded by Shaanxi Province Youth League, 2008.

"*Top-Ten Young Jurists in Shaanxi Province*", awarded by Shaanxi Province Law Society, 2008.

"Third Prize" of the National Award for Outstanding Research Achievements in Humanities and Social Sciences in Higher Education (highest level research award in China), 2013.

"Second Prize" of Distinguished Research Achievements in Social Sciences, granted by the People's Government of Shaanxi Province, 2013

"First Prize" of the Shaanxi Province Award for Outstanding Research Achievements in Humanities and Social Sciences in Higher Education, 2011.

"Second Prize" of Distinguished Research Achievements in Social Sciences, granted by the People's Government of Shaanxi Province, 2009

"Honorary Prize" of Distinguished Research Achievements in Social Sciences, granted by the People's Government of Shaanxi Province, 2007

"*Bole Prize*" (an award for exceptional contributions to the recruitment of top talents), Xi'an Jiaotong University, 2007

"*Honorary Cambridge Overseas Trust Scholarship*" and Fellowship of the Cambridge Overseas Society, by the Cambridge Overseas Trust (COT), 1999-2002.

"*Third-Prize" of Distinguished Research Achievements in Social Sciences* Obtained during 1997-2000, granted by the People's Government of Fujian Province, 2000

"*One Year Studentship for Chinese Scholars*", granted by the EU-China Higher Education Cooperation Programme, 1998.

"Top-Ten Young & Middle-aged Legal Scholars and Practitioners of Fujian Province", selected by the Fujian Province Law Society and endorsed by the People's Government of Fujian Province, 1998.

"Third-Prize" of Distinguished Research Achievements in Social Sciences Obtained during 1993-1996, granted by the People's Government of Fujian Province, 1998.

"*Qingyuan Teaching Award*", granted by Xiamen University for excellent teachers, 1998.

"*First Prize"/"Second Prize" Excellent Law Articles* [four times for articles published in 1994 (*Second*), 1995 (*Second*), 1996 (*First*) and 1997 (*First*) respectively], granted by the Fujian Province Law Society, 1995, 1996, 1997 and 1998 respectively.

"Second Prize" of Excellent Social Research Achievements Obtained in 1990-1997, granted by the People's Government of Xiamen City, 1997.

"Excellent Award" of "The Chinese Way to Rule of Law", a nation-wide award for excellent academic articles on law written by young scholars. The award was based on an article competition sponsored by the Law Institute of the Chinese Academy of Social Sciences (CASS), 1996.

"*Excellent Award*" of "*Challenge Cup",* the national competition of scientific & academic works made by college students, 1995.

"*Tan Kah Kee Award*", the highest scholarship given by Xiamen University for top students (named after the original founder of the university), 1996.

"*Excellent Graduate Student Award*", given by Xiamen University for excellent graduate students, 1996.

"*Guanghua Scholarship (first prize)*", a nation-wide scholarship for top students given by Guanghua Education Fund, 1995.

"*NanYue Excellent Graduate Students Scholarship",* the highest graduate student scholarship in Guangdong Province, 1993

"*Excellent Graduate Student Award*", given by Jinan University for excellent graduate students, 1993.

"*Morally & Academically Excellent Graduate Award",* given by Zhongshan (Sun Yat-sen) University to excellent graduates, 1991.

Invited Listee in: *Who's Who in Public International Law* (Vol. 1, Crestwall 2007)
Marquis Who's Who in the World (Vol. 24, 2007 and onwards)

IX. RESEARCH PROJECTS

"*US-China BIT Negotiation and the US Model BIT 2012*", MOFCOM project, 2012-present, Project Leader.

"*Interpretation of Core Provisions of Bilateral Investment Treaties*", State Social Sciences Fund Research Project, Principal Investigator (PI), 2010.

"Legal System for the Promotion and protection of Overseas Chinese Investment", State Social Sciences Fund Most Significant Research Project, Principal Investigator (PI) for the sub-project on "Legal Issues of Chinese Overseas Resources Investments", 2009.

"The Restructuring of International Economic Order after the Global Financial Crisis and the Chinese Countermeasures", Ministry of Education Most Significant Research Project, PI for sub-project "Global Financial Crisis and the Recent Changes and Trends in International Investment Treaty System", 2009.

"Public International Law on the 'Protection of Foreign Investment'" of the "International Academy of Comparative Law (IACL) Washington Congress 2010", General Reporter.

"Legal Issues of China's Overseas Investment and Cooperation Projects in Energy Sectors", Ministry of Justice State Research Project, 2008 (Project No. SFB2049).

"Technical Assistance to Support China's Integration into the World Trading Systems, EuropeAid/116313/C/SV/CN", EU Project (as Senior Expert).

"International Law Development Fund", by Xi'an Jiaotong University "985" Fund, 2006-2008, Chair of the Management Committee.

"Frontiers in International Trade Law", by Xiamen University, 2006-2008.

"*Chinese Bilateral Investment Treaties: Policy and Practice*", Xi'an Jiaotong University High-Level Talents Fund (a book with the same title was published by the OUP in 2009), 2005-2007.

"Redefining Sovereignty: an international debate on sovereignty and international economic law", Society of Legal Scholars (SLS), principal organizer (together with two colleagues), an edited collection was published in 2008 by Hart Publishng Oxford.

"Theory and Practice in Chinese Bilateral Investment Treaties", entrusted by the Ministry of Commerce (MOFCOM) of the Chinese Government, one of the key contributors, 2005-2006.

"*A Critical Appraisal of the Legal Framework Governing EU Investment in China "(1999-2004),* Ph.D. research project, *Trinity External Research Studentship* (by Trinity College, University of Cambridge, 1999-2002) and the *Overseas Research Studentship* (ORS) (by the Committee of Vice-Chancellors and Principals of the Universities of the United Kingdom, now the "Universities UK", 1999-2002). This eventually led to the monograph entitled *The Legal Framework of EU-China Investment Relations: A Critical Appraisal* described above.

"Studies on Foreign Investment Laws in the EU" (1998-1999), an International Collaborative Research Project with the Lauterpacht Research Centre of International Law (LRCIL) at University of Cambridge, *EU-China Higher Education Cooperation Programme (Contract A4 10209/98), 7,000 ECU*, project leader and principal researcher.

"Studies on the Legal Issues of the National Treatment and Market Access for Foreign Investment", entrusted by the *Ministry of Education* of the Chinese Government (1998-2000), project leader and principal researcher.

"Practices and Theories of the Extraterritorial Enforcement of Economic Regulations in United States and the Chinese Countermeasures thereof", State Social Science Fund, first principal contributor.

"New Challenges to and New Countermeasures for Chinese Foreign Investment Laws in the Process of All-round Open-up to the Outside World and Transforming to the Socialist Market Economy", State Social Science Fund, principal contributor.

"The Situation of Granting "National Treatment" to Foreign Investors in Other Countries and the Possibility & Problems of China Granting "National Treatment" to Foreign Investors", Ministry of Foreign Trade and Economic Cooperation (MOFTEC) (now Ministry of Commerce, MOFCOM) of the Chinese Government (1996-1997), first principal contributor and the reporter of the project.

X. CONSULTANCY

"*State Specially Recruited Expert*" appointed by the Chinese Central Government under the national "Recruitment for Global Experts Program" (the 1000 Plan), since 2011

Legal Advisor, The People's Government of Shaanxi Province, PR China, since 2011.

"*Expert Witness*" at the European Parliament hearing on "EU-China Investment Relations" organized by the Committee on International Trade, Nov 2012

*Senior Exp*ert, in European Commission project (*"Technical Assistance to Support China's Integration into the World Trading Systems, EuropeAid/116313/C/SV/CN").*

Also consulted by other foreign governments, transnational corporations and international law firms on international and comparative law matters.

XI. MEDIA COVERAGE

China Science Daily: *The International Style of XJTU Law School: An Interview with Professor Wenhua Shan*, by XIE Xiayu, published on 7 November 2013.

Legal Daily: *The Chinese Dream of an International Lawyer: An interview with Professor Wenhua Shan*, by WANG Minyan, published on 5 November 2013.

People's Daily (Overseas Edition): *Interview on China's Anti-Secession Law and its Implications*, 18 March 2005. Also reported at many major Chinese media including *Guangming Daily, Xinhua News Agency, CCTV* and *Ta Kung Po.*

Channel NewsAsia (Singapore): Interview on *China's Anti-Secession Law and International Law (360)* , 4 January 2005.

BBC World Service: Interview on *WTO and the Chinese Legal Profession*, 18 December 2001, Program No: N/A;
Interview on *Chinese Accession to the WTO*, 3 July 2001, Program No: 82 M 127.
Interview on *Tokyo Local High Court Judgement on Philippine Entertaining Women Case*, 19 Dec. 2000, Program No: 82 M 049.
Interview on *EU-China WTO Negotiations*, 14 May 2000, Program No: 82M 020.
Interview on *EU-China WTO Negotiations*, 31 Mar. 2000, Program No: 82M 013.

Xinhua News Agency (Yanhong Wang), *Experiencing Cambridge* (Exclusive Personal Interview with Dr. Wenhua Shan), Can Kao Xiao Xi (Reference Information), 26 April 2001, P. 16.

Ta Kung Po (Nancy Wong), *Why an Illegal War can be Carried on---Interview with Dr. Wenhua Shan at Lauterpacht Research Centre for International Law of the University of Cambridge*, Ta Kung Po (Hong Kong) 1 June 1999.

ANNEX 2

中华人民共和国

律师执业证

Lawyer's License

People's Republic of China

本证为持证人依法获准律师执业的有效证件。持证人执业应当出示本证，请司法机关和有关单位、个人予以协助。

中华人民共和国司法部

中华人民共和国

律师执业证

Lawyer's License
People's Republic of China

中华人民共和国司法部监制

执业机构 北京市康达（西安）律师事务所

执业证类别 兼职律师

执业证号 16101199420223060

法律职业资格或律师资格证号

（粤）司律证字第5559号

发证机关 陕西省司法厅

发证日期 2014 年03 月17 日

持 证 人 单文华

性 别 男

身份证号 440105197002280052

ANNEX 3

PCA Case No. 2013-13

IN THE MATTER OF AN ARBITRATION UNDER THE AGREEMENT BETWEEN THE GOVERNMENT OF THE PEOPLE'S REPUBLIC OF CHINA AND THE GOVERNMENT OF THE LAO PEOPLE'S DEMOCRATIC REPUBLIC CONCERNING THE ENCOURAGEMENT AND RECIPROCAL PROTECTION OF INVESTMENTS DATED 31 JANUARY 1993 AND THE 2010 UNCITRAL ARBITRATION RULES

- between -

SANUM INVESTMENTS LIMITED

"Claimant"

- and -

THE GOVERNMENT OF THE LAO PEOPLE'S DEMOCRATIC REPUBLIC

("Respondent," and together with Claimant, the "Parties")

AWARD ON JURISDICTION

ARBITRAL TRIBUNAL:
Professor Bernard Hanotiau
Professor Brigitte Stern
Dr. Andrés Rigo Sureda (Presiding Arbitrator)

Registry:
The Permanent Court of Arbitration

Tribunal Secretary:
Ms. Sarah Grimmer

13 December 2013

TABLE OF CONTENTS

I. THE PARTIES AND THEIR REPRESENTATIVES 3

II. PROCEDURAL HISTORY 3

III. FACTUAL BACKGROUND 5

IV. RELEVANT LEGAL PROVISIONS 11

V. SUMMARIES OF THE PARTIES' ARGUMENTS 13

A. WHETHER THE CLAIMANT IS COVERED BY THE BIT 13

1. Whether the BIT extends to the Macao SAR 13

(a) The Respondent's Position 13

(b) The Claimant's Position 23

B. WHETHER SANUM QUALIFIES AS AN INVESTOR UNDER THE TREATY 32

1. Whether the Claimant is established under the municipal laws of the PRC 32

(a) The Respondent's Position 32

(b) The Claimant's Position 33

2. Whether the Claimant is an "economic entity" 34

(a) The Respondent's Position 34

(b) The Claimant's Position 36

C. WHETHER SANUM BRINGS INVESTMENT-RELATED CLAIMS UNDER THE BIT 38

(a) The Respondent's Position 38

(b) The Claimant's Position 40

D. WHETHER LAOS CONSENTED TO THE ARBITRATION OF THE CLAIMANT'S CLAIMS UNDER THE BIT 41

1. Article 8 of the BIT 41

(a) The Respondent's Position 41

(b) The Claimant's Position 45

2. Article 3(2) of the BIT 49

(a) The Respondent's Position 49

(b) The Claimant's Position 51

E. WHETHER *LIS PENDENS* AND THE DOCTRINE AGAINST THE ABUSE OF PROCESS BAR THE CLAIMS OF THE CLAIMANT 53

(a) The Respondent's Position 53

(b) The Claimant's Position 55

VI. RELIEF REQUESTED 57

VII. THE TRIBUNAL'S ANALYSIS 58

A. APPLICABLE LAW 58

B. WHETHER THE CLAIMANT IS COVERED BY THE TREATY 58

1. Whether the Treaty extends to the Macao SAR 58

(a) The theoretical analysis of the relevance of the 1999 Notification to the Secretary-General of the UN 58

(b) The relevance of Article 29 of the VCLT and Article 15 of the VCST 60

(c) The Tribunal's analysis of the concrete situation of the PRC/Laos BIT 65

2. Whether Sanum qualifies as an investor under the Treaty 80

(a) Whether Claimant is established under the municipal laws of the PRC..........80

(b) Whether Sanum qualifies as an "economic entity" within the meaning of the Treaty? 81

3. Whether the Claimant has made an investment in Laos 83

4. Whether Laos Consented to Arbitrate Sanum's Claims under the Treaty...........84

(a) Whether the Respondent has consented to arbitrate Sanum's claims under Article 8 of the Treaty..84

(b) Whether the Respondent has consented to arbitrate Sanum's claims under Article 3(2) 90

5. Whether the Doctrines of *Lis Pendens* and Against the Abuse of Process Bar the Claims of the Claimant..94

VIII. COSTS 96

IX. DECISION...97

I. THE PARTIES AND THEIR REPRESENTATIVES

1. The Claimant is Sanum Investments Limited ("**Sanum**" or **"Claimant**"), an entity incorporated in the Macao Special Administrative Region of the People's Republic of China ("**PRC**") ("**Macao SAR**" or "**Macao**"). The Claimant is represented by Mr. David W. Rivkin and Ms. Catherine M. Amirfar (Debevoise & Plimpton LLP, New York); Mr. Christopher K. Tahbaz (Debevoise & Plimpton LLP, Hong Kong); and Mr. Todd Weiler (Barrister & Solicitor, London, Ontario, Canada).

2. The Respondent is the Government of the Lao People's Democratic Republic ("**Laos**" or "**Respondent**"). The Respondent is represented by the Laos Ministry of Foreign Affairs, Mr. David Branson (King Branson LLC, Washington, D.C.), Ms. Jane Willems, Ms. Teresa Cheng S.C. (De Voeux Chambers, Hong Kong), Professor George A. Bermann (Columbia University School of Law, New York) and L.S. Horizon (Vientiane).

II. PROCEDURAL HISTORY

3. The Claimant commenced these proceedings by a Notice of Arbitration ("**Notice**") dated 14 August 2013 pursuant to the Agreement between the Government of the People's Republic of China and the Government of the Lao People's Democratic Republic Concerning the Encouragement and Reciprocal Protection of Investments dated 31 January 1993 (**"PRC/Laos Treaty**", "**BIT**", "**Treaty**").[1]

4. On 8 May 2013, the Tribunal and the Parties attended a first procedural conference in London.

5. On 21 May 2013, after consultation with the Parties, the Tribunal issued Procedural Order No. 1, which designated: (a) Singapore as the place of arbitration; (b) the Permanent Court of Arbitration ("**PCA**") as Registry; and (c) the 2010 UNCITRAL Arbitration Rules as the applicable procedural rules. Procedural Order No. 1 also set forth the timetable of the proceedings.

6. On 7 June 2013, the Claimant filed an Amended Notice of Arbitration ("**Amended Notice**").

7. On 9 August 2013, the Respondent filed its Memorial on Jurisdiction with exhibits RE-01 to RE-18 and legal authorities RA-01 to RA-25.

---

[1] PRC/Laos Treaty (Ex. D to Claimant's Amended Notice of Arbitration).

8. On 1 October 2013, the Claimant filed its Statement of Claim and Response on Jurisdiction with (a) witness statements of Mr. John Baldwin, Mr. Clay Crawford, Mr. Richard A. Pipes; (b) expert reports of Mr. Joseph P. Kalt, Ph.D. (with Appendices A to C) and the Innovation Group (with Appendices A to G); (c) exhibits C-1 to C-421; and (d) legal authorities CLA-1 to CLA-118.

9. On 8 October 2013, the Tribunal held a pre-hearing telephone conference call with the Parties.

10. On 11 October 2013, the Presiding Arbitrator issued Procedural Order No. 2 on behalf of the Tribunal.

11. On 17 October 2013, the Respondent submitted its Reply in Support of its Objection to Jurisdiction with exhibits RE-19 to RE-23 and legal authorities RA-27 to RA-34.

12. On 31 October 2013, the Claimant filed its Rejoinder on Jurisdiction accompanied by exhibit C-422 and legal authorities CLA-119 to CLA-125.

13. On 6 November 2013, a hearing on jurisdiction was held in Singapore ("**Hearing on Jurisdiction**").[2] The attendees for the Claimant were Mr. John Baldwin, Mr. Shawn Scott, Mr. David Rivkin, Ms. Catherine M. Amirfar, Ms. Samantha J. Rowe, Dr. Todd Weiler, and Ms. Swee Yen Koh. The attendees for the Respondent were Ms. Jane Willems, Mr. David Branson, Mr. Werner Tsu, Mr. Kongphanh Santivong, Prof. Dr. Bountiem Phissamay, Mr. Ket Kiettisak, Mr. Khampheth Viraphondet, Mr. Sith Siripraphanh, Mr. Outakeo Keodouangsingh and Mr. Phoukong Sisoulath.

14. At the conclusion of the Hearing on Jurisdiction, the Tribunal requested the Parties to file further submissions on (a) the respective roles, if any, of Article 29 of the 1969 Vienna Convention on the Law of Treaties ("**VCLT**") and Article 15 of the 1978 Convention on the Succession of States in Respect of Treaties ("**VCST**"), in relation to the application or non-application of the PRC/Laos Treaty to the Macao SAR; and (b) an analysis of the texts of the PRC/Portugal, PRC/Netherlands, Macao/Portugal, Macao/Netherlands bilateral investment treaties to determine whether there exists any relationship between the treaties entered into by Macao and those entered into by the PRC.[3]

---

[2] In advance of the Hearing on Jurisdiction, the Parties provided the Tribunal with an agreed core hearing bundle of exhibits and legal authorities.

[3] Hearing Transcript, pp. 175-176; Agreement between the Kingdom of the Netherlands and the Macao SAR of the PRC on Encouragement and Reciprocal Protection of Investments, signed 22 May 2008

15. On 15 November 2013, the Respondent submitted its Post-Hearing Submission in Support of its Objection to Jurisdiction accompanied by Tables 1 to 4 and exhibits RE-24 to RE-46 and legal authorities RA-35 to RA-53 (“**Respondent’s Post-Hearing Submission**”), and the Claimant submitted its Response to the Tribunal’s Questions on Jurisdiction accompanied by legal authorities CLA-126 to CLA-150 (“**Claimant’s Response**”).

16. Following several e-mails from the Parties on 17 and 18 November 2013, on behalf of the Tribunal, the Presiding Arbitrator directed the Parties to refrain from providing additional submissions unless invited to do so by the Tribunal.

17. In Procedural Order No. 1, the Tribunal undertook to its decision on jurisdiction in a brief statement to the Parties indicating whether the jurisdictional objections were upheld or denied as soon as possible and not later than 15 December 2013. Such statement was to be followed by a fully reasoned decision of the Tribunal. This Award on Jurisdiction constitutes the fully reasoned decision of the Tribunal and thus obviates the need for a brief statement.

III. FACTUAL BACKGROUND

18. Prior to 1999, Macao was considered a “Chinese territory” over which Portugal exercised administrative power.[4] After the handover of Macao by Portugal in 1999, the PRC resumed sovereignty over Macao and established it as a special administrative region (“**SAR**”) under Article 31 of the Constitution of the PRC and the Basic Law of the Macao SAR (“**Macao SAR Basic Law**”).[5]

19. On 13 December 1999, the PRC filed a Notification regarding the Macao SAR with the Secretary-General of the United Nations (“**UN**”) (“**1999 Notification**”)[6] that is recorded in a

---

(“**Macao/Netherlands BIT**”) (CLA-128); Agreement between the Portuguese Republic and the SAR of Macao of the PRC Regarding the Reciprocal Promotion and Protection of Investments, signed 17 May 2000 (“**Macao/Portugal BIT**”) (CLA-129); Agreement on Encouragement and Reciprocal Protection of Investments between the Government of the PRC and the Government of the Kingdom of the Netherlands, signed 26 November 2001 (“**PRC/Netherlands BIT**”) (CLA-130); Agreement between the Portuguese Republic and the PRC on the Encouragement and Reciprocal Protection of Investments, signed 10 December 2005 (“**PRC/Portugal BIT**”) (CLA-131).

[4] Respondent’s Memorial on Jurisdiction, ¶ 23 referring to Articles 5(4) and 292 of the 1976 Constitution of Portugal, 2 April 1976 (RE-10); and Article 1 of the Joint Declaration of the Government of the PRC and the Government of the Republic of Portugal on the Question of Macao, 13 April 1987 (“**Joint Declaration**”) (RE-11).

[5] Respondent’s Memorial on Jurisdiction, ¶¶ 25, 73; Claimant’s Statement of Claim and Response on Jurisdiction, ¶ 227. .

[6] 1999 Notification (RE-08).

UN document entitled *Multilateral Treaties Deposited with the Secretary-General: Status as at 1 April 2009*.[7]

20. Sanum was established on 14 July 2005 under the laws of the Macao SAR.

21. In the spring of 2007, Mr. John Baldwin, Chairman of the Board of Sanum, travelled to Laos to explore possibilities for investing in Laos upon learning that a locally incorporated entity involved in the resort and gaming business—the ST Group ("**ST**")—was in need of financing to develop its gaming business.[8]

22. According to the Claimant, Mr. Baldwin subsequently met with individuals, attorneys, representatives of ST, and high-ranking government officials to discuss cooperation in the development of gaming enterprises in Laos.[9] Sanum eventually became involved in the operation and development of two casinos and five slot clubs in Laos.

23. The Claimant alleges that, prior to its investment, its representatives were assured by Laos government officials, including the Prime Minister, that Laos had favorable conditions for foreign investors,[10] strongly respected the rule of law,[11] and that Sanum would be accorded an ongoing majority control of its investment and long-term protection and security for those investments and their returns,[12] as well as a favorable and certain tax regime.[13] Sanum submits that the Prime Minister personally assured it that partnering with ST would be beneficial to it,[14] and that Laos would protect Sanum's investment.[15] Sanum further alleges that other officials of the Respondent also assured Sanum representatives that they would support Sanum for as long as it lived up to its commitments.[16]

---

7 United Nations, *Multilateral Treaties Deposited with the Secretary-General: Status as at 1 April 2009* (2009), Historical Information, China, Note 3, at VIII ("**UN Status of Multilateral Treaties**") (CLA-115/RE-18).

8 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 44.

9 Amended Notice, ¶¶ 18-19; Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 45-48.

10 Amended Notice, ¶ 20.

11 Amended Notice, ¶ 24; Claimant's Statement of Claim and Response on Jurisdiction, ¶ 52.

12 Amended Notice, ¶ 20.

13 Amended Notice, ¶ 21; Claimant's Statement of Claim and Response on Jurisdiction, ¶ 52.

14 Amended Notice, ¶ 22.

15 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 53.

16 Amended Notice, ¶ 23.

Conclusion of the Master Agreement

24. Sanum and ST formalized their relationship in a Master Agreement dated 30 May 2007, which would govern all of the joint ventures in which the parties would participate.[17] Specifically, ST promised Sanum 60% of each of its existing (and all future) gaming ventures, and Sanum promised to make payments to ST (*e.g*. US$1.5 million upon signing the Master Agreement and US$2 million upon receiving the government approvals to be arranged by ST) and to finance the development of their planned ventures.[18] According to the Respondent, the Master Agreement was not intended to be a definitive agreement, but an "agreement to agree."[19]

25. The Master Agreement envisaged the creation of three joint ventures: (1) the Savan Vegas Hotel and Casino ("**Savan Vegas**"), for which ST already held a concession; (2) the Paksong Vegas Hotel and Casino ("**Paksong Vegas**"), for which ST already held a concession; and (3) three slot clubs: the Vientiane Friendship Bridge Slot Club, also known as the Thanaleng Slot Club ("**Thanaleng**"); the Lao Bao Slot Club ("**Lao Bao**"); and the Ferry Terminal Slot Club, also known as Daensavan Slot Club ("**Ferry Terminal**").[20]

26. Sanum's investment and ownership in all of the joint ventures were contingent upon Government acceptance and approval.[21]

27. The Master Agreement provided that the gaming rights would be exclusively those of the joint ventures.[22]

Project Development Agreements

28. On 10 August 2007, two project development agreements ("**PDAs**") were concluded.[23]

---

[17] Amended Notice, ¶ 26; Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 49-51; Respondent's Memorial on Jurisdiction, ¶ 4.

[18] Amended Notice, ¶ 26; Claimant's Statement of Claim and Response on Jurisdiction, ¶ 49.

[19] Respondent's Memorial on Jurisdiction, ¶ 4.

[20] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 50; Respondent's Memorial on Jurisdiction, ¶ 5.

[21] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 51; Respondent's Memorial on Jurisdiction, ¶ 6.

[22] Respondent's Memorial on Jurisdiction, ¶ 6.

[23] Respondent's Memorial on Jurisdiction, ¶ 7.

29. The first was concluded between Laos on the one hand and Sanum, Xaya Construction Co. Ltd. (a Laotian company), and Mr. Xaysana Xaysoulivong, on the other hand, with respect to Savan Vegas ("**Savan Vegas PDA**").[24] Therein, it was agreed that a joint venture—Savan Vegas and Casino Co. Ltd.—would be established under the laws of Laos to implement the Savan Vegas PDA ("**Savan Vegas JVC**").[25] The share ownership was divided as follows: Laos would own 20%, Sanum 60%, Xaya Construction Co. Ltd. 10%, and Mr. Xaysoulivong 10%.[26]

30. The second PDA was concluded between Laos on the one hand and Sanum, Nouansavanh Construction Co. Ltd. (a Laotian company), and Mr. Sittixay Xaysana, on the other hand, with respect to Paksong Vegas ("**Paksong Vegas PDA**").[27] Therein, it was agreed that a joint venture—Paksong Vegas and Casino Co. Ltd.—would be established under the laws of Laos to implement the Paksong Vegas PDA ("**Paksong Vegas JVC**").[28] The share ownership was divided as follows: Laos would own 20%, Sanum 60%, Nouansavanh Construction Co. Ltd. 10%, and Mr. Xaysana 10%.[29]

31. Both PDAs provided for dispute settlement by arbitration before the Economic Dispute Organization in Singapore.[30]

32. The Claimant submits that, through the PDAs, the Government agreed to an "Investment Incentive Policy" pursuant to which the joint ventures would be exempt from certain taxes.[31] According to the Claimant, the Government subsequently entered into a Flat Tax Agreement ("**FTA**") with Savan Vegas that capped annual taxes through the end of 2013.[32]

33. On 31 October 2007, the Government, Sanum, and ST executed Shareholders' Agreements for Savan Vegas and Paksong Vegas.[33]

---

24 Respondent's Memorial on Jurisdiction, ¶ 7; Savan Vegas PDA (RE-03).

25 Respondent's Memorial on Jurisdiction, ¶ 7.

26 Respondent's Memorial on Jurisdiction, ¶ 7.

27 Respondent's Memorial on Jurisdiction, ¶ 7; Paksong Vegas PDA (RE-04).

28 Respondent's Memorial on Jurisdiction, ¶ 7.

29 Respondent's Memorial on Jurisdiction, ¶ 7.

30 Article 22 of the Savan Vegas PDA (RE-03) and Paksong Vegas PDA (RE-04).

31 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 7

32 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 7

33 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 57; Shareholders' Agreement between the Lao Government, Sanum, Xaya Construction Co., Ltd., Xaysana Xaysoulivong, and Savan Vegas, dated 31 October 2007 ("**Savan Vegas Shareholders' Agreement**") (C-056); Shareholders' Agreement

The Slot Clubs

34. According to the Claimant, negotiations over the future ownership and management of ST's three existing slot clubs—Thanaleng, Lao Bao, and Ferry Terminal—also proceeded in 2007 and 2008.[34]

35. On 6 August 2007, Sanum and ST entered into a Participation Agreement concerning the Lao Bao and Ferry Terminal Slot Clubs according to which Sanum would supply and maintain certain gaming machines in exchange for a percentage share in the revenue generated (60%).[35] Sanum and ST also entered into additional agreements concerning the Lao Bao and Ferry Terminal Slot Clubs, which granted Sanum management control of the clubs and protection of its 60% stake.[36]

36. On 4 October 2008, Sanum and ST entered into a Participation Agreement concerning the Thanaleng Slot Club, pursuant to which Sanum would supply and maintain certain gaming machines in exchange for revenue share.[37]

37. Sanum claims that it also invested in new slot club ventures in the provinces in which the Government had granted its investments monopoly gaming rights. On 25 October 2009, Savan Vegas opened a new slot club in Paksan. It also began exploring the possibility of having Savan Vegas open a slot club and international welcome center in Thakhaek.[38]

38. The Claimant describes its investment in Laos as follows:

> Sanum has made substantial investments […], including capital investments in its various Lao enterprises and projects exceeding US$85 million. It is a majority shareholder in both Savan Vegas and Paksong Vegas, which have been granted fifty-year land and development concessions and enjoy valuable monopoly gaming rights in five provinces pursuant to several agreements with the Lao Government, including the [PDAs] for each casino project. Sanum has ownership stakes in the Thanaleng, Lao Bao, and Ferry

---

between the Lao Government, Sanum, Nouansavanh Construction Co., Ltd., and Lao River Mining Sole Co., Ltd., and Paksong Vegas, dated 31 October 2007 ("**Paksong Vegas Shareholders' Agreement**") (C-057).

[34] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 59.

[35] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 59; Lao Bao and Ferry Terminal Participation Agreement, dated 6 August 2007 (C-051).

[36] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 59; Ancillary Agreement between ST and Sanum, dated 1 September 2009 (C-063); Assignment of Lease, Ferry Terminal slot club, dated 1 September 2009 (C-064); Assignment of Leases, Lao Bao Slot Club, dated 1 September 2009 (C-065).

[37] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 59.

[38] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 60.

> Terminal slot clubs, and is entitled to a share of their revenues. Sanum also brought in highly experienced slot and casino managers to assist in running Savan Vegas, and it has leveraged its extensive knowledge of the gaming industry to introduce new multistation games at Thanaleng, which proved very popular and contributed to the club's success. Such industry expertise and business know-how has generated considerable returns for Sanum's businesses, which have operated pursuant to the required licenses issued by the Lao Government.[39]

The Claimant's Claims

39. It is the Claimant's case that its investments, once operational, were successful, but that the Government of Laos, including its courts and provincial authorities, conducted itself in such a way as to breach multiple obligations under the Treaty; namely, breach of (a) the fair and equitable treatment obligation under Article 3(1); (b) the expropriation provision in Article 4; (c) the guarantee of transfer of payments provision in Article 5; and (d) the obligation under Article 3(2) to provide an investor no less favorable treatment than that provided to investors of third States.[40]

The Respondent's Limited Response on the Facts

40. The Respondent makes limited submissions on the facts at this stage of the proceedings.[41] It submits that (a) the investors have not made any capital investments but rather claim (without providing documentary evidence) to have loaned approximately US$65 million to the casino;[42] (b) over the first four years of casino operations, Savan Vegas reported gambling revenues increased to US$74 million per year but, according to Savan Vegas, every year the casino made a loss, relieving it of its obligation to pay out to its shareholders;[43] (c) there are concerns over the legitimacy of claimed expenses on the casino's books and loans apparently paid by Mr. Baldwin with respect to which he has been receiving interest payments.[44] The Respondent intimates that it will file a counterclaim seeking to terminate all of the relevant agreements with the Claimant.[45]

---

[39] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 273; Hearing Transcript, p. 66.

[40] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 313.

[41] Respondent's Reply on Jurisdiction, ¶¶ 54-57.

[42] Respondent's Reply on Jurisdiction, ¶ 55.

[43] Respondent's Reply on Jurisdiction, ¶ 56.

[44] Respondent's Reply on Jurisdiction, ¶ 56.

[45] Respondent's Reply on Jurisdiction, ¶ 57.

Related Proceedings

41. On the same day that the present arbitration was commenced, Lao Holdings N.V. ("**Lao Holdings**"), a company formed in Aruba, the Netherlands, and the 100% owner of Sanum, also commenced arbitration proceedings against Laos pursuant to the bilateral investment treaty concluded between the Netherlands and Laos in 2005 ("**Lao Holdings Arbitration**").[46]

42. In April 2013, Lao Holdings requested provisional measures from the tribunal in the related proceedings.[47] On 17 September 2013, the tribunal in the Lao Holdings Arbitration awarded provisional measures to the claimant ordering the parties to maintain the *status quo* with respect to investments subject to that arbitration.[48]

IV. RELEVANT LEGAL PROVISIONS

43. The Preamble to the Treaty provides, in relevant part:

> The Government of the People's Republic of China and the Government of the Lao People's Democratic Republic (hereinafter referred to as Contracting States),
> Desiring to encourage, protect and create favorable conditions for investment by investors of one Contracting State in the territory of the other Contracting State based on the principles of mutual respect for sovereignty, equality and mutual benefit and for the purpose of the development of economic cooperation between both States […]

44. Article 1(1) of the Treaty provides, in relevant part:

> The term "investments" means every kind of asset invested by investors of one Contracting State in accordance with the laws and regulations of the other Contracting State in the territory of the latter, including mainly
> (a) movable and immovable property and other property rights;
> (b) shares in companies or other forms of interest in such companies;
> (c) a claim to money or to any performance having an economic value;
> (d) copyrights, industrial property, know-how and technological process;
> (e) concessions conferred by law, including concessions to search for or to exploit natural resources.

45. Article 1(2)(b) of the Treaty provides, in relevant part:

> The term "investors" means:
> In respect of both Contracting States: […]
> (b) economic entities established in accordance with the laws and regulations of each contracting State.

---

[46] Respondent's Memorial on Jurisdiction, ¶ 2(iii).

[47] Respondent's Memorial on Jurisdiction, ¶ 10.

[48] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 24.

46. Article 3(1) and 3(2) of the Treaty provide:

> (1) Investments and activities associated with investments of investors of either Contracting State shall be accorded fair and equitable treatment and shall enjoy protection in the territory of the other Contracting State.
>
> (2) The treatment and protection as mentioned in Paragraph 1 of this Article shall not be less favorable than that accorded to investments and activities associated with such investments of investors of a third State.

47. Article 4(1) and 4(2) of the Treaty provide:

> (1) Neither Contracting State shall expropriate, nationalize or take similar measures (hereinafter referred to as "expropriation") against investments of investors of the other Contracting state in its territory, unless the following conditions are met:
> (a) as necessitated by the public interest;
> (b) in accordance with domestic legal procedures;
> (c) without discrimination;
> (d) against appropriate and effective compensation.
>
> (2) The compensation mentioned in paragraph 1(d) of this Article shall be equivalent to the value of the expropriated investments at the time when expropriation is proclaimed, be convertible and freely transferable. The compensation shall be paid without unreasonable delay.

48. Article 8(1), 8(2), and 8(3) of the Treaty provide:

> (1) Any dispute between an investor of one Contracting State and the other Contracting State in connection with an investment in the territory of the other Contracting State shall, as far as possible, be settled amicably through negotiation between the parties to the dispute.
>
> (2) If the dispute cannot be settled through negotiation within six months, either party to the dispute shall be entitled to submit the dispute to the competent court of the Contracting State accepting the investment.
>
> (3) If a dispute involving the amount of compensation for expropriation cannot be settled through negotiation within six months as specified in paragraph 1 of this Article, it may be submitted at the request of either party to an ad hoc arbitral tribunal. The provisions of this paragraph shall not apply if the investor concerned has resorted to the procedure specified in the paragraph 2 of this Article.

49. Article 29 of the VCLT states:

> Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.

50. Article 15 of the VCST provides:

> When part of the territory of a State, or when any territory for the international relations of which a State is responsible, not being part of the territory of that State, becomes part of the territory of another State:

> a) treaties of the predecessor State cease to be in force in respect of the territory to which the succession of States relates from the date of the succession of States; and
>
> b) treaties of the successor State are in force in respect of the territory to which the succession of States relates from the date of the succession of States, unless it appears from the treaty or is otherwise established that the application of the treaty to that territory would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

V. SUMMARIES OF THE PARTIES' ARGUMENTS

A. WHETHER THE CLAIMANT IS COVERED BY THE BIT

1. Whether the BIT extends to the Macao SAR

(a) The Respondent's Position

51. The Respondent argues that the BIT does not provide protection to the Claimant because the BIT does not extend to cover the Macao SAR.[49]

52. The Respondent notes that the PRC resumed the exercise of sovereignty over Macao in 1999, and established Macao as an SAR pursuant to Article 31 of the PRC Constitution and the Macao SAR Basic Law.[50] The Respondent alleges that the Macao SAR Basic Law establishes the capacity of Macao to enter into international trade arrangements on its own behalf[51] and to adopt its own policies and laws on the protection and development of industry and commerce,[52] which includes the power to execute bilateral investment treaties.[53] It further contends that the Macao SAR Basic Law provides that international agreements to which the PRC is a party would not apply automatically in the Macao SAR but must instead be decided by the Central Government of the PRC.[54]

49 Respondent's Memorial on Jurisdiction, ¶¶ 32-37.

50 Respondent's Memorial on Jurisdiction, ¶¶ 25, 71.

51 Respondent's Memorial on Jurisdiction, ¶ 27; Articles 106 and 112 of the Basic Law of the Macao SAR (RE-09).

52 Respondent's Memorial on Jurisdiction, ¶ 28; Article 114 of the Basic Law of the Macao SAR (RE-09).

53 Respondent's Memorial on Jurisdiction, ¶¶ 29-30; Articles 22 and Article 136 of the Basic Law of the Macao SAR (RE-09).

54 Respondent's Memorial on Jurisdiction, ¶ 31; Article 138 of the Basic Law of the Macao SAR (RE-09).

53. According to the Respondent, it is common ground that Article 29 of the VCLT, which contains the customary international law rule of "moving treaty frontiers", is operative in this case because Laos and the PRC are both signatories to the VCLT.[55]

54. The Respondent further submits that Article 15 of the VCST is an expression of customary international law.[56] According to the Respondent, the rule is "commonly understood to have two aspects, one negative (treaties of the predecessor State cease to be in force in the portion of territory in question, except for certain types of treaties or specific circumstances) and one positive (treaties of the successor State become in force in the portion of territory in question, except for certain types of treaties or specific circumstances)."[57] The Respondent specifies that the "rule formulated in Article 15 of the [VCST] in its negative and positive aspects and the exceptions applicable to the rule in both aspects are well grounded in customary international law."[58]

55. The Respondent submits that both Articles 29 of the VCLT and Article 15 of the VCST co-exist, are "very closely connected" and compatible.[59]

56. It is the Respondent's case that the Treaty does not extend to the Macao SAR because it falls within the exceptions to Article 29 of the VCLT[60] and the exceptions to Article 15 of the VCST.[61]

---

55 Respondent's Post-Hearing Submission, ¶ 2.

56 Respondent's Post-Hearing Submission, ¶¶ 2-12, referring to, *inter alia*, Cahier, "Quelques aspects de la Convention de 1978 sur la succession d'Etats en matière de traités", in Dutoit and Grisel (eds), *Mélanges Georges Perrin* (Lausanne: Payot, 1984), pp. 73-74 ("**Cahier**") (RA-39). In an e-mail dated 17 November 2013, the Claimant submitted that the Respondent's reference to Cahier:

> "misleadingly implies that Cahier was discussing the exceptions in Article 15 as being custom, when it is clear from an even cursory review that he was instead describing the customary moving treaty frontiers rule – *and not* the exceptions that were added to Article 15 by the International Law Commission. (The full, brief discussion by Cahier of Article 15 was the following: 'Article 15 provides that when part of a State's territory becomes part of the territory of another State, the predecessor's treaties cease to apply and the successor's treaties become applicable to it. This rule is the corollary of the principle announced in Article 29 of the VCLT, according to which a treaty is binding upon each party with regard to its entire territory. This provision corresponds to State practice, it was adopted without amendment at the Conference and it simply codifies a customary rule.')." (Claimant's emphasis)

See also Hearing Transcript, pp. 54, 57.

57 Respondent's Post-Hearing Submission, ¶ 4.

58 Respondent's Post-Hearing Submission, ¶ 12.

59 Respondent's Post-Hearing Submission, ¶¶ 15-16, 22.

60 Respondent's Memorial on Jurisdiction, ¶¶ 35-37; Hearing Transcript, p. 16.

57. The Respondent contends that the 1999 Notification filed by the PRC with the UN Secretary-General as depositary operates as a reservation to the territorial application of the BIT to the Macao SAR.[62] The Respondent emphasizes that the 1999 Notification *specifically* provided for the application of the treaties listed in its Annexes I and II to the Macao SAR,[63] and that the BIT was not listed in either of these two Annexes.[64]

58. The Respondent cites paragraph IV of the 1999 Notification, which states that the PRC "will go through separately the necessary formalities for [the] application [of treaties that are not listed in the Annexes to this Note] to the Macao [SAR] if it so decided."[65] The Respondent argues that Laos would have had to have been notified separately if the BIT were to be extended to the Macao SAR and it was not.[66] The Respondent also notes that Article 138 of the Macao SAR Basic Law requires consultation with the Macao SAR before a decision regarding treaty application, and points to the absence of evidence in this case that the Macao SAR has indeed been consulted.[67]

59. The Respondent rejects the argument of the Claimant that the 1999 Notification relates only to multilateral treaties by stating that: (a) the Overview of the UN Treaty Collection ("**UNTC**") does not distinguish between the different locations as to where the 1999 Notification is deposited; (b) the UNTC covers both multilateral and bilateral treaties; (c) the capacity of the UN to register, file and record treaties is not distinct as between bilateral and multilateral treaties; (d) Article 102 of the UN Charter requires "treaties" and "international agreements" to be registered with the Secretariat before parties to such treaties or agreements can invoke them before an organ of the UN, and, while neither the UN Charter nor the regulations define either term, the Secretariat defers to the definition of Member States submitting such instruments for registration; and (e) there is no distinction with regard to the depositary practice for bilateral and multilateral treaties.[68] The Respondent further notes that the requirements for the deposit of

---

61 Respondent's Memorial on Jurisdiction, ¶ 32; Hearing Transcript, pp. 15-16.

62 Hearing Transcript, pp. 20, 148-149.

63 Respondent's Memorial on Jurisdiction, ¶ 41.

64 Respondent's Memorial on Jurisdiction, ¶ 42; Hearing Transcript, pp. 18-19.

65 Respondent's Memorial on Jurisdiction, ¶¶ 41, 43; Hearing Transcript, p. 19.

66 Respondent's Memorial on Jurisdiction, ¶¶ 43, 53(5); Hearing Transcript, p. 26.

67 Respondent's Memorial on Jurisdiction, ¶¶ 43, 53(6), 78; Hearing Transcript, pp. 59-60.

68 Respondent's Reply on Jurisdiction, ¶ 42, referring to the UNTC at http://treaties.un.org; UN Charter: Chapter XVI: Miscellaneous Provisions (RA-28); Definition key terms used in the UNTC at http://treaties.un.org/Pages/Overview.aspx?path=overview/definition/page1_en.xml#agreements (RA-29); Notes verbales from the Legal Counsel relating to the depositary practice and the registration of treaties

instruments does not limit the UN Secretary-General to acting as depositary for multilateral treaties alone (in spite of the focus on multilateral treaties by the Summary of Practice of the Secretary-General as Depositary of Multilateral Treaties[69]) as evidenced by the phrase "deposit of binding instruments."[70]

60. Further, the Respondent submits that the reference to "multilateral treaties" in the UN document containing the 1999 Notification does not change the *effect* of the PRC's notification in which the PRC expressly refers to international agreements, and draws no distinction between multilateral or bilateral treaties.[71] The Respondent also argues that the Claimant's submission that the notification only applies to treaties that are to be deposited with the Secretary-General as depositary is irrelevant because that is an external reference and what should be considered is the intent of the PRC as expressed in the 1999 Notification, *i.e.*, that the Treaty is not listed as one that extends to the Macao SAR.[72]

61. In the Respondent's view, there exists an important body of practice as well as authority regarding the qualification of the rule of automatic succession (or extension) of treaties when it comes to certain types of treaties or circumstances, *e.g.*, "personal" or "bilateral" treaties.[73] According to the Respondent, the 1999 Notification drew a distinction between (a) treaties that apply to Macao by virtue of the application to the entire Chinese territory (including Macao) as a result of their character (*e.g.*, treaties concerning foreign affairs or defense); and (b) treaties that applied to Macao before 20 December 1999, the date of transfer of sovereign rights.[74] To determine whether treaties concluded by the PRC but not included in the 1999 Notification

---

pursuant to Article 102 of the UN Charter, http://treaties.un.org/Pages/Overview.aspx?path=overview/definition/page1_en.xml#agreements (RA-30).

[69] *Summary of Practice of the Secretary-General as Depositary of Multilateral Treaties*, ST/LEG/7/Rev. 1, United Nations, New York, 1999, ¶¶ 277, 285 (1999) ("**Summary of UNSG Depositary Practice**") (RA-03).

[70] Respondent's Reply on Jurisdiction, ¶ 43, referring to the Communication from the Legal Counsel of the United Nations in relation to the requirements for the deposit of instruments of ratification, acceptance, approval, accession and the like with the Secretary-General dated 11 March 2002 (Ref: LA41TR/221/1) (RA-31); see also Summary of UNSG Depositary Practice (RA-03).

[71] Hearing Transcript, pp. 149, 155-156.

[72] Hearing Transcript, pp. 149-150.

[73] Respondent's Post-Hearing Submission, ¶¶ 17-19.

[74] Respondent's Post-Hearing Submission, ¶ 20.

extend to Macao, the Respondent considers that it is necessary to refer to the treaty-making powers of Macao under the Joint Declaration and the Macao SAR Basic Law.[75]

62. The Respondent emphasizes the fact that both instruments recognize Macao's treaty-making powers in economic and cultural matters.[76] The Respondent argues that "[u]nder these conditions, there can be no doubt that bilateral investment treaties and other commercial treaties concluded by China with third countries do not automatically apply to Macao under the positive aspect of the basic rule [of Article 15] but are instead the object of an exception to such rule."[77]

63. The Respondent cites Article 20(5) of the VCLT which states that a State is deemed to have accepted a reservation if it has raised no objection within twelve months after either being notified of the reservation or expressing consent to the treaty, whichever is later.[78] The Respondent notes that Laos did not object to the 1999 Notification within the stipulated twelve months.[79]

64. The Respondent stresses that a state's unilateral declaration can create legal obligations,[80] regardless of the declaration's form.[81] The Respondent contends that good faith binds States to international obligations that are created by a unilateral declaration and that interested States are entitled to demand that such obligations be respected.[82] The Respondent argues that paragraph

---

75 Respondent's Post-Hearing Submission, ¶ 20; Joint Declaration (RE-11); Basic Law of the Macao SAR (RE-09).

76 Respondent's Post-Hearing Submission, ¶ 20; Respondent's Memorial on Jurisdiction, ¶ 27; Articles 106 and 112 of the Basic Law of the Macao SAR (RE-09); Joint Declaration (RE-11); Hearing Transcript, pp. 147-148

77 Respondent's Post-Hearing Submission, ¶ 21.

78 Respondent's Memorial on Jurisdiction, ¶ 44, referring to Article 20(5) of the VCLT (RE-07), which provides:

> "[…] unless the treaty otherwise provides, a reservation is considered to have been accepted by a State if it shall have raised no objection to the reservation by the end of a period of twelve months after it was notified of the reservation or by the date on which it expressed its consent to be bound by the treaty, whichever is later."

79 Respondent's Memorial on Jurisdiction, ¶ 44, referring to Article 20(5) of the VCLT (RE-07); Hearing Transcript, p. 27.

80 Respondent's Memorial on Jurisdiction, ¶¶ 49-51, referring to the *Nuclear Tests Case (New Zealand v. France)*, Judgment, I.C.J. Reports 1974 (20 Dec. 1974) ¶¶ 43, 45-47 ("***Nuclear Tests Case***") (RA-05) and Summary of Judgment in the *Nuclear Tests Case*, p. 99 (RA-06); Mr. Victor R. Cedeño, "First Report on Unilateral Acts of States," (A/CN.4/486), (1998) 2 YBILC (Part One), p. 327, ¶¶ 59, 86, 89 ("**Cedeño**") (RA-07); Hearing Transcript, pp. 24-25.

81 Respondent's Memorial on Jurisdiction, ¶ 52, referring to Cedeño, ¶ 85 (RA-07).

82 Respondent's Memorial on Jurisdiction, ¶ 54, referring to the *Nuclear Tests Case*, at ¶ 54 (RA-05); Hearing Transcript, p. 25.

IV of the 1999 Notification entitles Laos to rely on the PRC's unilateral declaration and supports its legitimate expectation that the BIT not be extended to the Macao SAR until the PRC made a notification to this effect.[83]

65. The Respondent notes that Laos accepted the position of the PRC by not objecting to it or otherwise taking any action with regard to it over the years.[84] From the above, the Respondent contends that the Contracting Parties had effectively established a different intention from the customary rule in Article 29 of the VCLT.[85]

66. The Respondent clarifies that, contrary to the contention of the Claimant, reservations can apply in the bilateral context and are not explicitly excluded by the VCLT.[86] It also distinguishes the present case from those cited by the Claimant, by noting that those cases involved reservations being proposed prior to or during the signing of the bilateral treaties.[87] Respondent stresses in any case that it relies on the reservation as a unilateral declaration that gives rise to legitimate expectations on the part of the other party and, correspondingly, to legal implications such as estoppel by convention.[88] The Respondent also argues that, under public international law, the unilateral declaration of a state can amount to a reservation and satisfy the "otherwise established" exception contained in Article 29 of the VCLT.[89]

67. The Respondent points out that the BIT entered into force in 1993 at a time when Macao was a dependent territory of Portugal. In 1999, when the PRC assumed sovereignty over Macao and established the Macao SAR, the PRC could not have extended the application of the BIT to Macao because the governmental powers of the Macao SAR were established in the Macao SAR Basic Law.[90] It further notes that trade and investment policy operate separately as

---

83 Respondent's Memorial on Jurisdiction, ¶¶ 53, 60-64, referring to the *Nuclear Tests Case*, ¶ 57 (RA-05); Hearing Transcript, p. 26.

84 Respondent's Memorial on Jurisdiction, ¶¶ 56-57; Respondent's Reply on Jurisdiction, ¶ 31.

85 Respondent's Reply on Jurisdiction, ¶ 31.

86 Respondent's Reply on Jurisdiction, ¶ 29, referring to Dörr & Schmalenbach, *Vienna Convention on the Law of Treaties: A Commentary* (2012), p. 241 ("**Dörr and Schmalenbach**") (RA-26).

87 Respondent's Reply on Jurisdiction, ¶ 29.

88 Respondent's Reply on Jurisdiction, ¶ 29.

89 Respondent's Memorial on Jurisdiction, ¶¶ 45-47, referring to Dörr and Schmalenbach, pp. 493-494 (RA-26); Summary of UNSG Depositary Practice, ¶¶ 277, 285 (1999) (RA-03); Corten & Klein, *The Vienna Conventions on the Law of Treaties: A Commentary* (2011) (Oxford University Press), p. 738 ("**Corten & Klein**") (RA-04); see also Hearing Transcript, pp. 20, 22-24, referring to Dörr and Schmalenbach, pp. 500-501.

90 Respondent's Memorial on Jurisdiction, ¶¶ 71-72.

between Mainland China and the Macao SAR.[91] This is illustrated, the Respondent contends, by the fact that the Macao SAR entered into separate BITs with the Netherlands and Portugal after 1999.[92]

68. The Respondent clarifies that the issue of the territorial application of the BIT to the Macao SAR involves and is intended to involve consideration of the PRC Constitution and the Macao SAR Basic Law, as established by legal authority and references in the BIT to municipal law.[93] The Respondent notes that Article 18 of the Macao SAR Basic Law provides that PRC national laws must be listed in Annex III if they are to be incorporated in the laws of the Macao SAR.[94] On this basis, the BIT has never been extended to the Macao SAR and therefore can only have effect in Mainland China.[95]

69. In response to the argument of the Claimant that the PRC could have prevented the default application of the "moving treaty frontiers" rule by expressly excluding Macao from the territorial scope of the BIT when it was executed in 1993, as the PRC and Portugal had already entered into the Joint Declaration on the issue of Macao at that time, the Respondent states that: (a) in 1993, the PRC did not have the jurisdiction to state the position of Macao; and (b) the Joint Declaration of the PRC and Portugal entered into in 1987 contains provisions—namely, Articles 3, 4, and 5 and Annex II—regarding the autonomy of Macao that were still being negotiated and had not yet been finalized in 1993, making it impossible to ascertain the effect of this Joint Declaration at that time.[96] Moreover, the Claimant contends that the Joint Declarations entered into by the PRC for Macao and Hong Kong with Portugal and the United Kingdom respectively oblige it to maintain their capitalist systems and respect their autonomy.[97]

70. The Respondent also notes that the Claimant relies on the exception in the Agreement between the Government of the Russian Federation and the PRC on the Promotion and Reciprocal Protection of Investments ("**PRC/Russia BIT**") concerning its application to the Macao SAR.[98] The Respondent argues that, in that case, the PRC merely reiterated its position as enunciated in

---

[91] Respondent's Memorial on Jurisdiction, ¶¶ 73-75.

[92] Respondent's Memorial on Jurisdiction, ¶¶ 73-75.

[93] Respondent's Memorial on Jurisdiction, ¶¶ 67-70, referring to Corten & Klein, pp. 737-738 (RA-04), the Preamble and Articles 7 and 12 of the Treaty.

[94] Respondent's Memorial on Jurisdiction, ¶ 76.

[95] Respondent's Memorial on Jurisdiction, ¶ 76.

[96] Respondent's Reply on Jurisdiction, ¶ 26, referring to the Joint Declaration (RE-11).

[97] Respondent's Reply on Jurisdiction, ¶ 41.

[98] PRC/Russia BIT, signed 9 November 2006 (CLA-90).

the 1999 Notification; it chose to create the exception in the text of the treaty itself.[99] The Respondent asserts that this does not undermine or nullify the legal effect of the 1999 Notification,[100] and is "consistent with the position adopted by China since the resumption of sovereignty over Hong Kong and Macao in 1997 and 1999, respectively."[101]

71. In response to the argument of the Claimant that the Respondent's interpretation of the BIT would be contrary to the purpose of the investment treaty regime, in that it would deny Hong Kong and Macao investors the protection available to other Chinese investors, the Respondent submits that by the provisions of the Macao SAR Basic Law, Macao is given full autonomy of its economic affairs, including the power to enter into agreements with other States in the field of economics and trade (Articles 136 and 138 of the Macao SAR Basic Law).[102] This internal arrangement, the Respondent claims, evidences the intention of the PRC, enunciated in the 1999 Notification, to preclude the automatic application of the "moving treaty frontiers" rule in relation to both the PRC's bilateral and multilateral treaties entered into before the handover.[103] This is not inconsistent with the purposes of the investment treaty regime, the Respondent argues, because the economic structure and development of the PRC and Macao was indisputably different in 1999.[104]

72. In response to the Claimant's argument that the Respondent's interpretation would have a wide impact as it would be applicable to all Chinese BITs, the Respondent submits that the *Claimant's* interpretation would have the effect of rendering over 130 BITs automatically applicable to Hong Kong and Macao; something that was never contemplated.[105] This number exceeds the number of BITs each SAR has entered into in its history.[106] It also brings the application of the BIT under an exception to Article 15 of the VCST by radically changing the condition of its operation.[107] The Respondent points out that the Macao SAR has the autonomy

---

[99] Respondent's Reply on Jurisdiction, ¶ 40.

[100] Respondent's Reply on Jurisdiction, ¶ 40.

[101] Respondent's Post-Hearing Submission, ¶ 26.

[102] Respondent's Reply on Jurisdiction, ¶ 26.

[103] Respondent's Reply on Jurisdiction, ¶ 26.

[104] Respondent's Reply on Jurisdiction, ¶ 26.

[105] Respondent's Reply on Jurisdiction, ¶ 39; Hearing Transcript, pp. 58-59.

[106] Respondent's Reply on Jurisdiction, ¶ 39.

[107] Hearing Transcript, pp. 58, 147-148.

to enter into its own BITs with other States,[108] and, like Hong Kong, it *has* entered into its own BITs with other States.[109]

73. With reference to BITs with third states concluded by both the PRC and Macao as well as BITs with third States entered into by the PRC and Hong Kong, the Respondent notes that none contain an express provision extending them to the Macao or Hong Kong SARs, respectively.[110] The Respondent places particular emphasis on the PRC/Netherlands BIT in which the Netherlands expressly extended it to cover the Netherlands Antilles and Aruba whereas the PRC did not similarly extend it to cover Macao or Hong Kong.[111]

74. The Respondent also submits that (a) before and after the resumption of sovereignty, the PRC, Hong Kong, and Macao have each entered into BITs with the *same* third States; (b) the territorial definition in the BITs clearly indicates that Macao and the Hong Kong SARs have the power to enter into BITs to cover their own territory notwithstanding that the PRC has also entered into BITs with the same third States. This indicates that the territorial limit of the PRC BITs are confined to Mainland China.[112] The Respondent also points out that different forms of dispute resolution provisions have been resorted to by the PRC, Hong Kong and Macao.[113]

75. It is the Respondent's submission that, if the PRC BITs would, by reason of the "moving treaty frontiers" rule, automatically extend to Macao and Hong Kong after the resumption of sovereignty, the PRC would not allow the SARs to enter into BITs with the same third States with which it has concluded treaties.[114] Nor would that be necessary.[115] It would lead to "legal chaos" for foreign investors in the PRC, Macao and Hong Kong.[116]

---

[108] Respondent's Reply on Jurisdiction, ¶ 26.

[109] Respondent's Reply on Jurisdiction, ¶ 39.

[110] Respondent's Post-Hearing Submission, ¶ 25; Macao/Netherlands BIT (CLA-128); Macao/Portugal BIT (CLA-129); PRC/Netherlands BIT (CLA-130); PRC/Portugal BIT (CLA-131).

[111] Respondent's Post-Hearing Submission, ¶ 25.

[112] See Respondent's Post-Hearing Submission, ¶¶ 31-34 for the territorial definitions contained in the PRC, Hong Kong and Macao BITs, which the Respondent claims, show that irrespective of the timing of the BITs into which it has entered, the PRC has chosen to maintain the position set forth in the two Notifications and not to extend any BITs to Macao or Hong Kong.

[113] Respondent's Post-Hearing Submission, ¶ 27.

[114] Respondent's Post-Hearing Submission, ¶ 30.

[115] Respondent's Post-Hearing Submission, ¶ 30.

[116] Respondent's Post-Hearing Submission, ¶ 30.

76. The Respondent further argues that its interpretation of the 1999 Notification is consistent with the PRC's "one country, two systems" policy in that it aligns with the economic and legal independence of the Macao SAR from Mainland China.[117] It contends, furthermore, that it is the position of the Claimant that contradicts this policy and would, in the long run, adversely affect the economic development of the SARs.[118] The Respondent submits that the interests of Laos would not be affected by its position because Macao and Laos did not have a treaty prior to the handover in 1999.[119]

77. The Respondent rebuts the Claimant's reliance on Gallagher & Shan for its interpretation on the grounds that: (a) the passage cited by the Claimant refers to the issue of "treaty coverage on persons (and entities)" which is different from the territorial coverage of a treaty; (b) the passage is based on the ICSID case of *Tza Yap Shum v. The Republic of Peru*, which stands for the proposition that investors should not be denied protection under Chinese BITs if the term "autonomy" in the Macao SAR Basic Law is properly construed, which under the circumstances of this case, supports the Respondent's position on the exception to the automatic extension of treaties; and (c) the decision in *Tza Yap Shum*—which it notes has been severely criticized—is distinguishable because it dealt with the issue of the nationality of a *natural* person, which is not an issue in the present case.[120]

78. The Respondent notes that the PRC is a unitary state and therefore the "federal clause" exception, whereby treaties entered into by individual federated States do not automatically bind the entire federation, is not applicable to it.[121] The Respondent nevertheless likens the PRC to a federation, as its three territorial units (namely the Mainland, the Hong Kong SAR, and the Macao SAR) have their own legal, economic, and judicial systems.[122] The SARs are largely

[117] Respondent's Reply on Jurisdiction, ¶ 26.

[118] Respondent's Reply on Jurisdiction, ¶ 35.

[119] Respondent's Reply on Jurisdiction, ¶ 36.

[120] Respondent's Reply on Jurisdiction, ¶ 37, referring to the Journal of World Investment & Trade, Volume 10, Number 6, December 2009, "Queries to the Recent ICSID Decision on Jurisdiction *Upon the Case of Tza Yap Shum v. Republic of Peru*: Should the PRC-Peru BIT 1994 be Applied to Hong Kong SAR under the 'One Country Two Systems' Policy", Chen An; *Tza Yap Shum v. The Republic of Peru*, ICSID Case No. ARB/07/6, Decision on Jurisdiction and Competence, February 12, 2009 ("***Tza Yap Shum***") (CLA-70/RA-10).

[121] Respondent's Memorial on Jurisdiction, ¶¶ 79-81, referring to *Oppenheim's International Law*, 9th ed. (1992) Vol. 1, ¶ 76 (RA-11); Corten & Klein, p. 746 (RA-12).

[122] Respondent's Memorial on Jurisdiction, ¶ 82.

autonomous from the Mainland and have the right to be consulted before treaties to which the PRC is a party are extended to them.[123]

79. The Respondent also argues that, prior to the handover to the PRC, Portugal treated Macao as a dependent territory. The International Law Commission ("**ILC**") noted that the "moving treaty frontiers" rule does not necessarily apply to the case of a dependent territory.[124]

(b) The Claimant's Position

80. The Claimant notes that it is uncontested that Macao became part of the territory of the PRC following the handover from Portugal on 1 January 1999.[125] It notes that the decision of the PRC to structure its governance of Macao as an SAR is a matter of domestic law, distinct from and irrelevant to the international law issue of whether Macao falls within the sovereignty of the PRC.[126]

81. The Claimant contends that whether the PRC/Laos BIT extends to Macao requires an application of the "moving treaty frontiers" rule, enshrined in Article 29 of the VCLT,[127] according to which, unless a different intention is established, a treaty must be understood as applicable automatically and of its own force in respect of any territory newly acquired by one of its parties.[128] It is the Claimant's case that the PRC treaties in force as of the date of the handover of Macao automatically apply to the entirety of the territory over which the PRC exercised its sovereignty, including Macao, absent any indication from the PRC to the contrary.[129]

---

123 Respondent's Memorial on Jurisdiction, ¶ 82.

124 Respondent's Memorial on Jurisdiction, ¶¶ 83-84, referring to the Report of the International Law Commission on the work of its twenty-sixth session, 6 May-26 July 1974, reproduced in A/9610/Rev. 1, *Yearbook of the International Law Commission,* 1974, vol. II (Part One), 157, p. 208 ("**ILC Commentary 1974**") (RA-13).

125 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 227.

126 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 227.

127 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 228-229, referring to the VCLT (RE-07); Odendahl, "Article 29: Territorial Scope of Treaties", in Dörr and Schmalenbach, p. 498 (CLA-102); ILC Commentary 1974, p. 208 ("**Odendahl**") (RA-13); Villiger, *Commentary on the 1969 Vienna Convention on the Law of Treaties* (Martinus Nijhoff 2009), pp. 392, 393 ("**Villiger**") (CLA-116).

128 Claimant's Response, ¶ 4; see also Hearing Transcript, pp. 157-160.

129 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 230.

82. The Claimant submits that Article 29 of the VCLT represents an applicable rule of customary international law.[130] The Claimant notes that Laos and the PRC are parties to the VCLT.[131] The Claimant also points out that Laos accepts that the exceptions contained in Article 29 of the VCLT are those that apply to this case.[132]

83. According to the Claimant, the rule in Article 29 of the VCLT is reflected, in part, in Article 15 of the VCST.[133] However, the Claimant contends that there is no evidence of the requisite consistent State practice or *opinio juris* to support the notion that all of the VCST's provisions reflect customary international law.[134] In particular, the Claimant argues that the exceptions to the rule in Article 15 of the VCST that differ from the customary rule reflected in Article 29 of the VCLT cannot be considered to reflect customary international law.[135] The Claimant notes that Laos and the PRC have not ratified the VCST.[136]

84. The Claimant states that even if the exceptions under Article 15 of the VCST applied as a matter of customary international law, which it denies, they would not preclude the automatic extension of the BIT to Macao in 1999.[137] Article 15 looks only to the language and application of the Treaty and not to the internal constitutional arrangements in a given State.[138] Moreover, the threshold for establishing the exceptions is a high one.[139]

85. Concerning the first exception, the Claimant argues that the Treaty contains no territorial limits; nor does it limit the category or territorial origin of investors entitled to its protection.[140]

---

130 Claimant's Response, ¶¶ 9-13; Hearing Transcript, pp. 71, 168. The Claimant emphasizes that it is not the case that the customary rule in Article 29 of the VCLT applied only at the time the BIT was executed in 1993, and that its application is supplanted by Article 15 of the VCST for the purposes of determining the BIT's territorial scope in 1999 and thereafter. Rather, the Claimant asserts that the principle in Article 29 means generally that, *at any given time*, a State is bound by a treaty in respect of any territory of which it is sovereign. The application of the customary rule in Article 29 means that a territorial change after the entry into force of a treaty alters the treaty's frontiers going forward. (Claimant's Response, ¶¶ 14-18)

131 Claimant's Response, ¶ 3.

132 Claimant's Response, ¶¶ 26.

133 Claimant's Response, ¶¶ 20-25.

134 Claimant's Response, ¶ 3; Hearing Transcript, pp. 73-74, 98, 161.

135 Claimant's Response, ¶¶ 3, 28-32.

136 Claimant's Response, ¶ 3; Hearing Transcript, p. 74.

137 Claimant's Response, ¶ 44.

138 Claimant's Response, ¶ 35.

139 Claimant's Response, ¶ 36; Hearing Transcript, pp. 71-72.

140 Claimant's Response, ¶ 37.

86. Concerning the second exception, the Claimant submits that the extension of the BIT to the Macao SAR is not incompatible with its object and purpose which is to "encourage, protect and create favorable conditions for investment by investors of one Contracting State in the territory of the other Contacting State[.]"[141] In the Claimant's view, allowing Macanese investors to benefit from the protections of the BIT is fundamentally compatible with the object and purpose as is extending the protections of the BIT to foreign investors who have invested in what is indisputably part of the territory of the PRC.[142]

87. Third, the Claimant argues that including Macao within the scope of application of the BIT does not radically change the conditions for the Treaty's operation, because (a) the only change effected is that Laos must provide investors from Macao the same protection and guarantees required for investors from Mainland China;[143] (b) this kind of change is simply the normal consequence of the application of the "moving treaty frontiers" rule and as such cannot constitute a "radical change"; if mere expansion were enough to constitute a "radical change", the exception would "swallow" the rule;[144] (c) this applies also in the case of bilateral treaties which are not distinguished from multilateral treaties in Articles 29 of the VCLT or Article 15 of the VCST; the PRC was Laos's treaty partner before 1999, and it remains so afterwards.[145]

88. According to the Claimant, it is uncontested between the Parties that there are two exceptions to Article 29 of the VCLT; namely that a "different intention" with regard to the territorial scope of the BIT "appears from the Treaty" or "is otherwise established".[146] The Claimant argues that the Respondent carries the evidentiary burden of establishing the PRC's "different intention",[147]

---

141 Claimant's Response, ¶ 38, citing the Preamble of the Treaty.

142 Claimant's Response, ¶ 38.

143 Claimant's Response, ¶ 39.

144 Claimant's Response, ¶ 40; Hearing Transcript, p. 162.

145 Claimant's Response, ¶¶ 42-43. The Claimant distinguishes the present situation from that under the context of Article 34 of the VCST which deals with the case of "Succession of States in Cases of Separation of Parts of a State" and includes the same "radical change of conditions for the operation of the treaty proviso as found in Article 15. There, the Claimant notes that "the question is whether one or more completely new States will succeed, in whole or in part, to the predecessor's treaty obligations. In contrast, Article 15 applies where territory has been transferred from one State to another; accordingly, the States in question remain the same at all times, with the only change being that their territory is either enlarged or contracted. [...] Where there is the creation of a new State 'very different from itself,' the 'personal nature' of a bilateral treaty may very well be an issue, because continuity of the treaty obligations would force the treaty partner into a reciprocal relationship with the successor, a completely new entity to which it has not agreed to be bound. In contrast, in the Article 15 paradigm, the identity of both bilateral treaty parties remains the same at all time." (Claimant's emphasis).

146 Claimant's Rejoinder on Jurisdiction, ¶ 12.

147 Claimant's Rejoinder on Jurisdiction, ¶ 12.

which must be established by evidence providing a "sufficient degree of certainty" that would overcome the default position.[148]

89. The Claimant asserts that the Treaty does not provide for the territorial limitation of its application or otherwise express a "different intention" or an intention to depart from the default customary rule.[149]

90. The Claimant rejects the Respondent's contention that the Preamble, Articles 7, 11 or 12 of the Treaty can be invoked to establish the first exception.[150] It disputes the Respondent's position that the reference to domestic law in Article 12 of the Treaty is relevant to the territorial scope of the Treaty;[151] Article 12 refers to "internal legal procedures" solely in the context of the entry into force of the Treaty but is silent on the application of the Treaty once effective, as well as on its territorial scope.[152]

91. Although the BIT was signed in 1993, or six years prior to the handover of Macao from Portugal to the PRC, the Claimant contends that both Parties to the BIT were aware—during both the negotiation and the conclusion of the BIT—that the PRC would resume the exercise of its sovereignty over Macao in 1999.[153] On this basis, the Claimant notes that either Party could have expressly excluded Macao from the scope of the BIT.[154]

92. The Claimant relies upon the explicit exclusion of Hong Kong and Macao from the PRC/Russia BIT to show that the PRC adopts express language excluding its SARs from the territorial scope of treaties if it in fact has the intention to do so, which was not the case here.[155]

93. The Claimant contests the argument of the Respondent that the PRC did not have the jurisdiction to state the position of Macao at the time of concluding the Treaty, as it was signed

---

148 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 231, referring to Karagiannis, "Article 29, Convention of 1969" in Corten & Klein ("**Karagiannis**") (CLA-100).

149 Claimant's Rejoinder on Jurisdiction, ¶ 13; Hearing Transcript, p. 77.

150 Hearing Transcript, p. 77.

151 Hearing Transcript, p. 78.

152 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 235-236, referring to Respondent's Memorial on Jurisdiction, ¶¶ 69-70; Hearing Transcript, p. 78.

153 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 237, referring to the Basic Law of the Macao SAR, Preamble (RE-09).

154 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 237.

155 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 238, referring to Protocol to the PRC/Russia BIT (CLA-90); Claimant's Rejoinder on Jurisdiction, ¶ 13; Hearing Transcript, pp. 80, 163.

before the handover.[156] It contends that the PRC had the jurisdiction to state its *own* position on the future territorial scope of the Treaty.[157] In response to the Respondent's argument that the Parties could not know in 1993 how the Joint Declaration would be effected as the negotiations relating to the handover were still being conducted at that time, the Claimant notes that the Joint Declaration had been in effect since 1987 and the parties knew that Chinese sovereignty would resume over Macao in 1993, which means that the PRC could have already provided for an exception to the "moving treaty frontiers" rule in the Treaty.[158]

94. The Claimant contends that Laos has provided no evidence establishing the intention to exclude Macao from the scope of the BIT, or to demonstrate that a "different intention" has been "otherwise established."[159]

95. The Claimant rejects the Respondent's characterization of the 1999 Notification as a unilateral declaration that prevents the BIT from applying to Macao.[160]

96. First, the Claimant notes that the 1999 Notification applies only to multilateral treaties for which the UN Secretary-General is depositary.[161] The PRC/Laos Treaty is a bilateral treaty that does not involve the UN Secretary-General in any capacity. Therefore, it is not surprising that it is not included in the list annexed to the 1999 Notification—no bilateral investment treaties are included on the list—,[162] and the formalities for the application of a treaty to Macao as set out in Paragraph IV of the 1999 Notification do not apply to the Treaty.[163] The Claimant contends that a contrary interpretation would effectively deny all investors from Macao and Hong Kong the protections enjoyed by their PRC counterparts, which would be incompatible with the purposes of both the investment treaty regime and the "one country, two systems" policy of the PRC.[164]

---

[156] Claimant's Rejoinder on Jurisdiction, ¶ 14.

[157] Claimant's Rejoinder on Jurisdiction, ¶ 14; Hearing Transcript, p. 81.

[158] Claimant's Rejoinder on Jurisdiction, ¶ 15; Hearing Transcript, pp. 81-82.

[159] Claimant's Rejoinder on Jurisdiction, ¶ 24.

[160] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 241, referring to Respondent's Memorial on Jurisdiction, ¶¶ 38-59.

[161] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 242, referring to UN Status of Multilateral Treaties (CLA-115); Hearing Transcript, p. 84.

[162] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 242, referring to UN Status of Multilateral Treaties (CLA-115); Hearing Transcript, p. 84.

[163] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 243; Hearing Transcript, pp. 85-86.

[164] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 244, referring to Gallagher & Shan, *Chinese Investment Treaties, Policies and Practice* (2009) ("**Gallagher & Shan**") (CLA-99).

97. The Claimant rejects the Respondent's argument that the Treaty was deposited with the UN Secretary-General and contends that the Respondent is confusing (a) the registration function of the UN Secretariat (pursuant to Article 102 of the UN Charter, which requires all UN members to register treaties to which they are a party with the UN Secretariat), which covers both multilateral and bilateral treaties[165] and (b) the treaty depository function of the UN Secretary-General, which is open only to multilateral and regional treaties but not to bilateral treaties.[166] In other words, "[t]he fact that the Treaty is included in the UNTC is simply a function of the Treaty having been *registered* with the United Nations, not of the Secretary-General's *depository* function."[167] In this case, the 1999 Notification referred only to treaties that were deposited with the Secretary-General, a category that necessarily excludes the Treaty by virtue of it being a bilateral treaty.[168]

98. In response to the Respondent's argument that the manner in which the 1999 Notification is treated by the UN does not change its effect, the Claimant argues that to accept this, the Tribunal would effectively have to find that the UN somehow misrepresented the context of the PRC's communication.[169] In any event, the Claimant submits that even within the text of the PRC's notification, reference is made to the UN Secretary-General's depositary function, which applies to multilateral instruments.[170]

99. Second, the Claimant contends that reservations do not apply to bilateral agreements since any valid reservation would necessarily modify the treaty for both parties.[171] Thus, the alleged failure by Laos to object to the 1999 Notification is irrelevant.[172] But even if reservations could apply to bilateral agreements, the Claimant notes that the 1999 Notification did not refer to the Treaty it purported to modify, and was not communicated directly to Laos, the other

---

165 Claimant's Rejoinder on Jurisdiction, ¶ 20, referring to UN Charter, Article 102 (RA-28); Hearing Transcript, p. 86.

166 Claimant's Rejoinder on Jurisdiction, ¶ 21; Hearing Transcript, pp. 86-87.

167 Claimant's Rejoinder on Jurisdiction, ¶ 22 (Claimant's emphasis); Hearing Transcript, pp. 86-87.

168 Claimant's Rejoinder on Jurisdiction, ¶ 23.

169 Hearing Transcript, pp. 163-164.

170 Hearing Transcript, pp. 164-165.

171 Claimant's Rejoinder on Jurisdiction, ¶ 25; Hearing Transcript, pp. 87-88.

172 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 245, referring to Aust, *Modern Treaty Law and Practice* (2008) (Cambridge University Press), pp. 131-132 (CLA-94); Respondent's Memorial on Jurisdiction, ¶ 43; Hearing Transcript, pp. 88, 90.

Contracting State.[173] According to the Claimant, these are fundamental requirements attaching to treaty reservations under international law.[174]

100. Third, the Claimant contends that the 1999 Notification does not qualify as a "unilateral declaration" that limited the territorial scope of the Treaty because, as explained above, the 1999 Notification does not apply to bilateral treaties.[175] The Claimant further notes that, as the 1999 Notification does not even refer to the Treaty, the intention of the PRC to bind itself through the alleged unilateral declaration could not have been "clearly established."[176]

101. Therefore, it could not have been assumed that the 1999 Notification would limit the territorial scope of the Treaty.[177]

102. The Claimant dismisses the Respondent's reliance on domestic law provisions on the basis that international law takes precedence over domestic law in determining the application of treaties and, correspondingly, that domestic laws do not affect the international obligations of a State.[178] On the same basis, the Claimant disputes the Respondent's argument that the internal arrangements between the PRC and the Macao SAR encompassed in the Macao SAR Basic Law establish the PRC's intention as regards the scope of the Treaty (*i.e.*, that Macao has full autonomy to manage its economic affairs and thus the automatic application of the "moving treaty frontiers" rule is excluded).[179] The Claimant stresses that the PRC never expressed such an intention on the international plane, and reliance on a State's internal structure cannot

---

173 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 246, referring to the VCLT, Article 23(1) (RE-07); UN Guide to Practice on Reservations to Treaties (2011), § 3.1.5.2 (CLA-112); UN International Law Commission, Draft Articles of the Law of Treaties with Commentary (1966) ("**ILC Commentary 1966**"), Commentary on Article 18, notes 3 & 4, p. 208 (CLA-114); Article 23(1) of the VCLT (RE-07); Claimant's Rejoinder on Jurisdiction, ¶ 25.

174 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 246, referring to the VCLT, Art. 2(1)(d) (RE-07); United Nations Guide to Practice on Reservations to Treaties (2011), § 3.1.5.2 (CLA-112); ILC Commentary 1966 (CLA-114); Article 23(1) of the VCLT (RE-07); Claimant's Rejoinder on Jurisdiction, ¶ 25.

175 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 247, referring to the *Nuclear Tests Case*, ¶ 53 (RA-05); Hearing Transcript, pp. 87-88.

176 Claimant's Rejoinder on Jurisdiction, ¶ 26

177 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 247.

178 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 248, referring to Schaus, "Article 27, Convention of 1969," in Corten & Klein, p. 700 ("**Schaus**") (CLA-105); Hearing Transcript, p. 91.

179 Claimant's Rejoinder on Jurisdiction, ¶ 28.

demonstrate to the requisite high degree of certainty that a State's intention to exclude the operation of the "moving treaty frontiers" rule has been "otherwise established."[180]

103. On this point, the Claimant stresses that the Respondent's position has the effect of making the territorial scope of treaties dependent on internal governmental organization and subject to shifts therein.[181] It notes that this would also have the effect of equating the delegation of economic autonomy and autonomy in entering into agreements with foreign states to automatic exceptions under the "moving treaty frontiers" rule, which it contends is an untenable result.[182] In any case, the Claimant notes that the Macao SAR Basic Law does not, on its face, provide for the exclusion of Macao from the bilateral treaties of the PRC that were in force at the moment of the handover.[183]

104. The Claimant defends its reliance on Gallagher & Shan by stating that (a) paragraph 2.48 of this source applies to "entities" incorporated in the SARs, as applicable here; (b) paragraph 2.45 is not premised on *Tza Yap Shum*; and (c) paragraph 2.45 refers to the SAR "investors" generally and is not limited to investors who are natural persons.[184]

105. The Claimant argues that the fact that the PRC and Macao entered into two bilateral agreements with the same third States almost a decade after the BIT entered into force, cannot impact the application of the "moving treaty frontiers" rule to the BIT as of 1999.[185] It is the Claimant's position that there is no evidence to suggest that the four treaties in question—PRC/Portugal BIT (2005), PRC/Netherlands BIT (2001), Macao/Portugal BIT (2000), Macao/Netherlands BIT (2008)—conflict or are mutually exclusive; to the contrary, the Claimant argues that they establish a complementary regime.[186] The PRC treaties do not contain language referring to or carving out Macao and the later treaties do not contain language superseding the former

[180] Claimant's Rejoinder on Jurisdiction, ¶ 28, referring to Karagiannis, p. 737 (CLA-100); Hearing Transcript, pp. 91-92.

[181] Claimant's Rejoinder on Jurisdiction, ¶ 29; Hearing Transcript, p. 92.

[182] Claimant's Rejoinder on Jurisdiction, ¶ 29.

[183] Claimant's Rejoinder on Jurisdiction, ¶ 30.

[184] Claimant's Rejoinder on Jurisdiction, ¶ 32 n. 52.

[185] Claimant's Response, ¶ 46; the Netherlands/Macao BIT (2008) (CLA-128); Portugal/Macao BIT (2000) (CLA-129); Netherlands/PRC BIT (2001) (CLA-130); Portugal/PRC BIT (2005) (CLA-131).

[186] Claimant's Response, ¶ 47; see also Hearing Transcript, pp. 94-96.

treaties.[187] This contrasts with the explicit carve-out contained in the PRC/Russia BIT with regard to the Macao and Hong Kong SARs.[188]

106. The Claimant characterizes the Macao/Netherlands and Macao/Portugal BITs as supplemental agreements that apply only in the territory of the Macao SAR.[189] The only consequence of this supplemental regime is that Macanese investors can file for arbitration under the PRC or Macao treaty.[190] Dutch or Portuguese investors complaining of breaches in Macao, however, can only bring claims against the PRC under the PRC treaties and against Macao under the Macao treaties.[191] The same does not apply with respect to bringing claims against Macao under the PRC/Laos Treaty because there is no supplemental Laos treaty with Macao.[192]

107. The Claimant also submits that the existence of supplemental Macao treaties does not conflict with the object and purpose of the PRC treaties: extending the PRC treaties to Macao ensures that Macanese investors enjoy dual sets of protection.[193] By contrast, not extending the PRC treaties to Macao would deny Macanese investors the protection of 130 BITs concluded by the PRC, leaving them the protection of only two BITs concluded by Macao,[194] and undermining the "one country, two systems" policy.[195]

108. The Claimant relies on the *Tza Yap Shum* decision in which the tribunal, after hearing evidence on the topic of the Hong Kong SAR's power to conclude investment treaties, found that there was nothing inconsistent between the parallel treaty regimes of Hong Kong and the PRC.[196]

109. The Claimant contends that the Respondent's admission that the "federal clause exception" does not apply here resolves this issue.[197] Alternatively, it contends that the rationale behind the

187 Claimant's Response, ¶ 47.

188 Claimant's Response, ¶ 47.

189 Claimant's Response, ¶ 48.

190 Claimant's Response, ¶ 49; Claimant's Rejoinder on Jurisdiction, ¶ 31.

191 Claimant's Response, ¶ 49.

192 Claimant's Response, ¶ 49.

193 Claimant's Response, ¶ 50; Claimant's Rejoinder on Jurisdiction, ¶ 32.

194 Claimant's Response, ¶ 50; the Claimant notes that there is a serious question over the ability of the SARs to conclude international agreements under international law that has yet to be tested. Accordingly, by denying investors from the SARs access to protection under the PRC treaties, SAR investors could be deprived of all protections (Claimant's Response, ¶ 51).

195 Claimant's Rejoinder on Jurisdiction, ¶ 32.

196 Claimant's Response, ¶ 51; Hearing Transcript, p. 96.

"federal clause exception" is irrelevant to this case because this Treaty does not have a federal clause provision, thereby requiring the Tribunal to resort to the default rule of customary international law.[198]

110. The Claimant rejects the Respondent's characterization of the 1999 handover as a transfer of a dependent territory from one administrative power to another. According to the Claimant, the handover in fact represented the resumption by the PRC of the exercise of its sovereignty over Macao.[199] But even were the Respondent's characterization of the 1999 handover accurate, which the Claimant denies, it states that the "moving treaty frontiers" rule would continue to apply by analogy.[200]

B. WHETHER SANUM QUALIFIES AS AN INVESTOR UNDER THE TREATY

1. Whether the Claimant is established under the municipal laws of the PRC

(a) The Respondent's Position

111. The Respondent notes that Article 1(2) of the BIT requires an investor that is a juridical person to be "established in accordance with the laws and regulations of each contracting State,"[201] which it says is indisputably the PRC in this case.[202] The Respondent contends that the Claimant is established in accordance with the laws and regulations of the Macao SAR and not the PRC.[203] As a result, the Claimant does not meet the definition of "investor" in the BIT and thus, the Tribunal lacks jurisdiction *ratione personae*.[204]

---

197 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 251-252, referring to Respondent's Memorial on Jurisdiction, ¶ 81 where it states that "[b]ecause the PRC is a unitary state, the principles pertaining to the 'federal clause' exception, as traditionally understood, are not applicable."; Hearing Transcript, pp. 92-93.

198 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 253, referring to Respondent's Memorial on Jurisdiction, ¶ 79; Karagiannis, p. 748 (CLA-100); ILC Commentary 1966, Commentary on Article 25, note 4, p. 213 (CLA-114).

199 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 254, referring to Respondent's Memorial on Jurisdiction, ¶¶ 25, 85.

200 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 254, referring to the ILC Commentary 1974, p. 209 (RA-14).

201 Respondent's Memorial on Jurisdiction, ¶¶ 88-89; Hearing Transcript, p. 28.

202 Respondent's Memorial on Jurisdiction, ¶ 89.

203 Respondent's Memorial on Jurisdiction, ¶ 86.

204 Respondent's Memorial on Jurisdiction, ¶ 86.

112. The Respondent clarifies that Mainland China applies PRC laws while the Macao SAR applies Macanese laws.[205] It then notes that the Claimant was not incorporated in accordance with the applicable PRC Company Law,[206] which does not apply to the SARs of Hong Kong and Macao.[207] For PRC law to be applicable to the Macao SAR, the Government of the PRC would have to have listed this law in Annex III to the Macao SAR Basic Law, which it did not do.[208]

113. The Respondent also argues that the Macao SAR Basic Law, which was promulgated by the PRC Congress on 31 March 1993, provided for a legal system applicable to the Macao SAR different and separate from the PRC legal system.[209] In conjunction with the aforementioned PRC Company Law, the Macao SAR Basic Law evidences that the PRC and the Macao SAR have different laws with regard to the incorporation of a company.[210]

114. The Respondent further maintains that the international community recognizes the separate legal systems of the PRC—specifically, PRC law as applicable to Mainland China and Macanese laws as applicable to the Macao SAR, as well as Hong Kong laws applicable to the Hong Kong SAR.[211] The Respondent gives the example of commercial arbitrations, where parties who choose either Hong Kong law or Macao law as the governing law do not expect their choice to translate to PRC law.[212]

(b) The Claimant's Position

115. The Claimant notes that the Parties agree that Sanum was established pursuant to the laws of the Macao SAR on 14 July 2005.[213]

116. The Claimant notes that SARs are jurisdictions separate from the PRC, but contends that their laws form part of PRC law for the purposes of the Treaty.[214] It argues that a contrary view

---

205 Respondent's Memorial on Jurisdiction, ¶ 91.

206 Respondent's Memorial on Jurisdiction, ¶¶ 92-93.

207 Respondent's Memorial on Jurisdiction, ¶¶ 92-93.

208 Respondent's Memorial on Jurisdiction, ¶ 98.

209 Respondent's Memorial on Jurisdiction, ¶ 94.

210 Respondent's Memorial on Jurisdiction, ¶ 95; Hearing Transcript, pp. 29-30, 61-62.

211 Respondent's Memorial on Jurisdiction, ¶ 96; Hearing Transcript, p. 30.

212 Respondent's Memorial on Jurisdiction, ¶ 96.

213 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 265, referring to Claimant's Amended Notice, ¶ 15; Exhibit A to Claimant's Amended Notice; Respondent's Memorial on Jurisdiction ¶ 87; Hearing Transcript, p. 103.

would effectively exclude Macao and Hong Kong investors from the protection of BITs worded similarly to the Treaty.[215]

117. The Claimant maintains that the term "laws and regulations" of the PRC, as referred to in the Treaty, refers to a State comprised of autonomous regions with their own legal regimes and must be taken to include the laws of all such sub-units falling within the entire territory over which that State exercises its sovereignty, unless a different intention is apparent or established.[216] The Claimant highlights that the laws of the separate jurisdictions apply within the territory over which the PRC exercises its sovereignty and the absence of a legal or factual basis to impose a more restrictive definition to such laws.[217]

118. The Claimant also argues that, contrary to the intention expressed in the Preamble to the Treaty, a more restrictive interpretation of the Treaty would lead to an imbalance in the territorial scope of the protections offered by the host States, in that Laotian investors would receive Treaty protection in the SARs of Hong Kong and Macao, while Hong Kong and Macao investors would be denied similar coverage in Laos.[218]

2. Whether the Claimant is an "economic entity"

(a) The Respondent's Position

119. The Respondent contends that the Claimant does not meet the requirement of being an "economic entity," as set forth in Article 1(2) of the BIT for the following reasons: (a) an "economic entity" must have economic or commercial activities within the PRC; (b) the BIT was not intended to protect shell companies like the Claimant; (c) the nationality of the "economic entity" is to be determined by whether its management seat and control are located

---

214 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 266, referring to Gallagher & Shan, ¶ 2.76 (2009) (CLA-99); Hearing Transcript, pp. 103-104.

215 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 267.

216 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 268, referring to the ILC Commentary 1966, Commentary on Article 25, note 4, p. 213; notes 1-3, p. 213 (CLA-114); Hearing Transcript, pp. 104-105.

217 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 269, referring to Respondent's Memorial on Jurisdiction, ¶ 91.

218 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 270, referring to the Preamble of the PRC/Laos Treaty (Ex. D to Amended Notice); Hearing Transcript, pp. 75, 162-163.

within the PRC; and alternatively, (d) the BIT is not intended to protect the investments of non-Contracting States.[219]

120. The Respondent first notes that the requirement in the Treaty that an "investor" be an "economic entity" means that an entity must have economic activities related to the investment that is the subject of a claim in order to qualify as an investor. This evidences an intention to exclude mere shell companies from the definition of an "investor."[220]

121. Concerning the nationality of the "economic entity", the Respondent first contends that, subject to the wording and interpretation of the Treaty, there are three criteria by which the nationality of a company can typically be determined: (a) place of incorporation; (b) seat or *siège social*; and (c) place of effective control.[221]

122. The Respondent submits that the second criterion—the seat or *siège social*—pertains to the description of "economic entity."[222] According to the Respondent, this means that the place in which the economic activities are conducted must be the State in which the company is incorporated.[223] It further argues that to allow a shell corporation to conduct its economic activities in third States and yet avail itself of the BIT protections of the State in which it is merely incorporated would be tantamount to treaty shopping, which the Contracting Parties did not intend to permit under the Treaty.[224] Moreover, the economic activities must pertain to the investment that is the subject of the claim in question under the Treaty.[225]

123. The Respondent disagrees with the majority in *Tokios Tokelès v. Ukraine* which adopted a purposive interpretation of the BIT and meaning of "investor" under Article 1(2) of that treaty.[226] The majority concluded that the treaty "extended its protections to entities incorporated in third countries using the nationality of the individuals who controlled the enterprise (or the management seat of the entity that controlled the enterprise) to determine the

219 Respondent's Memorial on Jurisdiction, ¶ 101.

220 Respondent's Memorial on Jurisdiction, ¶¶ 102-105.

221 Respondent's Memorial on Jurisdiction, ¶¶ 106-107.

222 Respondent's Memorial on Jurisdiction, ¶ 108.

223 Respondent's Memorial on Jurisdiction, ¶ 109.

224 Respondent's Memorial on Jurisdiction, ¶ 109.

225 Respondent's Memorial on Jurisdiction, ¶ 110.

226 Respondent's Memorial on Jurisdiction, ¶ 111, referring to *Tokios Tokelès v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction, April 29, 2004 ("***Tokios Tokelès***") (RA-14).

nationality of the claimant."[227] The Respondent notes that in construing the BIT preamble of that case, the tribunal found that the BIT was intended to "create and maintain favourable conditions for the investment of investors of one state in the territory of the other,"[228] which shows that the tribunal did not limit its consideration to the place of incorporation.[229] The Respondent argues that considering only the place of incorporation would be even less appropriate in this case, as the "investor" is defined as an "economic entity."[230]

124. The Respondent notes that the majority of the *Tokios Tokelès* tribunal declined to impose the "origin of capital" requirement.[231] The Respondent observes that the dissent in that case characterized this position as contrary to the object and purpose of the ICSID Convention and system.[232] Here, the Respondent notes that even if the BIT contains no "origin of capital" requirement, the reference to an "economic activity" evidences that the object and purpose of the BIT is to protect investments belonging to a national of a Contracting State only and not those belonging to the national of a third State that has established a shell company in a Contracting State.[233]

125. The Respondent reiterates that international law determines the nationality of an investor by more than the place of incorporation and considers other factors such as the seat of management and the financial control of the corporation.[234]

(b) The Claimant's Position

126. The Claimant contends that Sanum clearly falls within the broad definition of "economic entity."[235] The Claimant rejects the contention of the Respondent that the term "economic

227 Respondent's Memorial on Jurisdiction, ¶ 111.

228 Respondent's Memorial on Jurisdiction, ¶ 111, referring to *Tokios Tokelès*, ¶ 31 (RA-14).

229 Respondent's Memorial on Jurisdiction, ¶ 112, referring to *Autopista v. Venezuela*, ICSID Case No. ARB/00/5, Decision on Jurisdiction, September 27, 2001, ¶ 107 ("***Autopista***").

230 Respondent's Memorial on Jurisdiction, ¶ 112, referring to *Autopista*, ¶ 107.

231 Respondent's Memorial on Jurisdiction, ¶ 113, referring to *Tokios Tokelès*, ¶ 77 (RA-14).

232 Respondent's Memorial on Jurisdiction, ¶ 114, referring to *Tokios Tokelès*, ¶ 6 of Dissenting Opinion of Professor Prosper Weil (RA-14).

233 Respondent's Memorial on Jurisdiction, ¶ 115.

234 Respondent's Memorial on Jurisdiction, ¶¶ 119-120, referring to the International Law Commission, Fifty-eighth Session, Draft articles on Diplomatic Protection Adopted by the Drafting Commission on second reading, Art. 9, A/CAN/L.684 (2006) (RA-16); OECD Benchmark Definition of Foreign Investment (Draft) – 4th Edition, DAF/INV/STAT2006)2/REV.3, 2007 (RA-17).

235 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 264.

entity" in Article 1(2) was intended to exclude "entities that are mere shell companies" from the coverage of the Treaty.[236]

127. First, the Claimant contends that the fundamental rule of treaty interpretation—that the text is to be construed "in accordance with the *ordinary meaning* to be given to the terms"—applies when there is no indication that the parties intended to assign a special meaning to a treaty term.[237] As applied to this case, Sanum therefore meets the definition of an "economic entity," as it is a private company that was incorporated to pursue investment opportunities and participate in all commercial and industrial sectors allowed by law.[238]

128. Second, the Claimant notes that the BIT does not expressly indicate an origin of capital requirement, and submits that the Respondent has provided neither evidence nor authority for its contention that the Contracting States intended to restrict the definition of protected investors.[239] The Claimant contends that tribunals cannot impose extra-textual limits on the scope of BITs[240] but should strictly adhere to the treaty terms.[241] The Claimant notes that the BIT in this case only requires that an economic entity be established pursuant to the laws of a Contracting State, which means that the inquiry ends once the State of incorporation is ascertained.[242]

129. The Claimant contests the reliance of the Respondent on the dissenting opinion in *Tokios Tokelės* on the basis that this opinion relied heavily on the facts of that case and the purpose of ICSID arbitration, considerations which are not present in this case.[243] The Claimant also

---

236 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 257, referring to Respondent's Memorial on Jurisdiction, ¶ 105.

237 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 258, referring to Article 31(1) and (4) of the VCLT (RE-07) (Claimant's emphasis).

238 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 259, referring to *Economic Definition*, Oxford English Dictionary (CLA-96); *Entity Definition*, Oxford Dictionaries (CLA-97); Exhibit A to Amended Notice, Article 2; Hearing Transcript, pp. 106-107.

239 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 260, referring to Respondent's Memorial on Jurisdiction, ¶¶ 101-110, 115; Hearing Transcript, p. 107.

240 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 260, referring to *Tokios Tokelės*, ¶ 36.

241 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 261, referring to *The Rompetrol Group N.V. v. Romania*, ICSID Case No. ARB/06/3, Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility, April 18, 2008, ¶ 109 (CLA-76); *Saluka Investments BV v. The Czech Republic*, Partial Award (UNCITRAL, 17 March 2006), ¶¶ 197, 239, 241 (CLA-66); Hearing Transcript, pp. 108-109.

242 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 260, referring to *ADC Affiliate Limited and ADC & ADMCA Management Limited v. The Republic of Hungary*, ICSID Case No. ARB/03/16, Award, October 2, 2006, ¶ 357 (CLA-3).

243 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 262, referring to *Tokios Tokelės*, ¶¶ 5, 9, 23, 27 of Dissenting Opinion of Professor Prosper Weil (CLA-77); Hearing Transcript, pp. 107-108.

dismisses the reliance of the Respondent on cases potentially dealing with piercing the corporate veil because such issue is irrelevant to this case.[244]

130. Finally, the Claimant contends that the term "economic entities" was intended to broaden the scope of treaty coverage, in view of the more general requirement in investment treaties that investors be "natural and legal persons" and the fact that the PRC laws do not actually assign legal personality to all entities, even if they are established for business purposes.[245]

C. WHETHER SANUM BRINGS INVESTMENT-RELATED CLAIMS UNDER THE BIT

(a) The Respondent's Position

131. The Respondent submits that Article 8(1) and 8(3) of the BIT require that a dispute involving the quantification of the compensation for expropriation arises in connection with an investment in the territory of a Contracting State.[246]

132. The Respondent notes that the Claimant has only submitted the articles of association of Savan Vegas and Paksong Vegas (Laos companies in which Sanum has a 60% ownership and Laos has a 20% ownership) as evidence of its investment in Laos.[247] The Respondent notes that the contribution of the Claimant for its shares takes the form of loans that are being repaid annually from casino proceeds. It contends that this contribution does not meet the requirement of Article 1(1)(b) of the BIT, which includes "shares in companies or other forms of interest in such companies" in its definition of investment.[248]

133. The Respondent rejects the Claimant's submission that its investment consists of "investing in real property; employing its know-how and acquiring other tangible assets in order to establish and maintain gaming facilities described above, and in obtaining concession[s] from the

---

[244] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 263, referring to Respondent's Memorial on Jurisdiction, ¶ 116 (referring to *Barcelona Traction, Light and Power Company, Limited*, Judgment, I.C.J. Reports 1970 (RA-15)).

[245] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 264, referring to Gallagher & Shan, ¶¶ 2.72, 2.80 (CLA-99); Hearing Transcript, p. 109.

[246] Respondent's Memorial on Jurisdiction, ¶ 123.

[247] Respondent's Memorial on Jurisdiction, ¶ 123.

[248] Respondent's Memorial on Jurisdiction, ¶ 122.

[R]espondent which accorded its investment enterprises exclusive rights to operate gaming facilities in five provinces."[249]

134. The Respondent first contests the Claimant's argument that it has invested in movable or immovable property assets in the territory of Laos, pursuant to Article 1(1)(a) of the BIT, on the grounds that the said property rights belong not to Sanum but to the local companies that are to operate the gaming facilities.[250]

135. Second, the Respondent notes that it cannot identify any "know-how of Sanum employed in Lao PDR" or "other tangible assets" that would meet the definition of an investment, and further notes that the "concessions" to which Sanum refers were actually accorded to its investment enterprise—namely, Savan Vegas and Paksong Vegas, and not to it.[251]

136. Last, the Respondent contends that the two PDAs do not qualify as investments, because they replace existing PDAs (concluded on 11 April 2006 and amended on 26 July 2006) to which Sanum is not a party and from which Sanum cannot derive rights.[252] Moreover, the Respondent notes that "[n]o specific right was granted to Sanum under the PDAs," as the PDAs merely (a) express the intention of the Parties to cooperate on project development (Article 4, PDAs); (b) involve Laos granting development rights to both Sanum and ST (Article 2, PDAs); and (c) provide that the development project area is to be considered as part of the PDA "after the company has completely developed the land area of 50 hectares allowed by the Government." (Article 2(2), PDAs).[253]

137. The Respondent also notes that the PDAs only contemplate the conclusion of future contracts upon the establishment of a joint venture (Article 6, PDAs) or a lease agreement for the concession area (Article 4(4), PDAs).[254] It contends that the shareholders' rights, the gaming license, and lease agreement were granted not to the Claimant but to Savan Vegas and Paksong Vegas, the local vehicles.[255]

249 Respondent's Memorial on Jurisdiction, ¶ 124, referring to Amended Notice, ¶ 115.

250 Respondent's Memorial on Jurisdiction, ¶¶ 124-125, referring to Amended Notice, ¶ 115.

251 Respondent's Memorial on Jurisdiction, ¶ 126, referring to Amended Notice, ¶ 115.

252 Respondent's Memorial on Jurisdiction, ¶ 127.

253 Respondent's Memorial on Jurisdiction, ¶ 127.

254 Respondent's Memorial on Jurisdiction, ¶ 127.

255 Respondent's Memorial on Jurisdiction, ¶ 127.

138. The Respondent argues that the rights arising out of the PDAs cannot be taken as "claims for money or to any performance having an economic value (Article 1(1)(c) of the BIT)," and that the PDAs themselves do not legitimately give rise to expectations regarding financial value because they do not guarantee the formation of a joint venture or the granting of a gaming license.[256]

(b) The Claimant's Position

139. The Claimant contends that the text of the Treaty neither excludes indirect investments from its coverage nor provides a basis on which to distinguish between the operating entities and Sanum for the purposes of defining qualifying "investments."[257]

140. Sanum highlights the substantial investments it has made in the various Laotian enterprises and projects, including (a) capital investments exceeding US$ 85 million; (b) being a majority shareholder in Savan Vegas and Paksong Vegas; (c) ownership stakes in the Thanaleng, Lao Bao, and Ferry Terminal slot clubs; and (d) using its industry expertise and business know-how to generate returns and advance its different enterprises.[258]

141. The Claimant stresses that Article 1(1) defines "investments" to include "*every kind of asset* invested,"[259] and notes that the restriction that the Respondent seeks to impose on this provision would be fundamentally unfair to the Claimant, especially in view of its substantial contributions to Laos.[260]

142. The Claimant rebuts the Respondent's contention that the PDAs do not qualify as investments because they do not constitute contractual guarantees and therefore cannot form the basis of

---

256 Respondent's Memorial on Jurisdiction, ¶ 127.

257 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 273. The Claimant also cites cases in which investment treaty tribunals have found all investments, including indirect investments, to be encompassed by broad language in the relevant treaties (*see* Claimant's Statement of Claim and Response on Jurisdiction, ¶ 273 n. 578); Hearing Transcript, p. 110.

258 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 273, referring to *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, August 3, 2004, ¶ 137 ("***Siemens***") (CLA-71); *Mobil Corporation et al v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, June 10, 2010, ¶ 165 (CLA-49); *Franck Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award, April 8, 2013, ¶¶ 378-80 (CLA-33); *Ioannis Kardassopoulos v. Georgia*, ICSID Case No. ARB/05/18, Decision on Jurisdiction, July 6, 2007, ¶¶ 123-124 (CLA-40).

259 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 272, referring to PRC/Laos Treaty, Article 1 (Ex. D to Amended Notice) (Claimant's emphasis); Hearing Transcript, p. 110.

260 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 273.

legitimate expectations. The Claimant argues that the relevant contracts did in fact contain guarantees, in the form of the Lao Government granting development rights to the respective casino companies and promising to issue the required licenses for their operation.[261] The Claimant further notes that international tribunals have considered contractual rights to be "assets," just like tangible property, where a bilateral investment treaty has defined "investments" broadly.[262]

143. The Claimant submits that Laos has cited no authority to establish the relevance of the method by which Sanum invested in the local companies to the issue of whether its investments are covered under the BIT.[263] The Claimant contends that the loans extended by Sanum to the local companies fall under the category of "claim[s] to money" under Article 1(1) of the Treaty.[264] The Claimant notes that the loans that form part of continuing financing arrangements of an investment and that are interposed on a non-regular basis have been recognized as protected investments.[265]

D. WHETHER LAOS CONSENTED TO THE ARBITRATION OF THE CLAIMANT'S CLAIMS UNDER THE BIT

1. Article 8 of the BIT

(a) The Respondent's Position

144. The Respondent argues that the ordinary meaning of Article 8(3) establishes that Laos did not consent to the arbitration of Sanum's claims under the BIT.

145. It notes that Article 8(1) first imposes a six-month negotiation period on the parties.[266] If the negotiation is unsuccessful, then the BIT assigns Laotian courts general jurisdiction to hear any

261 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 274; Savan Vegas PDA, Articles 2(1), 3, 8(10) (C-004); Paksong Vegas PDA, Articles 2(1), 3, 8(10) (C-005).

262 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 274, referring to *Compañia de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic,* ICSID Case No. ARB/97/3, Award August 20, 2007, ¶ 7.5.18 (CLA-23); Hearing Transcript, pp. 110-111.

263 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 275.

264 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 275, referring to *Ceskoslovenska Obchodni Banka, A.S. v. Slovak Republic*, ICSID Case No. ARB/97/4, Decision of the Tribunal on Objections to Jurisdiction, May 24, 1999, ¶¶ 77, 81-83 (CLA-19); Hearing Transcript, p. 111.

265 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 275, referring to *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Award, September 28, 2007, ¶ 214 (CLA-69).

266 Respondent's Memorial on Jurisdiction, ¶¶ 131-132; Hearing Transcript, pp. 33-35.

dispute connected with the investment (Article 8(2))[267] and an ad hoc arbitral tribunal the more specific jurisdiction of hearing only those "dispute[s] involving the amount of compensation for expropriation"[268] and not "dispute[s] involving expropriation."[269]

146. Accordingly, it is the Respondent's position that all of the Claimant's other claims—*i.e.*, the breach of the fair and equitable treatment standard, expropriation, and breach of contract—are excluded from these proceedings.

147. In reliance on Article 31(1) of the VCLT that requires a treaty to be interpreted according to the ordinary meaning of its terms, the Respondent contends that the Parties have consented to international arbitration only for the quantum of an expropriation, and are required by the BIT to submit all other disputes, including the issue of whether an expropriation has occurred in the first place, to the local courts of the host State.[270] The Respondent relies on three arbitral tribunal decisions that have interpreted arbitration clauses in treaties providing for disputes on the "amount of compensation" only to be determined by international arbitration.[271] The Respondent contends that the Claimant's argument on this matter requires a departure from and an enlargement of the actual wording of the text.[272]

148. The Respondent also argues that the limited scope of Article 8(3) is confirmed when read in the context of the expropriation clause (Article 4) and Preamble of the BIT.[273]

149. The Respondent notes that Article 4(1) of the BIT defines the term "expropriation" and enumerates the conditions that must attach to an expropriation,[274] while Article 4(2) of the BIT

---

267 Hearing Transcript, p. 35.

268 Respondent's Memorial on Jurisdiction, ¶ 132; Respondent's Reply on Jurisdiction, ¶ 47; Hearing Transcript, pp. 35-36.

269 Respondent's Reply on Jurisdiction, ¶ 47.

270 Respondent's Memorial on Jurisdiction, ¶¶ 133-135.

271 Respondent's Memorial on Jurisdiction, ¶¶ 133-135, relying on *Berschader v. Russian Federation*, Arb. Inst. of Stockholm Chamber of Commerce, Award, Case No. V 080/2004, ¶¶ 152-158 (Apr. 21, 2006) (involving the Belgium/Luxembourg-Russian BIT of 1989) ("***Berschader***") (RA-18); *RosInvest Co. UK Ltd. v. Russian Federation* (RosInvest), Arb. Inst. of Stockholm Chamber of Commerce, Award on Jurisdiction, Case No. V 079/2005, ¶ 110 (Oct. 2007) (involving the UK-Russian BIT of 1989) ("***RosInvest***") (RA-19); *Austrian Airlines v. Slovak Republic* (Austrian Airlines), UNCITRAL, Final Award, ¶¶ 96-99 (Oct. 9, 2009) (involving the Austrian-Czech BIT of 1990) ("***Austrian Airlines***") (RA-20); Hearing Transcript, pp. 36-38.

272 Respondent's Reply on Jurisdiction, ¶ 47.

273 Respondent's Memorial on Jurisdiction, ¶ 137; Hearing Transcript, p. 38.

274 Respondent's Memorial on Jurisdiction, ¶ 138; Hearing Transcript, p. 38.

defines the amount of compensation that must accompany an expropriation.[275] It then contends that the Respondent's consent to international arbitration applies only to disputes involving Article 4(2) and not Article 4(1).[276]

150. The Respondent also notes that the Preamble of the BIT and the "generally recognized principles of international law accepted by both Contracting States," referred to in Article 8(7) of the BIT, further confirm the Respondent's interpretation of Article 8(3);[277] namely, that the scope of the arbitration clause and the clause giving jurisdiction to Laotian courts must be understood against the principle of "mutual respect of sovereignty." The principle of "mutual respect of sovereignty, equality and mutual benefit" as affirmed in the Preamble and embodied in the "principles of international law accepted" by both the PRC and Laos under Article 8(7) of the Treaty constitute part of the Five Principles of Pacific Coexistence that both Contracting States have recognized.[278]

151. In this case, the Respondent argues that the principle of mutual respect of sovereignty mandates respecting the Contracting States' choice to give exclusive jurisdiction to their respective judicial organs over the disputes connected to an investor's investments under Article 8(2), save for that relating to the compensation amount for an expropriation (Article 8(3)).[279]

152. The Respondent then argues that the common treaty practice of Laos and the PRC, as well as the treaty practice of each of these States with other States, further confirms its interpretation. It notes that the PRC has committed to respecting the sovereignty of Laos in its ratification of the International Declaration on the Neutrality of Laos dated 23 July 1962.[280] The Respondent also notes that preambles of other BITs signed by Laos, such as those with Australia and Indonesia, also refer to the principle of respect for the mutual independence and sovereignty of States.[281]

---

275 Respondent's Memorial on Jurisdiction, ¶ 139; Hearing Transcript, p. 38.

276 Respondent's Memorial on Jurisdiction, ¶ 140; Respondent's Reply on Jurisdiction, ¶ 47; Hearing Transcript, p. 39.

277 Respondent's Memorial on Jurisdiction, ¶¶ 141-142; Respondent's Reply on Jurisdiction, ¶ 47.

278 Respondent's Memorial on Jurisdiction, ¶ 143.

279 Respondent's Memorial on Jurisdiction, ¶ 144.

280 Respondent's Memorial on Jurisdiction, ¶ 146, referring to the Department of State Bulletin, Vol. XLVII, No. 1207 dated 13 August 1962 (RE-13).

281 Respondent's Memorial on Jurisdiction, ¶ 147, referring to Preamble, Laos/Australia BIT signed on 6 April 1994 (RE-14) and Laos/Indonesia BIT signed on 18 October 1994 (RE-15).

153. It submits that several BITs signed by the PRC also refer to the principle of mutual respect of sovereignty,[282] and limit the scope of arbitral jurisdiction to only those disputes involving the quantum of an expropriation claim while assigning the resolution of all other disputes to the local courts of the host State.[283]

154. The Respondent cautions the Tribunal against relying on the findings of other arbitral tribunals or state courts that have interpreted narrow consent clauses broadly in order to allow the investor to arbitrate expropriation claims.[284] The Respondent argues that none of the bilateral investment treaties in those cases incorporate the principle of mutual respect of sovereignty, as does the BIT here.[285] The application of the principle of mutual respect of sovereignty obliges the Tribunal to respect the Contracting States' choice of submitting disputes of a foreign investor to local courts.[286]

155. The Respondent further cites the notification made by the PRC on 7 January 1993, pursuant to Article 24(5) of the ICSID Convention, as to the jurisdiction of ICSID, in which the PRC stated that it "would only consider submitting to the jurisdiction of disputes over compensation resulting from expropriation and nationalization."[287]

156. The Respondent rejects any argument that the Claimant may make with regard to Article 8(3) being construed as containing a fork-in-the-road clause that would operate to exclude international arbitration once a foreign investor has submitted to Laotian courts any dispute

---

282 Respondent's Memorial on Jurisdiction, ¶ 148, referring to Preamble, the PRC/Mongolia BIT 1991 (RE-16) and Preamble, the PRC/Australia BIT 1988.

283 Respondent's Memorial on Jurisdiction, ¶ 148, referring to Article 8(3) of the PRC/Mongolia BIT 1991 (RE-16).

284 Respondent's Memorial on Jurisdiction, ¶ 149; Hearing Transcript, pp. 39-41, referring to *Renta 4 S.V.S.A et al. v. Russian Federation*, Arb. Inst. of Stockholm Chamber of Commerce, Award on Preliminary Objections, Case No. V 024/2007 (Mar. 20, 2009) (involving the Spanish-Russian BIT of 1991) ("***Renta 4***") (RA-21) (the Respondent argues that in that case the tribunal was able to find jurisdiction because the arbitration clause contained a reference to the expropriation clause which did not contain a split between the principle of expropriation and quantum of expropriation); *Tza Yap Shum* (CLA-70/RA-10) (the Respondent notes that the treaty in this case does not contain the restriction of the principle of mutual respect of sovereignty as is contained in the Treaty); *Czech Republic v. European Media Ventures*, 2007 EWHC 2851 (Comm), involving the Belgium/Luxembourg-Czech BIT (1992) ("***European Media Ventures***") (RA-22) (the Respondent notes that it does not have the award in this case).

285 Respondent's Memorial on Jurisdiction, ¶ 149, referring to *Renta 4* (RA-21); *Tza Yap Shum* (CLA-70/RA-10); *European Media Ventures*, (RA-22); Hearing Transcript, pp. 41-42.

286 Hearing Transcript, pp. 42-43.

287 Respondent's Memorial on Jurisdiction, ¶ 150, referring to Notification of the People's Republic of China to ICSID pursuant to Article 25(4) of the ICSID Convention dated 9 January 1993 (RE-17).

connected to an investment.[288] It clarifies that Article 8(3) mandates an interpretation under which international arbitration is excluded only when the investor submits to Laotian courts a dispute on the amount of compensation for expropriation, which is the only claim that can ever be arbitrated.[289]

(b) The Claimant's Position

157. The Claimant rejects the Respondent's interpretation of Article 8(3) of the Treaty.

158. The Claimant relies on *Tza Yap Shum*, which contains language similar to that of the BIT.[290] There, the tribunal found that the phrase "dispute involving the amount of compensation for expropriation" (as set out in Article 8(3) of the Treaty) simply meant that the dispute must *include* the determination of the amount of compensation but must not necessarily be limited to it.[291] The tribunal noted that the phrase evinced that the parties had consented to arbitrate all issues pertinent to the determination of the amount of damages, which necessarily includes whether damages must be awarded at all.[292]

159. The Claimant contends that this interpretation is consistent with the language of Article 4(1) of the Treaty, which sets out standards for the determination of whether an expropriation has taken place. It is thus clear, the Claimant argues, that whether an expropriation has occurred is an assessment that is a necessary element of any claim "involving the amount of compensation for expropriation."[293] The Claimant submits that the term "involving" is broad and extends the Tribunal's jurisdiction beyond disputes in which the only point of dispute is quantum.[294]

---

[288] Respondent's Memorial on Jurisdiction, ¶¶ 151-154; Hearing Transcript, pp. 43-45. (In this way, the Respondent seeks to distinguish the findings of the tribunal in *Tza Yap Shum.* That tribunal, the Respondent says, was motivated to interpret the jurisdictional clause broadly because it contained a fork-in-the-road provision such that if an investor submitted its dispute on the principle of expropriation to a local court, it was barred from access to international arbitration on the quantum of expropriation. The Respondent argues that this is not the case under the PRC/Laos Treaty).

[289] Respondent's Memorial on Jurisdiction, ¶¶ 151-154; Hearing Transcript, pp. 43-45.

[290] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 281; Hearing Transcript, pp. 123-125; *Tza Yap Shum* (CLA-70/RA-10).

[291] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 281, referring to Respondent's Memorial on Jurisdiction, ¶ 134; *Tza Tap Shum* (CLA-79).

[292] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 281.

[293] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 281; *Tza Tap Shum*, ¶ 152 (CLA-79/RA-10); Hearing Transcript, p. 117.

[294] Hearing Transcript, p. 117.

160. The Claimant argues that a contrary interpretation would render Article 4(1) meaningless, because the standards set out in Article 4(1) for determining an unlawful expropriation do not strictly fit within a dispute restricted to the amount or quantum of damages.[295] The Claimant further notes that, contrary to the contention of the Respondent, there can be no distinction between the question of whether the investor received "appropriate and effective compensation" under Article 4(2) and the question of whether an expropriation occurred under Article 4(1), as the former is an element of the latter.[296] The Claimant further points out that clauses like Article 4(1) and 4(2)—variants of which can be found in many investment arbitration treaties, including those with broad dispute resolution provisions—do not relate to the forum for making expropriation claims but merely set out the conditions for lawful expropriation and the standard for compensation.[297]

161. The Claimant maintains that Article 8(1) and 8(2) of the BIT do not have the effect of designating the local courts as the exclusive forum for the resolution of disputes apart from the quantum of expropriation, as the Respondent claims, because Article 8(1) provides for the amicable settlement of disputes and Article 8(2) gives the parties the option of submitting the dispute to the courts of the host State after the designated waiting period.[298]

162. The Claimant cites to courts and tribunals that have interpreted treaty provisions similar to Article 8(3) to confer jurisdiction over the question of whether an expropriation has occurred.[299]

163. The Claimant contests the Respondent's reliance on, what the Claimant characterizes as, "the only three cases in which tribunals declined to read such clauses as conferring jurisdiction over disputes as to the existence of an expropriation".[300] The Claimant further contends that those

---

295 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 282.

296 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 283; Hearing Transcript, pp. 119-120.

297 Claimant's Rejoinder on Jurisdiction, ¶ 39; Hearing Transcript, p. 120.

298 Claimant's Rejoinder on Jurisdiction, ¶ 38.

299 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 284; Claimant's Rejoinder on Jurisdiction, ¶ 36, citing: (1) *Tza Yap Shum*, at 151 (CLA-70/RA-10); (2) *European Media Ventures*, ¶ 44 (RA-22) (see also Hearing Transcript, pp. 128-129); (3) *Quasar de Valors (formerly Renta 4 S.V.S.A. et al.) v. The Russian Federation*, Award on Preliminary Objections (SCC 20 March 2009), at 5, 20–21 (RA-21) ("***Quasar de Valors***") (see also Hearing Transcript, pp. 125-128); (4) *Franz Sedelmayer v. The Russian Federation*, Arbitration Award (SCC, 7 July 1998), at 9, 71–73 (CLA-34) (see also Hearing Transcript, p. 129); and (5) *Saipem S.p.A. v. The People's Republic of Bangladesh*, ICSID Case No. ARB/05/07, Decision on Jurisdiction and Recommendation on Provisional Measures, March 21, 2007, ¶¶ 70, 76, 116–118, 29–133 (CLA-64) (see also Hearing Transcript, p. 129).

300 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 285, referring to the Respondent's reliance on (1) *Austrian* Airlines, ¶ 102 (RA-20); (2) *Berschader*, ¶¶ 152-158 (RA-18); and, (3) *RosInvest*, ¶ 110 (RA-19).

decisions would not in any case support a similar outcome in this case, as they can be distinguished.[301] For instance, none of them contain fork-in-the-road provisions in their dispute settlement clauses.[302] In addition, the Claimant contends that five of the tribunals that have interpreted clauses like Article 8 have done so expansively.[303]

164. Further, the Claimant argues that the interpretation of the Respondent disregards the context of Article 8(3).[304] The Claimant submits that a proper reading of Article 8(2) of the PRC/Laos Treaty is that an investor is entitled to submit its dispute to the State courts, but that it will be barred from seeking arbitration of its expropriation claim if it in fact pursues this option.[305] The Claimant asserts that the Respondent's contention that an investor must first submit the issue of whether an expropriation has occurred to the domestic courts effectively deprives the investor of access to arbitration; its opportunity to arbitrate the dispute will be foreclosed by its submission of the issue of expropriation to the domestic courts.[306]

165. The Claimant contends that Article 8(2) and 8(3) provide an investor two options if the dispute cannot be settled through negotiation within six months.[307] Article 8(3) contains a fork-in-the-road provision.[308] The Claimant asserts that had the Contracting Parties intended to require the investor to litigate whether an expropriation had occurred before submitting the question of quantum to a tribunal, they would not have stipulated that "*either*" process could begin after six months.[309]

---

301 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 285-286. Concerning the Respondent's reliance on (1) *Austrian Airlines,* the Claimant notes that unlike the Treaty in this case, the BIT in that case explicitly stated that an investor could only challenge an expropriation before the local authorities (RA-20) (see also Hearing Transcript, p. 130); (2) *Berschader*, the Claimant notes that the panel had considered the phrase "amount or mode of compensation" after it had already concluded that it lacked jurisdiction on an entirely separate ground and its conclusions on the scope of the arbitration clause were 'superfluous' *obiter dicta* (see also Hearing Transcript, pp. 130-131) (RA-18); and, (3) *RosInvest*, the Claimant notes, *inter alia*, that that decision did not consider whether the word 'payment' may lead to consideration of the reality of its predicate: 'expropriation' (RA-19); see also Hearing Transcript, pp. 131-132.

302 Hearing Transcript, p. 129.

303 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 280-284; Claimant's Rejoinder on Jurisdiction, ¶ 36; see also Hearing Transcript, p. 129.

304 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 287-288.

305 Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 287-288.

306 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 289, referring to *Tza Yap Shum*, ¶¶ 154-161 (CLA-70/RA-10).

307 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 290.

308 Hearing Transcript, pp. 117, 120.

309 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 290.

166. The Claimant also disagrees with the Respondent's contention that the fork-in-the-road bar in Article 8(3) merely precludes an investor who has submitted a dispute over the quantum of compensation to a domestic court from bringing the same claim before an arbitral tribunal.[310] First, the Claimant notes that Article 8(3) categorically states that arbitration shall not be permitted if the investor has submitted the dispute "involving the amount of compensation for expropriation" to the local courts; a statement that can only make sense if Article 8 permits an investor to choose between litigating and arbitrating all aspects of its expropriation claim.[311]

167. Second, the Claimant notes that the determination of the fact of an expropriation and the amount of compensation for an expropriation are linked in the Treaty, so that a court could not determine one issue without also determining the other.[312]

168. Third, the Claimant contends that the Respondent's interpretation renders the right to arbitration illusory, which in turn defeats the object of the Treaty to encourage investment.[313]

169. And finally, the Claimant contends that the principle of mutual respect for sovereignty is not undermined by holding a State to the commitments it made for the benefit of its treaty partner.[314] On a broader but related note, the Claimant also contends that the Respondent has not expounded as to how the "principle of mutual respect for sovereignty, equality and mutual benefit," as contained in the Preamble of the BIT supports its interpretation.[315] The Claimant points out that investment treaties with expansive dispute resolution provisions contain similar language.[316]

---

310 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 291, referring to Respondent's Memorial on Jurisdiction ¶¶ 151-154.

311 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 292; Hearing Transcript, pp. 121-122.

312 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 293.

313 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 294, referring to *Tza Yap Shum*, ¶ 153 (CLA-70/RA-10); *RosInvest*, ¶ 130 (RA-19); *Amco v. Republic of Indonesia*, ICSID Case No. ARB/81/1, Award on Jurisdiction, September 25, 1983, ¶ 24 (CLA-7); Hearing Transcript, pp. 117-118, 121-122.

314 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 295, referring to *Case of the S.S.'Wimbledon' (U.K. v.Japan)*, 1923 (ser. A) No. 1, Judgment (P.C.I.J., 17 August 1923), p. 25 (CLA-84); *CME Czech Republic B.V. v. The Czech Republic*, Partial Award (UNCITRAL 13 September 2001), ¶ 533 (CLA-21); *Quasar de Valors*, ¶ 31 (RA-21); Lalive, "The First World Bank Arbitration (*Holiday Inns v Morocco*)—Some Legal Problems," *British Yearbook of International Law* (1980), at 158 (CLA-101); Hearing Transcript, pp. 119-120.

315 Claimant's Rejoinder on Jurisdiction, ¶ 37.

316 Claimant's Rejoinder on Jurisdiction, ¶ 37; referring to the Australia/Pakistan BIT (CLA-119) and the Australia/India BIT as examples (CLA-120); Hearing Transcript, p. 119.

2. Article 3(2) of the BIT

(a) The Respondent's Position

170. The Respondent rejects the Claimant's attempt, based on Article 3(2) of the BIT, to import the arbitration clauses contained in BITs entered into by Laos with third States to this dispute so as to widen this Tribunal's jurisdiction.[317]

171. The Respondent argues that the most favored nation ("**MFN**") clause under the BIT does not encompass dispute settlement for the following reasons: (a) the scope of the MFN clause is limited to "fair and equitable treatment" and "protection" and does not refer to dispute settlement;[318] and (b) the context of Article 3(2) of the BIT confirms that the MFN clause does not apply to dispute settlement.[319]

172. First, the Respondent contends that the plain meaning of Article 3(2) is that the MFN clause is limited to "fair and equitable treatment" and "protection" as listed in Article 3(1), which does not cover access to international arbitration.[320] The Respondent notes that, for an MFN clause to enlarge the scope of an arbitration clause, its wording must be broad enough to include arbitration proceedings.[321]

173. The Respondent argues that "fair and equitable and full protection and security" clause is a standard term in most modern BITs that has appeared in such treaties since the 19th century, including in the first Chinese model BIT and other BITs contemporary to that at issue here.[322] The Respondent stresses that the term "protection" refers to the "protection and security" standard.[323] The Respondent therefore concludes that the scope of the MFN clause is restricted

---

[317] Respondent's Memorial on Jurisdiction, ¶¶ 155-157, referring to the Amended Notice, ¶ 2, pp. 119-123, 126.

[318] Respondent's Memorial on Jurisdiction, ¶ 158; Hearing Transcript, pp. 47-48.

[319] Respondent's Memorial on Jurisdiction, ¶ 158.

[320] Respondent's Memorial on Jurisdiction, ¶ 159, referring to Amended Notice, ¶ 2, pp. 119-123, 126; Hearing Transcript, p. 48.

[321] Respondent's Memorial on Jurisdiction, ¶ 159, referring to *RosInvest*, ¶ 110 (RA-19); Hearing Transcript, pp. 151-152 (referring to *Tza Yap Shum*, ¶ 126) and pp. 152-153 (referring to *RosInvest* and the distinction made in that case between investments or investors in applying the MFN clause).

[322] Respondent's Reply on Jurisdiction, ¶ 50.

[323] Respondent's Reply on Jurisdiction, ¶ 51, referring to Gallagher & Shan, pp. 134-135 (RA-34); Hearing Transcript, p. 151.

to Article 3(1), which is "fair and equitable treatment" with the "protection" indicated therein having no relation to access to international arbitration.[324]

174. The Respondent argues that the context of Article 3(2) confirms its non-application to dispute settlement.[325] The specific reference in Article 3(2) to Article 3(1) manifests the clear intention of the Contracting States that "the MFN clause would import only [the] more favorable substantive treatments from third-party treaties, and not arbitration or other dispute resolution provisions."[326]

175. In the Respondent's view, Article 3(2) would have specifically referred to Article 8 if the Contracting States' intention was to be able to import an arbitration clause from another treaty to expand the consent in Article 8(3) of the BIT, which is not the case here.[327] The Respondent therefore contends that the jurisdiction of the Tribunal is limited to that specified in Article 8(3) of the BIT.[328]

176. The Respondent submits that the principle of mutual respect for sovereignty, as referenced in both the Preamble and Article 8(7) of the BIT, precludes the expansive interpretation of the MFN clause.[329] The Respondent contends that a broad application of the MFN to enlarge access to arbitration would directly violate the agreement of the Contracting States to limit the scope of permissible arbitration.[330]

177. The Respondent stresses that the Contracting Parties assigned disputes of the kind brought by the Claimant exclusively to the courts of the Contracting States, pursuant to Article 8(2) of the BIT.[331] To allow the Claimant to import broader consent clauses that would allow it to arbitrate claims for breach of the fair and equitable treatment standard, breach of contract, and liability for expropriation, would circumvent the Contracting States' agreement on this matter.[332]

---

324 Respondent's Reply on Jurisdiction, ¶ 53; Hearing Transcript, pp. 49-50.

325 Respondent's Memorial on Jurisdiction, ¶ 161.

326 Respondent's Memorial on Jurisdiction, ¶ 162.

327 Respondent's Memorial on Jurisdiction, ¶ 162.

328 Respondent's Memorial on Jurisdiction, ¶ 162.

329 Respondent's Memorial on Jurisdiction, ¶¶ 163-164.

330 Respondent's Memorial on Jurisdiction, ¶ 165.

331 Respondent's Memorial on Jurisdiction, ¶ 165.

332 Respondent's Memorial on Jurisdiction, ¶ 166.

178. The Respondent emphasizes that "an MFN clause cannot change the scope, *ratione materiae*, of the jurisdiction of an arbitral tribunal."[333] The Respondent distinguishes this case from other cases in which the consent clauses were broader than that found in Article 8(3) and over which the tribunals had *ratione materiae* jurisdiction for all of the disputes brought by the claimant.[334]

(b) The Claimant's Position

179. The Claimant contends that the MFN clause of Article 3(2) extends the jurisdiction of the Tribunal to claims for the breach of the obligation of fair and equitable treatment, as enshrined in Article 3(1); the guarantee of free transfer of payments in Article 5; and other protections that are imported from more favorable bilateral investment treaties, including the Claimant's right to have its expropriation claim resolved through international arbitration.[335]

180. The Claimant rejects the Respondent's contention that any right imported through Article 3(1) is limited to the substantive entitlements in Article 3(1), thereby excluding dispute settlement.[336]

181. First, the Claimant contends that the "protection" that Article 3(1) accords to investments extends to all protections provided in the Treaty—including access to international arbitration—and not merely substantive ones.[337] Moreover, Article 3(2) promises no less favorable treatment and protection for "activities associated with such investments." The Claimant argues that the settlement of disputes is an "activity" associated with an investment.[338] The Claimant further argues that arbitration clauses are highly valued by investors and are considered essential to the range of protection offered in investment treaties.[339]

---

[333] Respondent's Memorial on Jurisdiction, ¶ 167, referring to *Impregilo S.p.A. v. Argentina*, ICSID Case No. ARB/07/17), Decision on Jurisdiction, June 21, 2011, Concurring and Dissenting Opinion of Brigitte Stern ("***Impregilo***") (RA-24).

[334] Respondent's Memorial on Jurisdiction, ¶ 167, referring to *Impregilo* (RA-24).

[335] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 297; Hearing Transcript, p. 132.

[336] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 298.

[337] Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 299-300. The Claimant also argues that such a reading is consistent with the Preamble to the Treaty which includes the protection of investment as one of its primary purposes. Claimant's Statement of Claim and Response on Jurisdiction, ¶ 300; Hearing Transcript, pp.133-134, 144.

[338] Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 300-301, referring to *Hochtief AG v. Argentine Republic*, ICSID Case No. ARB/07/31, Decision on Jurisdiction, October 24, 2011, ¶ 73 (CLA-38); Hearing Transcript, p. 135.

[339] Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 301-302, referring to *RosInvest*, ¶¶ 130, 132 (RA-19); *AWG Group Ltd. v. Argentine Republic*, Decision on Jurisdiction (UNCITRAL, 3 August 2006), ¶ 59 ("***AWG Group***") (CLA-9); *Gas Natural SGD, S.A. v. The Argentine Republic*, ICSID Case

182. The Claimant contests the Respondent's attempt to restrict the term "protection" to "full protection and security." It points out that the full protection and security standard obliges the State to provide the investor with access to justice, just as the fair and equitable treatment standard entitles the investor to have its claims adjudicated by an impartial decision maker.[340] The Claimant further argues that this obligation gains particular significance when the investor brings claims for unfair treatment by the domestic courts; it is only by bringing its claims before an international tribunal that the investor will have access to the standard of justice required under the fair and equitable treatment standard.[341]

183. Second, the Claimant contends that tribunals that have considered broad MFN clauses, such as the one at issue here, have authorized the importation of dispute resolution clauses.[342] The Claimant rejects the Respondent's argument that those cases contained broader arbitration clauses than the Treaty. It argues that the principle underlying the decisions of those tribunals applies here, *i.e.*, that the less favorable treatment bestowed on the Claimant by the Respondent has been prejudicial and has effectively foreclosed access to international arbitration.[343]

184. The Claimant highlights, in particular, the *RosInvest* case, in which the tribunal noted that the MFN clause permitted the importation of the dispute resolution clause because it was a procedural option that offered the investor protection from interference with the use and enjoyment of the investment.[344] It contends that the reasoning of the *RosInvest* tribunal applies

No. ARB/03/10, Decision of the Tribunal on Preliminary Questions of Jurisdiction, June 17, 2005, ¶ 29 ("***Gas Natural***") (CLA-36); Hearing Transcript, p. 133.

[340] Claimant's Rejoinder on Jurisdiction, ¶ 42, referring to Dr. Todd Weiler, *The Interpretation of International Investment Law: Equality, Discrimination and Minimum Standards of Treatment in Historical Context* 101-103 (Martinus Nijhoff Publishers, 2013) (CLA-125); Hearing Transcript, pp. 133-134, see also p. 170 where the Claimant states that the right of access to justice is included under either formulation of the standard, *i.e*., "full protection and security" or "protection".

[341] Claimant's Rejoinder on Jurisdiction, ¶ 42, referring to *Frontier Petroleum Serv. Ltd. v. Czech Republic*, Final Award (UNCITRAL, 12 November 2010), ¶ 263 (CLA-35); Hearing Transcript, pp. 134-135.

[342] Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 303-304, referring to *RosInvest*, ¶¶ 126, 130, 136 (RA-19); *Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, January 25, 2000, ¶¶ 54, 56 ("***Maffezini***") (CLA-46); *Gas Natural*, ¶¶ 9, 31 (CLA-36); *Siemens*, ¶¶ 102-103 (CLA-71); *National Grid PLC v. Argentine Republic*, Decision on Jurisdiction (UNCITRAL, 20 June 2006), ¶ 93 (CLA-53); *Camuzzi International S.A. v. República Argentina*, ICSID Case No. ARB/03/7, Decision of the Arbitral Tribunal on Jurisdictional Objections, June 10, 2005, ¶¶ 16-17, 28 and 34(iii) (CLA-17); *AWG Group*, ¶¶ 57, 68 (CLA-9).

[343] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 306; Hearing Transcript, pp. 136-137.

[344] Claimant's Rejoinder on Jurisdiction, ¶ 43, referring to *RosInvest*, ¶ 128 (RA-19).

here, where interference with the "activities associated with such investments" (Article 3(2)) would also require access to the procedural option of international arbitration.[345]

185. The Claimant rejects as irrelevant and speculative the Respondent's contention that (a) the MFN clause would have specifically referred to Article 8 of the Treaty if it were meant to apply to arbitration; and (b) importing a broader arbitration clause would award the Claimant a right specifically foreclosed.[346] As regards the latter argument, the Claimant notes that the Treaty does not list arbitration or any other dispute resolution mechanism as an exception to the MFN clause.[347]

E. WHETHER *LIS PENDENS* AND THE DOCTRINE AGAINST THE ABUSE OF PROCESS BAR THE CLAIMS OF THE CLAIMANT

(a) The Respondent's Position

186. The Respondent alleges that the Claimant's 7 June 2013 Amended Notice is an attempt to add to these proceedings the claims from the Lao Holdings Arbitration. The Respondent contends that this "duplication of claims submitted before two separate Tribunals must be procedurally barred."[348] In its view, prior to the submission of the Amended Notice, the claims were separate, and their incorporation in this arbitration has caused the Respondent prejudice in its selection of arbitrators and the preparation of its defenses.[349]

187. The Respondent contends that Lao Holdings was specifically created to own Sanum so that two BIT arbitrations could be filed against the Respondent.[350] The Respondent notes that it rejected the Claimant's efforts to consolidate the two arbitrations.[351] That the Claimant now seeks to consolidate these cases by importing its claims in the Lao Holdings Arbitration into this arbitration is a "patent abuse of process."[352]

345 Claimant's Rejoinder on Jurisdiction, ¶ 44; Hearing Transcript, p. 137 (see also Hearing Transcript, pp. 143-146 for further discussion on *RosInvest*).

346 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 307, referring to Respondent's Memorial on Jurisdiction, ¶¶ 162, 166.

347 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 307, referring to *RosInvest*, ¶ 135 (RA-19); *Gas Natural*, ¶ 30 (CLA-36).

348 Respondent's Memorial on Jurisdiction, ¶ 168.

349 Respondent's Memorial on Jurisdiction, ¶ 168; Hearing Transcript, pp. 153-154.

350 Respondent's Memorial on Jurisdiction, ¶ 169.

351 Respondent's Memorial on Jurisdiction, ¶ 169.

352 Respondent's Memorial on Jurisdiction, ¶ 169.

188. Second, the Respondent notes that the doctrine of *lis pendens* prevents identical claims from being brought against the same party.[353] The Respondent argues that it should not be forced to defend the same claims twice before different arbitral tribunals.[354] The Respondent notes that the procedural timetables of both arbitrations provide for defenses to be raised at separate times.

189. The Respondent refers to the inequality and inefficiency of the Respondent having to defend a different argument based on different evidence in the later proceedings as the Claimant would be able to modify its argument based on the defense of the Respondent in the earlier proceedings.[355]

190. Lastly, the Respondent maintains that procedural equality prevents the Claimant from having "two bites at the cherry," and notes that the rule of *lis pendens* has as its primary purpose the prevention of dual verdicts on the same claims.[356]

191. The Respondent then notes that "[n]ow that Claimant Sanum has spelled out in 170 pages its full amendments, [it] further objects under Articles 17 and 22 of the UNCITRAL Rules and requests that the arbitrator deny the amendments."[357] By way of providing context to this claim, it reiterates that Lao Holdings was specifically created in January 2012 to enable the Claimant to avail of the protections accorded under the Netherlands/Laos BIT,[358] and that Lao Holdings made untrue statements in order to ensure that the ICSID tribunal had jurisdiction *ratione temporis* to decide its claims.[359] It characterizes the amendment of the Claimant's claims in this case as a further "attempt to manipulate the investment arbitration system."[360]

192. In response to the contention of the Claimant that it had to amend its Notice because of the refusal of the Respondent to consolidate the two cases, the Respondent notes that the requested

---

[353] Respondent's Memorial on Jurisdiction, ¶ 170; Hearing Transcript, pp. 52-53.

[354] Respondent's Memorial on Jurisdiction, ¶ 170.

[355] Respondent's Memorial on Jurisdiction, ¶ 170.

[356] Respondent's Memorial on Jurisdiction, ¶¶ 171-172, referring to Born, *International Commercial Arbitration*, Vol. II, Wolters Kluwer, page 2949 [2009] ("**Born**") (RA-25).

[357] Respondent's Reply, ¶ 11.

[358] Respondent's Reply, ¶¶ 3-5.

[359] Respondent's Reply, ¶¶ 7-10.

[360] Respondent's Reply, ¶ 11.

amendment was not to enhance efficiency but was intended, rather, to transfer claims arising under the Netherlands/Laos BIT to this case.[361]

193. The Respondent highlights that Article 17 of the 2010 UNCITRAL Rules allows the Tribunal to avoid "unnecessary delay and expense and to provide a fair and efficient process"[362] and that Article 22 of the UNCITRAL Rules allows the Tribunal to reject an amendment that causes "delay" and "prejudice."[363] The Respondent points to the effort exerted and costs incurred in the Lao Holdings Arbitration, and notes that the Claimant had sought the production of documents in this case to be used in the Lao Holdings Arbitration.[364]

194. It also notes that Article 22 of the 2010 UNCITRAL Rules prevents an amendment in this case because this amendment falls outside the jurisdiction of the Tribunal, as shown by (a) the initial decision of the Claimant to file separate claims under the Netherlands/Laos BIT and the PRC-Laos BIT, respectively; and (b) the allegedly limited scope of the PRC/Laos BIT, which the Respondent claims applies only to claims regarding the quantum of expropriation.[365] As further proof of the alleged lack of jurisdiction of the Tribunal over the claims the Claimant wishes to introduce in this arbitration, the Respondent points to an allegedly private dispute—between Sanum and its local partner—that it contends does not belong in an investment arbitration.[366]

(b) The Claimant's Position

195. The Claimant contends that the doctrine of *lis pendens* is inapplicable in this case because there is no identity of parties and claims in the two cases.[367] It further submits that *lis pendens* provides a ground for staying one proceeding until the other has terminated. It argues that there are no grounds to support a stay in this case as the resolution of one case will not resolve the other and, moreover; the simultaneous conduct of both cases actually enhances efficiency.[368]

---

361 Respondent's Reply, ¶ 12.

362 Respondent's Reply, ¶¶ 13-14; Hearing Transcript, p. 53.

363 Respondent's Reply, ¶¶ 15, 17.

364 Respondent's Reply, ¶ 17.

365 Respondent's Reply, ¶¶ 18-19; Hearing Transcript, p. 53.

366 Respondent's Reply, ¶ 20.

367 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 310, referring to *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Decision on Jurisdiction, December 8, 2001, ¶¶ 89-89 (CLA-10); Hearing Transcript, p. 141.

368 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 310, referring to Born, at 2933 (RA-25).

196. The Claimant rejects the Respondent's allegation that the Claimant is committing an abuse of process. It argues that Laos chose to have two separate proceedings in this case; Sanum had proposed to consolidate the proceedings prior to the selection of arbitrators in both cases.[369] It notes that Laos has benefited from seeing the Claimant's detailed arguments in both proceedings before having to file its defense.[370] The Claimant also argues that the two claimant parties have the right to bring claims under two different treaties as they are from different States and have separate rights under the treaties.[371]

197. Finally, the Claimant contends that the amendment of its Notice to include claims in the Lao Holdings arbitration could not have prejudiced the Respondent in its selection of arbitrators, given that Laos has been able to appoint the same arbitrator in both proceedings.[372] The Claimant also points out that the amendment of its Notice was discussed at the first procedural hearing, agreed upon by the Parties, and memorialized by the Tribunal in its Procedural Order No. 1.[373]

198. As to the Respondent's contention that the Amended Notice should be rejected pursuant to 2010 UNCITRAL Rules 17 and 22, the Claimant raises four points. First, the Claimant contends that this argument is untimely, given that Laos did not object to this amendment when the process for this amendment was discussed and adopted, when the allegedly detailed Amended Notice was filed, or when the Respondent filed its Response on Jurisdiction.[374] The Claimant insists that "Laos cannot complain of an 'abuse of process' when it agreed to the process."[375]

199. Second, the Claimant asserts that the 2010 UNCITRAL Rules neither prohibit nor require that a notice of arbitration be amended prior to the presentation of a claimant's case in the opening memorial, and argues that Article 22 typically applies not to the notice of arbitration, but to the adding or supplementing of claims after the submission of the claim or counterclaim.[376]

---

369 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 311; Hearing Transcript, pp. 139, 141, 172-173.

370 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 311.

371 Hearing Transcript, p. 140.

372 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 311; the Claimant also submits that it attempted to have the same tribunal constituted to hear the two cases (Hearing Transcript, pp. 139, 140).

373 Claimant's Rejoinder on Jurisdiction, ¶ 46, referring to Procedural Order No. 1, at 4; Hearing Transcript, p. 140.

374 Claimant's Rejoinder on Jurisdiction, ¶ 48; Hearing Transcript, p. 142.

375 Claimant's Rejoinder on Jurisdiction, ¶ 48.

376 Claimant's Rejoinder on Jurisdiction, ¶ 49.

200. Third, the Claimant notes that neither its Amended Notice nor its Statement of Claim has caused unfairness, prejudice, or delay; both submissions predated the Respondent's filing of any pleadings in this matter.[377] As to the Respondent's claims concerning the Lao Holdings Arbitration, the Claimant contends that the Respondent's work in that case need not be duplicated and is in fact directly applicable to the present matter.[378] The Claimant also points out that any inefficiency or added costs resulting from the parallel litigation can be attributed to the refusal of the Respondent to consolidate the two arbitrations.[379]

201. Fourth, the Claimant contends that the Respondent has not explained its argument under Article 22, that the Lao Holdings claims fall outside the jurisdiction of this Tribunal, and questions the relevance of what it describes as the Respondent's speculation as to why the Claimant filed two separate arbitrations.[380]

VI. RELIEF REQUESTED

202. The Respondent requests that:

i) The Tribunal decline jurisdiction because Sanum is not a qualified investor under the BIT.

ii) The Tribunal decline jurisdiction because the claims brought are not investment related claims.

iii) The Tribunal decline jurisdiction because the Respondent did not consent to arbitrate Sanum's claims under the BIT.

iv) In the alternative, the Tribunal dismisses the several claims introduced into this arbitration by the Amended Notice filed 7 June 2013, incorporating the duplicative claims previously made in the Holdings arbitration.

v) The Tribunal issue an award of the Respondent's costs incurred in connection with this arbitration, including Laos' legal fees and other costs, and Laos' share of the fees and expenses of the Tribunal and the Administrative Centre.

---

377 Claimant's Rejoinder on Jurisdiction, ¶ 50.

378 Claimant's Rejoinder on Jurisdiction, ¶ 50.

379 Claimant's Rejoinder on Jurisdiction, ¶ 51.

380 Claimant's Rejoinder on Jurisdiction, ¶ 52.

203. The Claimant requests an award:

i) Dismissing the Respondent's objections to the Tribunal's jurisdiction in their entirety;

ii) Awarding Sanum its costs and expenses of this proceeding, including attorneys' fees, in an amount to be determined in the course of this proceeding by such means as the Tribunal may direct; and

iii) Ordering such other relief as may be just and appropriate in the circumstances.

VII. THE TRIBUNAL'S ANALYSIS

A. APPLICABLE LAW

204. It is common ground between the Parties that public international law is the applicable law. It is also undisputed that the VCLT is binding upon Laos and the PRC.

B. WHETHER THE CLAIMANT IS COVERED BY THE TREATY

1. Whether the Treaty extends to the Macao SAR

205. The question of the application or non-application of the PRC/Laos BIT to the Macao SAR is central to the question of jurisdiction. The Claimant considers that it applies, while the Respondent argues that it does not. If the Respondent is correct, the case stops as the Tribunal would have no jurisdiction and would not need to examine the other objections to jurisdiction. If the Claimant is correct, the Tribunal must continue its mission by examining the other objections to jurisdiction.

(a) The theoretical analysis of the relevance of the 1999 Notification to the Secretary-General of the UN

206. One of the main arguments relied upon by the Respondent is that the 1999 Notification to the UN Secretary-General contains the list of treaties that the PRC intended to extend to the Macao SAR. In the Respondent's Memorial on Jurisdiction, it states:

> Similarly, the 1999 Notification regarding the Macao SAR, which the PRC filed on 13 December 1999 and on which Lao PDR has been relying, provides:

> "[…] *IV.* ***With respect to other treaties that are not listed in the Annexes to this Note, to which the People's Republic of China is or*** will ***become a Party, the Government of the People's Republic of China will go through separately the necessary formalities for their application to the Macao Special Administrative Region if it so decided***."

The BIT is not listed in the two Annexes referred to in the 1999 Notification. Thus, it was not extended to the Macao SAR.[381]

207. The Claimant has answered this argument by underlining that it ignores an important difference between multilateral treaties and bilateral treaties:

> […] on its face, the Notification did not intend to cover the universe of international agreements to which the PRC is a party. Rather, as is evident from the official record, the Notification applied only to multilateral treaties for which the UN Secretary-General acts as depositary: "By a notification dated 13 December 1999, the Government of the People's Republic of China informed the Secretary-General of *the status of Macao in relation to treaties deposited with the Secretary-General*." The PRC-Laos Treaty, however, is not such an instrument: it is a bilateral treaty with regard to which the Secretary-General plays no role. Thus, contrary to what Respondent argues, no conclusion about the territorial scope of the Treaty can be drawn from the fact that it does not appear in the lists, annexed to the Notification, of multilateral PRC treaties that would apply to Macau after the handover. In fact, none of the PRC's numerous bilateral agreements (or multilateral agreements with other depositaries) is included in those annexes, because there was no reason to notify the Secretary-General of purported territorial limitations for treaties where he plays no role.[382]

208. In its Reply on Jurisdiction, the Respondent tried to explain that there is no difference between multilateral and bilateral treaties[383] as can be seen from the fact that the bilateral treaties are also published in the UNTS, and to support this line of argument, it cited Article 102 of the UN Charter, which provides:

> 1. Every treaty and every international agreement entered into by any Member of the United Nations after the present Charter comes into force shall as soon as possible be **registered** with the Secretariat and **published** by it.
> 2. No party to any such treaty or international agreement which has not been registered in accordance with the provisions of paragraph 1 of this Article may invoke that treaty or agreement before any organ of the United Nations.[384]

---

381 Respondent's Memorial on Jurisdiction, ¶¶ 41-42 (Respondent's emphasis).

382 Claimant's Statement of Claim and Response on Jurisdiction, ¶ 242 (Claimant's emphasis).

383 Respondent's Reply on Jurisdiction, ¶ 42; Notes verbales from the Legal Counsel relating to the depositary practice and the registration of treaties pursuant to Article 102 of the UN Charter, http://treaties.un.org/Pages/Overview.aspx?path=overview /definition/page1_en.xml#agreements (emphasis added) (RA-30).

384 UN Charter: Chapter XVI: Miscellaneous Provisions (RA-28) (emphasis addded).

209. The Tribunal must, however, emphasize that such an approach ignores the fundamental difference between the role of the UN as depositary and its role as an instance of registration. The role as depositary concerns exclusively multilateral treaties; the role as instance of registration concerns bilateral treaties. In both situations, the UN ensures the publication of the treaties. It is not because multilateral treaties and bilateral treaties are all published in the UNTS that the roles played upwards by the UN are not to be differentiated. When acting as depositary, the UN Secretary-General plays an important role as far as reservations to multilateral treaties are concerned, while no question of reservation arises in relation to bilateral treaties.

210. The Tribunal cannot therefore accept this line of argument by the Respondent. The Tribunal finds that the 1999 Notification has no relevance as far as bilateral treaties are concerned. As such, it does not need to enter into an examination of the Respondent's arguments to the effect that the 1999 Notification could be considered either as a reservation to the application of Article 29 of the VCLT or as a binding unilateral declaration according to which the PRC/Laos BIT—not being mentioned among the multilateral treaties listed therein—is not applicable to the Macao SAR.

211. The Respondent's reliance on the 1999 Notification being of no avail, the Tribunal must analyze the legal parameters that are applicable in this case.

(b) The relevance of Article 29 of the VCLT and Article 15 of the VCST

The Parties' Positions

212. The Parties have invoked both Article 29 of the VCLT and Article 15 of the VCST.

213. As the written and oral submission of the Parties were far from exhaustive on these Articles, at the end of the Hearing on Jurisdiction, the Tribunal sought clarification from the Parties on the following point:

> The respective roles, if any, of Article 29 of the [VCLT] and Article 15 of the [VCST] in relation to the application or non-application of the PRC/Laos Treaty to the Macau SAR.

214. It is useful to reproduce here these two articles. Article 29 of the VCLT reads as follows:

> **Article 29 - Territorial Scope of Treaties**
>
> Unless a different intention **<u>appears from the treaty</u>** or **<u>is otherwise established</u>**, a treaty is binding upon each party in respect of its entire territory. (emphasis added)

215. Article 15 of the VCST reads as follows:

> **Article 15 - Succession In Respect of Part of Territory**
>
> When part of the territory of a State, or when any territory for the international relations of which a State is responsible, not being part of the territory of that State, becomes part of the territory of another State:
>
> (a) treaties of the predecessor State cease to be in force in respect of the territory to which the succession of States relates from the date of the succession of States; and
>
> (b) treaties of the successor State are in force in respect of the territory to which the succession of States relates from the date of the succession of States, unless it **appears from the treaty** or **is otherwise established** that the application of the treaty to that territory would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation. (emphasis added)

216. The Respondent summarizes its position on the respective roles of Articles 15 and 29 as follows:

> Respondent submits its analysis on Question I in two parts. The first part establishes that Article 15 of the [VCST] is an expression of customary international law (A). The second part establishes that both Article 29 and Article 15 are applicable to this case as they are both expressions of customary international law and their co-existence is not incompatible (B).[385]

217. The conclusion of the Respondent's analysis is that:

> […] there can be no doubt that bilateral investment treaties and other commercial treaties concluded by China with third countries do not automatically apply to Macao under the positive aspect of the basic rule but are instead the object of an exception to such rule.[386]

218. The Claimant, for its part, argues the following:

> Article 29 is applicable to the PRC-Laos Treaty both because the PRC and Laos are parties to the VCLT and because Article 29 undeniably represents the applicable rule of customary international law. In contrast, neither the PRC nor Laos has ratified the [VCST]. […] [T]here is no evidence of the requisite consistent State practice or *opinio juris* to support the notion that its provisions reflect customary international law. In particular, the aspect of Article 15 of the [VCST] that differs from the customary rule reflected in Article 29—its exceptions—cannot be considered to reflect customary international law. […] Even if the exceptions in Article 15 were somehow deemed to constitute applicable law, the PRC-Laos Treaty does not fall under its exceptions.[387]

---

385 Respondent's Post Hearing Submission, ¶ 2.

386 Respondent's Post Hearing Submission, ¶ 21.

387 Claimant's Response, ¶¶ 3, 6.

The Tribunal's Analysis

219. It is common ground that both the PRC and Laos are parties to the VCLT. It is also common ground that neither the PRC nor Laos are parties to the VCST. The customary nature of Article 15 is controversial between the Parties: they both accept that the general rule of the "moving treaty frontiers" of Article 15 of the VCST is customary, but the Claimant argues that the exceptions to Article 15 are not customary.

i) Both Article 29 of the VCLT and Article 15 of the VCST are rules of customary international law

220. It is undisputed by the Parties that Article 29 in its entirety has the force of binding customary international law.[388] As this is not controversial the Tribunal does not consider that it needs to make lengthy developments to support this statement of law.

221. By contrast, although there is unanimity or "quasi-unanimity" among the doctrine to consider that Article 15 also represents customary international law, in view of the diverging analyses presented by the Parties, the Tribunal will elaborate at some length on this question.

222. The Tribunal first notes that the ILC, in its 1974 Commentary on Draft Article 14 (which became Article 15) of the VCST, is explicit that the "moving treaty frontiers" rule was a pre-existing customary rule.[389] In the same sense, Mr. Yasseen, the president of the ILC Drafting Committee that prepared the text of the VCST, declared: "This principle is a generally recognized principle of international law; it is observed in the practice of States and can be considered as part of customary international law."[390]

223. The Tribunal also cites some authors who have written on this issue, for example, Philippe Cahier explains that Article 15 "corresponds to State practice, was adopted without modification

[388] Respondent's Post-Hearing Submission, ¶ 2; Claimant's Statement of Claim and Response on Jurisdiction, ¶¶ 228-232; Claimant's Rejoinder on Jurisdiction, ¶¶ 11-12; Hearing Transcript, pp. 14:1-22; 71:1-73:14.

[389] ILC Commentary 1974, at pp. 208-209 (RA-13); see also Hearing Transcript, pp. 158-160, 169-170.

[390] Yasseen, "La Convention de Vienne sur la succession d'Etats en matière de traités," AFDI, 1978, at p. 92 (RA-40). [English translation provided by the Tribunal, the original French being: "Ce principe est un principe généralement reconnu du droit international; il est observé dans la pratique des Etats et peut être considéré comme faisant partie du droit international coutumier."]

by the Conference and simply codifies a customary rule."[391] Also, in a course given at the Hague Academy of International law on "La succession d'Etats" in a Section entitled "L'existence de règles coutumières : la portée juridique des Conventions",[392] it was noted that there are some rules whose customary value are contested: "I. Les règles à l'égard desquelles existent des controverses doctrinales",[393] but that others clearly have customary value: "III. Les règles des Conventions qui ont indéniablement une valeur coutumière".[394] Among the latter was included: "la règle coutumière de la variabilité des limites territoriales d'application des traités".[395]

224. The Claimant has admitted that Article 15 is customary as far as the general rule is concerned but submits that the exceptions are not customary. The Tribunal notes that the Claimant has not provided any reason in support of this position and the Tribunal has found no indication that such a dichotomy can be made; the doctrine on the customary character of Article 15 has never made such distinction but has referred to the rule as a whole.

ii) The rules are not incompatible, but merely deal with different moments in the evolution of a situation

225. Article 15 explains and regulates what happens at the moment of transition from one sovereign to another whereas Article 29 prescribes what the general situation is outside of a transitional period, whether a territory has undergone a transition or not. In other words, the rule of Article 15 can correctly be described as the "moving treaty frontiers" rule. The rule of Article 29 does not deal with a situation of change,[396] but only states the general principle of international law

---

391 Cahier, pp. 73-74 (RA-39) [English translation provided by the Tribunal, the original French being: "[…] correspond à la pratique des Etats, il a été adopté sans changement par la Conférence et il ne fait que codifier une règle coutumière."]

392 Stern, *La succession d'Etats*, Hague Academy of International Law Collected Courses, t. 262, 2000 ("**Stern**") (CLA-140). [English translation from the French: "State Succession" and "The existence of customary rules: the legal scope of the Conventions"]

393 Stern, at p. 147 (CLA-140). [English translation from the French: "The rules whose customary nature is controversial"]

394 Stern, at p. 164 (CLA-140). [English translation from the French: "The rules of the Conventions that have an undeniably customary nature"]

395 Stern, at p. 169 (CLA-140). [English translation from French: "The customary international law rule of the moving treaty frontiers".]

396 See for example, Odendahl, p. 489 : "[…] questions of State succession are not covered by Article 29." (CLA-102). See, in the same sense, Doehring, The Scope of the Territorial Application of Treaties: Comments on Article 25 of the ILC's 1966 Draft Articles on the Law of Treaties (1967) 27 *Z.a.o.R.V.* 483, pp. 488-489: "The draft [Article 25 that became Article 29] gives no answer as to the legal situation created when, in the course of the application of a treaty, a change occurs in the national boundaries of a State." (CLA-133).

related to the territorial extension of a State's sovereignty, which can be described as the principle of the territorial application of a State's legal order.

226. Of course, this does not mean that the two rules do not have an extremely close relationship, which explains why they were not always clearly distinguished by the Parties. The situation described in Article 29 can be the result of the application of Article 15, or, it can also be seen the other way around, *i.e.*, that Article 15 regulates the transition in the way it does, because this is the normal result of the territorial application of the law. This was indeed emphasized in The Hague Academy course on State Succession already mentioned:

> This rule [Article 15] is but an application, in a given succession process, namely the transfer of a portion of territory between two States which remain in existence, of the general principle on the territorial application of treaties or, in other words, of the rules on the distribution of competences among States.[397]

227. This is also indicated by the ILC, when discussing the draft article that was to become Article 15:

> As to the rationale of the rule, it is sufficient to refer to the principle embodied in article 29 of the [VCLT] under which, unless a different intention is established, a treaty is binding upon each party in respect of its entire territory. This means generally that at any given time a State is bound by a treaty in respect of any territory of which it is sovereign, but is equally not bound in respect of territory which it no longer holds.[398]

228. In other words, the two rules exist side-by-side, Article 15 being the corollary of Article 29 and Article 29 being a consequence of Article 15.

iii) The exceptions to Article 15 of the VCST are encompassed in the exceptions to Article 29 of the VCLT

229. This close relationship explains indeed why the exceptions to the two rules are in fact very similar—contrary to what the Claimant argued—as can be seen from what has been emphasized in the two Articles in paragraphs 214 and 215 above.

230. In both Articles, the non-application of a treaty to the whole territory can only result from the treaty itself or if it is otherwise established. The reasons for the non-application of a treaty to an

---

397 Stern, p. 169. [English translation provided by the Tribunal, the original French being: "Cette règle n'est que la mise en oeuvre, dans un processus successoral spécifique, le transfert d'un territoire entre deux Etats dont chacun reste identique à lui-même, du principe général de l'application territoriale des traités, autrement dit des règles de répartition des compétences entre Etats."]

398 ILC Commentary 1974, p. 208(3) (RA-13).

expanded territory at the moment of a succession are more limited than the reasons for the non-application of a treaty to the entire territory, but are included in them. Indeed, automatic succession applies unless it appears from the treaty itself or is otherwise established that such a result would not be appropriate *for one of two reasons*: either because such succession would be incompatible with the object and the purpose of the treaty or because it would radically change the conditions of its operation. As far as the non-application of a treaty to the whole territory is concerned, it is sufficient that such non-application results from the treaty or, *for whatever reason*, the State sees fit to decide such non-application: for example, the PRC and the Russian Federation decided that the PRC/Russia BIT would not apply to the Macao SAR, for no stated reason.

231. This analysis means that in order to ascertain whether or not the PRC/Laos BIT applies to the Macao SAR, Article 15 of the VCST with its exceptions as well as Article 29 of the VCLT with its exceptions—which are two faces of the same coin—are relevant.

(c) The Tribunal's analysis of the concrete situation of the PRC/Laos BIT

232. A first remark to be made by the Tribunal is the difficulty it faced in ascertaining the application or non-application of the PRC/Laos BIT to the Macao SAR due to the paucity of factual elements presented by the Parties: there were no affidavits from the PRC, Laos or the Macao SAR, which could probably have been obtained from the respective authorities.

233. Moreover, the response to a question raised by a member of the Tribunal during the Hearing on Jurisdiction did not clarify the matter. The question was the following:

> So, my question is: Has there been any negotiation, any list of bilateral treaties? I'm very surprised that this does not exist […][399]

234. The response from counsel for the Respondent was the following:

> Now, as to your question of the lists of treaties that, on the one hand, have been entered into by China, there is, to my knowledge, no list, no official list […][400]

235. The response from counsel for the Claimant was similar:

> There is no evidence in the record that any similar Notification in any way, shape, or form was made by China in respect of the category of bilateral investment treaties. It's not in the record. It didn't happen.[401]

---

399 Hearing Transcript, p. 56:23-25.

400 Hearing Transcript, p. 60:12-14.

236. The Tribunal, being left with no actual information on the status of the PRC/Laos BIT must analyze the situation by application of the relevant rules: Article 15 of the VCST and Article 29 of the VCLT. In the Tribunal's view, the conditions of Article 15 shall be verified first, as the transition came first in the chronology of events relevant to the issue of whether the Treaty applies or not.

237. The Tribunal will therefore turn first to Article 15 of the VCST and apply the rule developed in the framework of the international law on State succession. It is well known that it is the PRC's contention that no transfer of sovereignty took place in December 1999, since it merely "resumed" its exercise of sovereignty over Macao, as it did over Hong Kong. The Tribunal wants to put it beyond doubt that its approach does not contradict this position of the PRC when it applies the rules on State succession. Indeed, as explained by an author in relation to Hong Kong (an explanation that also applies to Macao), "there is little doubt that the 'transition' on 1 July 1997 largely comports with the definition of 'state succession'—as 'the replacement of one state by another in the responsibility for the international relations of territory'—and that the issues raised as a result of this event are generally covered within the branch of international law which 'deals with the legal consequences of change of sovereignty over territory.'"[402]

238. The central question is: Does the PRC/Laos BIT enter into the general rule or the exceptions to Article 15 and Article 29? If the general rule applies, the BIT will be applicable to the Macao SAR; if one of the exceptions applies, the BIT will not be applicable to the Macao SAR. The general rule—*i.e.*, the extension of the treaty to the whole territory, at the moment of a transfer of sovereignty or at any time—applies if none of the exceptions are satisfied. In order to ascertain whether or not the general rule applies, a negative approach must be adopted, *i.e.* an approach that verifies first whether any of the exceptions apply. If the answer is negative, it can be asserted that the applicable rule is the general rule of extension of the treaty to the new part of the territory, or in the case there is no succession, to the whole territory.

i) Does it appear from the PRC/Laos BIT that it was not extended to the Macao SAR at the moment of recovery of sovereignty by the PRC, because the application of the Treaty to that territory would be incompatible with the object and purpose of the Treaty?

239. The object and purpose of the BIT is stated in the Preamble in the following terms:

---

[401] Hearing Transcript, p. 85:4-7.

[402] Mushkat, in "Hong Kong and Succession of Treaties", *ICLQ*, 1997, pp. 191-197 ("**Mushkat**").

> [The two Contracting States] desiring to encourage, protect, and create favorable conditions for investment by investors […] based on the principles of mutual respect for sovereignty, equality and mutual benefit and for the purpose of the development of economic cooperation between both States, [h]ave agreed as follows […][403]

240. The purpose is twofold: to protect the investor and develop economic cooperation. The Tribunal does not find—and no element has been provided by the Respondent to that effect—that the extension of the PRC/Laos BIT could be contrary to such a dual purpose. In fact, the larger scope the Treaty has, the better fulfilled the purposes of the Treaty are in this case: more investors—who would not otherwise be protected—are internationally protected, and the economic cooperation benefits a larger territory that would otherwise not receive such benefit.

241. In other words, the Tribunal is satisfied that the extension of the PRC/Laos Treaty to the Macao SAR is not incompatible with its object and purpose, which again is to "encourage, protect and create *favorable conditions for investment* by investors of one Contracting State in the territory of the other Contracting State […] and for the purpose of the *development of economic cooperation* between both States […]".[404]

242. Allowing investors from the Macao SAR to benefit from the protections of the PRC/Laos Treaty is fundamentally compatible with this object and purpose, the more so that there is no other possibly competing BIT adopted by the Macao SAR with Laos.

ii) <u>Is it otherwise established that the PRC/Laos BIT was not extended to the Macao SAR at the moment of recovery of sovereignty by the PRC, because the application of the Treaty to that territory would radically change the conditions for its operation?</u>

243. The question which must be answered next is whether the extension of the PRC/Laos BIT to the Macao SAR radically changes the conditions of application of the Treaty. The Tribunal considers that this question is particularly relevant considering the different economic philosophy that pertains to Mainland China and the Macao SAR, which is illustrated by the famous formula "one country, two systems."

244. Concerning the question of bilateral treaties and whether or not a succession to them radically changes the conditions for their operation, there are two schools of thought.

245. For some States, the personal aspect of a bilateral treaty implies that the replacement of one State with another in a bilateral relationship radically changes the condition for its operation

403 Preamble to the PRC/Laos Treaty (Ex. D to Amended Notice).

404 Preamble to the PRC/Laos Treaty (emphasis added) (Ex. D to Amended Notice).

with the consequence that the general rule of continuity should not apply. For other States, the continuity rule applies generally to bilateral treaties as well as to multilateral treaties, unless there are specific elements that lead to the conclusion that a change in the Contracting Parties would radically change the conditions for their operation.

246. The Tribunal notes first that Article 15 does not distinguish between multilateral and bilateral treaties. Second, the Tribunal considers that it would be excessive to say that all bilateral treaties are *so* personal, *so* related to *intuitu personae* questions that they cannot survive a State's succession. In other words, the Tribunal considers that it is necessary to consider the application of the general rule to bilateral treaties on a case-by-case basis.

247. In the case at hand, a specific element is the fact that the States Parties to the PRC/Laos BIT were States with planned economies, and that the extension of this BIT was to include a capitalist region. This could give some credibility to the argument that there is a fundamental change of circumstances which would call for the non-extension of the Treaty. Some doctrinal approaches would seem to support to such an argument. In The Hague Lecture on State Succession mentioned earlier, it was indicated that:

> […] political treaties constitute a specific category of treaties concluded *intuitu personae*, according to the characteristics of a specific State, such as treaties of alliance, or certain commercial **treaties concluded between States with a planned economy**. Their extinction in case of succession is, again, an application of a general principle of international law which is the fundamental change of circumstances."[405]

248. It can indeed be the case that when a treaty is concluded between two States with planned economies, the extension of such treaty to a capitalist economy would fundamentally change the conditions for its application if the treaty was based on features specific to a planned economy and irreconcilable with the liberal principles of a capitalist economy. The Tribunal, however, has not found in the Respondent's case any indication in this direction or any attempt to prove the existence of different conditions for the application of the PRC/Laos BIT in Mainland China and in the Macao SAR.

---

[405] Stern, p. 170 (CLA-140) [English translation provided by the Tribunal, the original French being:

> "Les traités politiques constituent une catégorie spécifique de traités conclus *intuitu personae*, en fonction des caractéristiques d'un Etat précis, tels que des traités d'alliance, ou certains traités commerciaux conclus entre Etats à économie planifiée. Leur extinction en cas de succession apparaît, encore une fois, comme une mise en oeuvre d'un principe général du droit international qui est le *changement fondamental de circonstances*."] (emphasis added)

249. In the present case, it is the Tribunal's view that a treaty that would not be extended to the Macao SAR under Article 15 would be a treaty imposing "communist" values or institutions in the Macao SAR. This is very clear under the "one country, two systems" doctrine, which is reflected both in the respective Preambles of the Joint Declaration and the Basic Law of the Macao SAR.

250. The Preamble to the Joint Declaration affirms that "[t]he current social and economic systems in Macao will remain unchanged, and so will the life-style."[406] The Preamble to the Basic Law of the Macao SAR states that "[…] under the principle of "one country, two systems", the socialist system and policies will not be practiced in Macao."[407]

251. It appears that the treaties that will not be extended under the applicable principles are those whose application would endanger the capitalist system and the liberal way of life. Such is not the case of the PRC/Laos BIT; to the contrary.

252. Indeed, a comparison of the BITs of the Netherlands and Portugal entered into with the PRC (which are very similar to the PRC/Laos BIT) and the Macao SAR, respectively, show that they contain very similar provisions. For example, the articles on the settlement of investment disputes are the same but for one feature; this tends to prove that the rules of the PRC/Laos BIT can be considered as compatible with their application in the Macao SAR and do not need to be rejected for incompatibility with the capitalist economic system.[408]

253. It could also be said—and the Respondent presented arguments to this effect—that the automatic extension should not apply, as it has been *otherwise established* by the Joint Declaration[409] and the Macao's SAR Basic Law,[410] which both recognize Macao SAR's treaty-making powers in economic matters.

254. The Joint Declaration deals in the following manner with the treaties of the PRC (the second paragraph of this Article has been reproduced in Article 138 of the Basic Law of the Macao SAR):

---

406 Joint Declaration (RE-11).

407 Basic Law of the Macao SAR (RE-09).

408 A similar analysis has been performed as far as the resumption of the sovereignty of the PRC over Hong Kong by Mushkat (p. 169): "[…] the transfer of sovereignty over Hong Kong cannot be deemed a 'fundamental change' that 'radically transforms' the nature of the territory, allowing claims of *rebus sic stantibus*" to refute continuity of the applicable treaty regime."

409 Joint Declaration (RE-11).

410 Basic Law of the Macao SAR (RE-09).

> **VIII**
> Subject to the principle that foreign affairs are the responsibility of the Central People's Government, the Macao [SAR] may on it's own, using the name "Macao, China", maintain and develop relations and conclude and implement agreements with states, regions and relevant international or regional organizations in the appropriate fields, such as the economy, trade, finance, shipping, communications, tourism, culture, science and technology and sports. […]
>
> The application to the Macao [SAR] of international agreements to which the [PRC] is a member or becomes a party shall be decided by the Central People's Government, in accordance with the circumstances and needs of the [SAR], and after seeking the views of the government of the [SAR].

255. Based on these articles, the Respondent argued that the automatic extension provided for in Article 15 has to be rejected as it was otherwise provided by the Joint Declaration and the Basic Law of the Macao SAR.

256. According to the Tribunal, this argument merits consideration as it could appear at first sight that the PRC and Portugal have provided for a specific way to deal with the extension of international agreements of the PRC to the Macao SAR, and have therefore superseded the automatic extension provided for as the general rule in Article 15 of the VCST.

257. The Tribunal notes at the outset that the Basic Law of the Macao SAR in and of itself, as an internal law, cannot be considered as legally capable of modifying the international rule set out in Article 15. It is well known that "the binding character of treaties is determined by international law, which on this point takes precedence over internal law."[411]

258. The Tribunal, however, considers that the same is not true of the Joint Declaration which can be considered an international treaty and, more precisely, a devolution treaty, by which the two States involved in a process of succession decide the modalities of such succession.

259. Before entering into a consideration of the legal value of such a devolution treaty, the Tribunal wishes to focus on the meaning of Article VIII of the Joint Declaration, reproduced word-for-word in Article 138 of the Basic Law of the Macao SAR, as the Parties presented diverging interpretations of these articles. The Tribunal recalls the main elements of Article VIII: "The application to the Macao [SAR] of international agreements […] shall be decided by the Central People's Government […] after seeking the views of the government of the Region."

260. The Respondent principally relied on this article for the proposition that, because the Macao SAR was not consulted by the PRC before the Treaty was extended to its territory, the Treaty

[411] Schaus, in Corten & Klein, p. 700 (CLA-105).

has no application to Macanese investors. Indeed the Respondent places great weight on the fact that the views of the Macao SAR in relation to the PRC/Laos BIT have never been requested:

> To my knowledge, neither in Macao nor in Hong Kong has the local government been consulted over a possible extension of an International Treaty upon the request of the Central Government. Beijing has never consulted or has never asked the Government, either the executive body or the legislative body, over the potential application in Macao of treaties to which China has entered into […][412]

261. The Claimant has a radically different reading of the same language:

> What Laos has said is that this means that you don't apply the customary rule until the PRC actually consults with the Macao SAR. But, in fact, the more consistent reading with respect to the customary rule is—and supported by the text here, is that, in fact, the customary rule applies until such time if and when the PRC decides to actually make explicit a contrary intention, and at that juncture should take the step of consultation.[413]

262. In other words, according to the Respondent, the PRC/Laos BIT could only have been extended after seeking the views of the Macao SAR Government; and, according to the Claimant, the PRC/Laos BIT is to be presumed applicable to the Macao SAR until the PRC Government decides, after consulting the Macao SAR, that it does not apply. The Tribunal considers that neither of these lines of reasoning stands scrutiny.

263. The Claimant's analysis is not coherent with the basic rule of interpretation of treaties embodied in Article 31 of the VCLT, requiring that a treaty "shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The wording of Article VIII of the Joint Declaration is to the effect that the treaties will be applied *when* the PRC Government so decides and not that they will be applied *unless* the PRC Government so decides.

264. But the Respondent's analysis, although coherent with the wording of the text, does not bring about the result sought by the Respondent. This is so because of the legal nature of the Joint Declaration, which can be considered as a devolution treaty.[414]

---

[412] Hearing Transcript, p. 60:4-11.

[413] Hearing Transcript, p. 93:8-15.

[414] By analogy, it can be mentioned that the Joint Declaration concerning Hong Kong has been registered as a treaty in the UN. See Slinn, Aspects juridiques du retour de Hong Kong à la Chine, *AFDI*, 1996 (p. 274): "Le côté délicat de la question du statut de l'arrangement se reflète dans l'emploi du titre «Déclaration commune» plutôt que de celui d'«accord», encore que l'instrument ait été enregistré par les deux parties comme un accord international conformément à l'article 102 de la Charte de l'ONU."

265. Such treaties can only bind third parties if they apply the customary principles of international law. This was explained in The Hague Course on State Succession. One of the customary rules on State succession is the rule of the "*effet relatif des traités*", the consequences of which were described in the following manner:

> Bien entendu, cette règle signifie simplement que les traités de dévolution s'ils donnent des solutions différentes de celles qui sont prévues par les règles de la succession d'Etats ne s'imposent pas aux Etats tiers ; si ces traités mettent en œuvre les solutions résultant du droit coutumier, la manière dont la succession d'Etats est réglée s'impose aux Etats tiers, parce qu'ils sont tenus au respect du droit international. Là encore la règle n'apparaît que comme une transposition, dans le domaine de la succession d'Etats, d'une des règles de base du droit des traités, qui est la règle de l'effet relatif des traités, codifiée à l'article 57 de la Convention de Vienne sur le droit des traités.[415]

266. This was also underscored in relation to the Joint Declaration between the PRC and Great Britain concerning Hong Kong by an author, who said that "[n]otwithstanding the reasonableness of the Hong Kong formula or the 'devolutionary' function of the Sino-British Joint Declaration, questions may be posed in relation to the binding effect on third parties."[416]

267. As pointed out by the Claimant during the Hearing on Jurisdiction, no element has been submitted to the Tribunal to indicate that Laos was informed of such an internal procedure or whether such procedure was ever enforced:

> […] there is actually no evidence in the record about the actual practice of the PRC with respect to this consultation, internal procedure, none. So, we actually have no evidence about when it has been invoked, in what circumstance it has been invoked, whether it's a law on the books and doesn't reflect practice—nothing. We have nothing on that.[417]

[English translation from the French: "The delicate aspect of the question of the status of the arrangement is reflected in the use of the title "Joint Declaration" rather than "Agreement", even though the instrument was registered by the two parties as an international agreement pursuant to Article 102 of the UN Charter."] The same is possibly true for this Joint Declaration, but the Tribunal was provided with no information to that effect.

415 Stern, p. 169 (CLA-140). [English translation from the French: "Of course, this rule simply means that if devolution treaties adopt different solutions to those foreseen by the rules of State succession, those solutions do not bind third States; if the treaties adopt solutions that conform with customary international law, the manner by which the State succession is governed does apply to third States because they are obliged to abide by international law. There again the rule only appears as a transposition, in the domain of State succession, of one of the fundamental rules of the law of treaties, which is the rule of the relative effect of treaties, codified by Article 57 of the VCLT."]

416 Mushkat, p. 194.

417 Hearing Transcript, p. 90:19-25.

268. In other words, Laos, having not been informed that its treaty with the PRC would only be extended after a procedure of consultation—which in fact never seems to have been enforced—, cannot claim that such an agreement between the PRC and Laos could set aside the international rule applicable to a bilateral treaty between itself and the PRC.

269. In the absence of convincing elements to the contrary, the Tribunal is left with no other option but to consider that, by application of Article 15 of the VCST, the PRC/Laos BIT must be deemed to have been extended to the Macao SAR. This provisional conclusion has to be verified and confirmed by the analysis of the application to the situation of Article 29 of the VCLT which has broader exceptions than the ones included in Article 15 of the VCST.

iii) Does it appear from the PRC/Laos BIT that it is not applicable to the whole territory?

270. The Tribunal notes, on the one hand, that the PRC/Laos BIT does not contain an express provision stating that *it applies to the Macao SAR*. But this is not necessary as the principle of territorial extension of the State's legal order embodied in Article 29 applies, unless otherwise indicated.

271. The Tribunal further notes, on the other hand, that it is also evident that the PRC/Laos BIT has *not expressly excluded its application to the Macao SAR*, as has, for example, been the case of the Protocol accompanying the PRC/Russia BIT entered into in 2006.[418] This Protocol expressly provides that "[u]nless otherwise agreed by both Contracting Parties, the Agreement does not apply to" the Macao SAR.[419] Both Parties mentioned during the Hearing on Jurisdiction the fact that the Treaty does not mention that it does not apply to the entire territory.

272. In the morning session, counsel for the Respondent stated:

> And the principle reads as follows: "Treaties are binding upon the entire territory, unless it's provided otherwise in the Treaty and intention appears in the Treaty or is otherwise established." We have been through the Treaty together. It does not provide for a definition of the territory. So, the principle would be, under Article 29, that unless it is otherwise intended by the Parties or by—here, by China, then it should apply to the entire territory of China.[420]

[418] PRC/Russia BIT (CLA-90).

[419] PRC/Russia BIT (CLA-90).

[420] Hearing Transcript, p. 14:14-22.

273. In the afternoon session, counsel for the Claimant echoed this statement:

> Now, you heard Ms. Willems this morning, I think confirm this when she stated, "There is no provision as to restriction of territory." On this we agree.[421]

274. This element should, however, not be overestimated as it might simply be explained by the fact that the PRC/Laos BIT was signed in 1993, and that at that time it would not have made sense to exclude the Macao SAR which was not then a part of the Chinese territory under PRC sovereignty. By contrast, with respect to the PRC/Russia BIT, which was signed in 2006, it made sense to deal with the question of the extension of the BIT to Macao. As stated by Mark Villiger:

> A general presumption is established that, when a State concludes a treaty, the latter applies to the entire territory of the State, and individual areas and territories **need only be mentioned** where there is a special reason for doing so, in particular **to exclude them** from the treaty's application. […] If there are territorial changes, the treaty continues, in principle, to apply to the entire territory; different intentions would have to be renegotiated with, or at least be tacitly approved by, the other parties."[422]

275. It is a fact that no intention to exclude the Macao SAR from the application of the PRC/Laos BIT has been transmitted by the PRC to Laos, at least none that the Tribunal has been made aware of.

276. On the other hand, the return of Macao to Chinese sovereignty was not a unforeseen event; it had been negotiated for a relatively long period of time. The first step was the establishment of diplomatic relations between the PRC and Portugal on 8 February 1979, which permitted the launching of negotiations between the two countries on the future of Macao. Official negotiations began in June 1986 in Beijing and gave birth to the Joint Declaration of 1987 which entered into force on 15 January 1988. The Joint Declaration states that Macao will return to the PRC's sovereignty on 20 December 1999, and organizes the transitory period.[423]

---

[421] Hearing Transcript, p. 77:12-14.

[422] Villiger, pp. 392-393 (emphasis added) (CLA-116).

[423] This information is public and is derived from an article by Goy, *La rétrocession de Macau*, AFDI, 1997, pp. 271-285. See also Claimant's Rejoinder: "[…] it *was* clear in 1993 that both Portugal and the PRC recognized that the former's administration over Macau would cease, thereby restoring full Chinese sovereignty over its territory" (¶ 15) (Claimant's emphasis). See also the Hearing Transcript, p. 80:2-9, where counsel for the Claimant stated:

> "So, there is no dispute that six years before the Treaty was signed, the PRC had concluded in 1987 the Joint Declaration with Portugal which provided that the Government of the People's Republic of China will resume the exercise of sovereignty over Macao with effect from 20 December 1999. And as the Tribunal's aware, it's a

Thus, at the moment of the conclusion of the PRC/Laos BIT, it was already common knowledge that in a few years' time, Macao would be under the PRC's sovereignty.

277. This factual situation means that no definite conclusion can be drawn either from the silence of the Treaty on its extension to the Macao SAR, or its silence on the non-extension of the Treaty to the Macao SAR.

iv) Is it otherwise established that the PRC/Laos BIT is not applicable to the whole territory?

278. This question in fact turns on the meaning of the existence of two sets of BITs by the same foreign country—Laos—one with the PRC and one with the Macao SAR. The question thus raised is whether the possibility of co-existence of a PRC-BIT and a Macao SAR-BIT with the same third State "otherwise establishes" that the PRC/Laos BIT cannot apply to the Macao SAR.

279. Having been made aware of the existence of two instances where there co-exists a BIT with the PRC and with the Macao SAR, the Tribunal asked, at the close of the Hearing on Jurisdiction, for clarification on that point. As indicated by the President of the Tribunal:

> [I]t has been brought to our attention […] that there are two—in the case of Portugal and the Netherlands, there are actually treaties entered into by Macao with these countries and also with China. […] [I]t would be helpful to us if you could analyze the text of these four treaties in terms of any relationship between the two and how they [work] or don't together.[424]

280. The motivation for this question was to ascertain whether the analysis of these BITs could give some "otherwise established" indications on the respective role of these two series of treaties and, for example, help to ascertain whether the existence of one necessarily excluded the existence of the other.

281. An initial remark must be made by the Tribunal. The four treaties—the PRC/Portugal, PRC/Netherlands, Macao/Portugal, Macao/Netherlands treaties—were concluded after the handover of Macao to the PRC in 1999. As such, they do not call for the application of Article 15 of the VCST, but only of Article 29 of the VCLT. Interestingly, in the case of Portugal, the Macao/Portugal BIT preceded the PRC/Portugal BIT by five years, while in the case of the

pretty detailed Declaration about the intent of the two Parties with respect to the transfer of sovereignty in 1999".

[424] Hearing Transcript, p. 176:7-13.

Netherlands, the PRC/Netherlands BIT was concluded seven years prior to the Macao/Netherlands BIT.

282. This sequence of events—a PRC-BIT followed by a Macao-BIT with the same third country, and a Macao-BIT followed by a PRC-BIT with the same third country—has been analyzed by the Claimant as indicating that "there is no evidence that the PRC considered duplicate treaties between itself and Macau on the one hand and third States on the other to be contradictory or mutually exclusive."[425]

283. The Tribunal considers this analysis compelling.

284. A first point which was has come to light is that the territorial scope of the two series of BITs is not the same.

285. In the PRC/Portugal BIT signed in 2005, the territorial scope is as follows:

> **Article 1(2)b)**
> For the Macao Special Administrative Region of the People's Republic of China, the territory comprised by the Macao peninsula and the islands of Taipa and Coloane.

286. In the Macao SAR/Portugal BIT signed in 2000, the territorial scope is as follows:

> **Article 1(4)**
> The term "territory" means the territory in which the Parties have, in accordance with international law and their national laws, sovereign rights or jurisdiction, including land territory, territorial sea and air space above them, as well as those maritime areas adjacent to the outer limits of the territorial sea, including seabed and subsoil thereof […]

287. In the PRC/Netherlands BIT signed in 2001, the territorial scope is as follows:

> **Article 1 (4)**
> For the purpose of this Agreement, the term "territory" means respectively:
> - For the People's Republic of China, the territory of the People's Republic of China, the People's Republic of China, the People's Republic of China, the People's Republic of China (including the territorial sea and air space above it) as well as any area beyond its territorial sea within which the People's Republic of China has sovereign rights of exploration of and exploitation of resources of the seabed and its sub-soil and superjacent water resources in accordance with Chinese law and international law.

---

425 Claimant's Response, ¶ 47.

288. In the Macao SAR/Netherlands BIT signed in 2008, the territorial scope is as follows:

> **Article 1(c)(ii)**
> - in respect of the Macao Special Administrative Region of the People's Republic of China, the territory is peninsula of Macau and the islands of Taipa and Coloane.

289. The Respondent draws the following conclusions from the comparison of the territorial scope of the two series of BITs:

> The territorial definition in the BITs clearly indicates that the Macao [SAR] [has] the power to enter into BITs to cover [its] own territory notwithstanding the fact that China has also entered into BITs with these same third states. This indicates that the territorial limit of the Chinese BITs [is] confined to Mainland China.[426]

290. The Tribunal does not accept this conclusion. It can indeed also mean, with as much if not more logic, that the PRC-BIT applies to the whole territory including the Macao SAR, while the Macao SAR-BIT is confined to the territory of Macao but cannot extend to Mainland China.

291. Another argument put forward by the Respondent is that the overlapping of the PRC and Macao BITs with the same third State would bring about "legal chaos for foreign investors."[427]

292. In the Tribunal's view, the superposition of instruments of protection does not bring about chaos, but rather better protection to foreign investors. The Tribunal agrees with the Claimant when it states that "[t]he fact that the PRC authorized Macau to enter into the bilateral investment treaties at issue does not otherwise establish an intention that its own BITs should not extend to the territory of Macau; it is equally consistent with a <u>supplemental</u> regime of protection for Macanese investors, above and beyond that provided by the PRC treaties."[428]

293. If one takes the example of the two BITs with Portugal, it is apparent that Article 9 of the PRC-BIT and Article 8 of the Macao-BIT are very similar, with a difference being that the PRC-BIT gives a further option to the investor—in addition to the choice of the competent national courts and an *ad hoc* arbitration tribunal under the rules of UNCITRAL—to resort to ICSID arbitration:

---

[426] Respondent's Post-Hearing Submission, ¶ 27.

[427] Respondent's Post-Hearing Submission, ¶ 30.

[428] Claimant's Response, ¶ 48 (Claimant's emphasis).

Macao SAR/Portugal BIT, 2000	**PRC/Portugal BIT, 2005**
Article 8 1 – Disputes between an investor of one Contracting Party and the other Contracting Party relating to an investment in the first area of the second will be resolved through negotiations. 2 – If the dispute cannot be resolved in accordance with the preceding paragraph within six months from the date on which one of the litigants have requested in writing, the investor may choose to submit the dispute to one of the following instances: a) The competent courts of the Contracting Party in whose area the investment is located; or b) At an ad hoc arbitral tribunal established in accordance with the rules of arbitration of the United Nations Commission for Trade and Development (UNCITRAL), which are then in force	Article 9 1. Any dispute concerning investments between a Party and an investor of the other Party should as far as possible be settled amicably between the parties in dispute. 2. If the dispute cannot be settled within six months of the date when it has been raised by one of the parties in dispute, it shall, at the request of the investor of the other State, be submitted at the choice of the investor to: a) the competent court of the Party that is a party to the dispute; b) arbitration under the Convention of 18 March 1965 on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID); c) an ad hoc arbitral tribunal to be established under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL) or other arbitration rules.

294. The Tribunal does not consider that the concomitant application of these two BITs would lead to “legal chaos”. The more dispute settlement options an investor has, the better it is protected, and the more enhanced the economic cooperation will be between the concerned States.

295. In the Tribunal’s view, the existence of two treaties facilitates rather than hinders the fulfillment of the goals of the BITs, which are the protection of the foreign investors and the economic development of the host State. The Tribunal notes that the same analysis was performed by the tribunal in the *Tza Yap Shum* case, where it stated that “Hong Kong’s power to conclude its own

investment promotion and protection treaties with countries wherewith China also has entered into a BIT is not necessarily redundant."[429]

296. The Respondent has presented another argument, based on the Macao SAR's autonomy in economic matters, to support the view that the PRC/Laos BIT does not apply to the Macao SAR, *i.e.*, "[t]he very fact that Macao has entered into no BIT with Laos reveals that the Macao SAR under its autonomy has chosen not to enter into any investment protection treaty with Laos."[430]

297. The Tribunal is not convinced by such reasoning. In its view, it is also possible to make the argument to the contrary: that the Macao SAR has not entered into a BIT with Laos because it considered that its investors were sufficiently protected by the PRC/Laos BIT?

298. A last mention should be made of a remark made by the Claimant related generally to the object and purpose of BITs. After stating that "there is thus no conflict where extending the PRC treaties to Macau ensures that Macanese investors enjoy dual sets of protections in the two instances discussed above", the Claimant added that:

> […] the object and purpose is not served by denying Macanese investors the protection of the 130 BITs concluded by the PRC—in circumstances where there is no statement or convincing evidence mandating the contrary conclusion from either the PRC or the Macau SAR – and leaving them to avail themselves of only two bilateral treaties that Macau has concluded on its own behalf.[431]

299. Of course, the Tribunal limits its finding to the specific PRC/Laos BIT, which it has analyzed on the basis of the few factual elements provided to it and in application of the relevant rules of international law. Other conclusions might be arrived at with other factual circumstances surrounding other BITs.

300. The Tribunal concludes therefore that the PRC/Laos BIT is applicable to the Macao SAR.

---

[429] *Tza Yap Shum*, ¶ 76 (CLA-70/RA-10).

[430] Respondent's Post-Hearing Submission, ¶ 37.

[431] Claimant's Response, ¶ 50 (Claimant's emphasis). See also, in the same sense, Claimant's Statement of Claim and Response on Jurisdiction, ¶ 244, where the Claimant states that the Respondent's position:

> "[…] would categorically deny all investors from Macau and Hong Kong the protections generally afforded to other Chinese investors worldwide. Such an outcome is not only inconsistent with the purposes of the investment treaty regime, it is incompatible with China's "one country, two systems" policy, which was created to enhance—not diminish—the protections afforded to investors and other denizens of the SARs."

2. Whether Sanum qualifies as an investor under the Treaty

(a) Whether Claimant is established under the municipal laws of the PRC

301. The Parties disagree as to whether the reference to "the laws and regulations of each contracting State" in Article 1(2)(b) of the Treaty should be understood in the sense of covering the full territorial extension of each State or, in the case of the PRC, of excluding the Macao SAR and the Hong Kong SAR.

302. The Respondent's argument for excluding the SARs is based on the existence of three different legal regimes in the State of China: one for Mainland China and one for each of the SARs. These regimes include different company laws and the company law of Mainland China does not apply to the SARs. For the Tribunal, the issue is not how many laws or legal regimes there are in the PRC and whether the investor has been established under one or the other, but whether an economic entity established under any one of such legal regimes is an economic entity established in accordance with the laws and regulations of the PRC. In other words, should the Tribunal include a territorial limitation in interpreting the scope of Article 1(2)(b)?

303. The language of the Treaty does not differentiate between economic entities in accordance with the legal regime under which they were established. There is no difference of treatment between the two States. The Preamble affirms the desire "to encourage, protect and create favorable conditions for investment by investors of one Contracting State in the territory of the other Contracting State […]". The Tribunal has already decided that the Treaty applies to all the territory over which the PRC is sovereign. It is consequent with that decision that an economic entity established under the laws applicable in any part of the territory of the PRC is to be considered to have been established under the laws and regulations of the PRC.

304. The Respondent has placed particular emphasis on the mutual respect of the sovereignty of the parties recorded in the Preamble of the Treaty. There is no doubt that the PRC has sovereignty over the Macao SAR and the Hong Kong SAR; it would not be respectful of that sovereignty for the Tribunal to consider that laws enacted in either of the two SARs are not enacted in the PRC.

305. Therefore, the Tribunal concludes that the Claimant is an economic entity established in accordance with the laws and regulations of the PRC as required by Article 1(2)(b) of the Treaty.

(b) Whether Sanum qualifies as an "economic entity" within the meaning of the Treaty?

306. The Respondent has interpreted the term "economic entity" as showing the intent of the Contracting Parties to the Treaty to exclude shell companies. Respondent contends that, in order to qualify as an economic entity, an investor must perform some economic activities in the State the protection of which the investor seeks and not in third States. In addition, these activities need to pertain to the investment that is the subject of the claim. The Respondent has related these conditions for an investor to qualify as such under the Treaty to the criteria used to ascertain the nationality of a company. For the Respondent, "economic entity" is concerned with the criterion of the seat of a company; the concept of "economic entity" encompasses more than the concept of incorporation. It is the Respondent's contention that mere incorporation does not in and of itself determine the nationality of an investor.

307. The Tribunal has difficulty in reading these limitations into the Treaty. As pointed out by the Claimant, Chinese treaties are drafted so as to include entities that may not be separate legal entities with their own legal personality. The concept of "economic entity" contemplates a wider array of entities than the concept of corporation and is related to the particularities of the Chinese legal system. Rather than a limitation on the concept of investor, "economic entity" is a wider term that may include entities that are engaged in economic activities but without separate legal personality.

308. The Tribunal also has difficulty with the connection allegedly intended by the Treaty between the concept of nationality and economic entity. The Treaty requires that the economic entity be incorporated in the PRC or Laos. To extend the criteria to define nationality through the use of "economic entity" in the definition of investor is a far-fetched exercise in interpreting the text of the Treaty. It is hardly consonant with the canons of interpretation under the VCLT to which both Contracting Parties subscribe.

309. The search for a convenient place of incorporation is common practice whether for fiscal reasons or for the network of investment treaties a country may have concluded. There is nothing wrong *per se* in this search. As stated by the *Aguas del Tunari, S.A. v. Republic of Bolivia* tribunal:

> It is not uncommon in practice, and—absent a particular limitation—not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.[432]

310. In the same vein the *Phoenix Action Ltd v. The Czech Republic* tribunal articulated the position as follows:

> International investors can of course structure *upstream* their investments, which meet the requirement of participating in the economy of the host State, in a manner that best fits their need for international protection, in choosing freely the vehicle through which they perform their investment.[433]

311. However, tribunals have rejected the practice of so-called treaty shopping when a company is incorporated in a certain jurisdiction after a dispute has arisen in order for the investor to avail itself of access to arbitration that it otherwise would not have:

> [A]n international investor cannot modify *downstream* the protection granted to its investment by the host State, once the acts which the investor considers are causing damages to its investment have already been committed.[434]

312. The Respondent has not argued that this was the case in the dispute before the Tribunal.

313. The Respondent has relied extensively on the separate opinion in *Tokios Tokelès*. The Respondent has submitted that the decision in *Tokios Tokelès* was wrong. It is not for this Tribunal to determine whether the majority of that tribunal or the dissenting arbitrator was correct. Suffice it to say here that *Tokios Tokelès* is irrelevant to the matter before this Tribunal. The Claimant is not controlled by nationals of Laos who incorporated it in the Macao SAR and now claim protection under the Treaty against their own State; that is not the issue here.

314. The Respondent has affirmed that, "[t]he purpose and object of this BIT is to protect nationals of one State when investing in the other. It is not to extend the protection to investors and capital from outside the two States."[435] The Claimant is an economic entity national of the PRC. The Respondent itself has recognized that the Treaty does not include origin-of-capital requirements. Therefore, this argument of the Respondent is without merit.

---

[432] *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction, October 21, 2005, ¶ 330(d).

[433] *Phoenix Action, Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009, ¶ 94 ("***Phoenix***") (emphasis in original).

[434] *Phoenix*, ¶ 95 (emphasis in original).

[435] Respondent's Memorial on Jurisdiction, ¶ 118.

315. To conclude, the Tribunal determines that Sanum qualifies as an investor under the Treaty.

3. Whether the Claimant has made an investment in Laos

316. The Respondent contends that the Claimant has not made an investment in Laos because it did not directly invest in Laos and because the contributions made in relation to the shares owned in Savan Vegas and Paksong Vegas were "apparently made by loans that are being repaid annually from proceeds of the casino."[436] The Tribunal will proceed to consider whether indirect investments qualify as investments under the BIT and, if this is the case, whether contributions made in the form of loans to the local companies qualify as investments.

317. For ease of reference the Tribunal reproduces here Article 1(1) of the BIT. It reads as follows:

> The term 'investments' means every kind of asset invested by investors of one contracting State in accordance with the laws and regulations of the other Contracting State in the territory of the Latter, including mainly,
> (a) movable and immovable property and other property rights;
> (b) shares in companies or other forms of interest in such companies;
> (c) a claim to money or to any performance having an economic value;
> (d) copyrights, industrial property, know-how and technological process;
> (e) concessions conferred by law, including concessions to search for or to exploit natural resources.

318. The definition is wide-ranging and open. First, while certain investments are highlighted, the list is not exclusive. It is a list of the investments that the parties to the BIT considered to be the main investments covered, but not exclusively covered, under the Treaty. Second, the term "investments" is defined as "every kind of asset invested". Third, the term "investments" is not qualified by any adjective such as "direct". More importantly, it would be surprising that the parties would have intended to exclude indirect investments and at the same time include among the "main" investments "shares in companies or other forms of interest in such companies". This provision covers the common business practice of foreign investors using local companies as vehicles to channel the investment, as occurred in this instance.

319. The Tribunal notes that the Respondent has not supported its argument with any reference to decisions of arbitral tribunals and has not rebutted or contested the arguments of the Claimant set forth in its Statement of Claim and Response on Jurisdiction other than observing in general that certain submissions have not been dealt with as "a result of their irrelevance or non-

[436] Respondent's Memorial on Jurisdiction, ¶ 123.

application to this case and hence the absence of a refutation must not be taken as an admission to as the correctness of the assertions."[437]

320. As to the contributions made to the companies in the form of loans, Article 1(1) of the Treaty does not specify the form in which the contributions must be made to qualify as an investment, whether in the form of loans or equity. On the other hand, Article 1(1) explicitly includes in the definition "a claim to money" as one of the main items to be considered as investments. Loans are undoubtedly "claims to money" that qualify as investments, as long as they are invested, which is undoubtedly the case here. Sanum alleges also that it has employed its know-how in the hotel and gaming facilities industry.[438]

321. The Tribunal therefore concludes that Sanum has made an investment protected by the PRC/Laos BIT.

4. Whether Laos Consented to Arbitrate Sanum's Claims under the Treaty

(a) Whether the Respondent has consented to arbitrate Sanum's claims under Article 8 of the Treaty

322. The issues before the Tribunal are whether access to arbitration is available to the investor before it has recourse to the local courts, and whether the investor may have recourse to arbitration to determine whether an expropriation has occurred. It will be useful to reproduce here the terms of Article 8 of the Treaty and the related paragraphs 1 and 2 of Article 4.

323. Article 8 provides:

> 1. Any dispute between an investor of one Contracting State and the other Contracting State in connection with an investment in the territory of the other Contracting State shall, as far as possible, be settled amicably through negotiation between the parties to the dispute.
>
> 2. If the dispute cannot be settled through negotiation within six months, either party to the dispute shall be entitled to submit the dispute to the competent court of the Contracting State accepting the investment.
>
> 3. If a dispute involving the amount of compensation for expropriation cannot be settled through negotiation within six months as specified in paragraph 1 of this Article 1, it may be submitted at the request of either party to an ad hoc arbitral tribunal. The provision of this paragraph shall not apply if the investor concerned has resorted to the procedure specified in the paragraph 2 of this Article.

437 Respondent's Reply on Jurisdiction, ¶ 23.

438 Amended Notice, ¶ 115.

324. The relevant paragraphs of Article 4 read as follows:

> 1. Neither Contracting State shall expropriate, nationalize or take similar measures (hereinafter referred to as "expropriation") against investments of investors of the other Contracting State in its territory, unless the following conditions are met:
>   a. as necessitated by the public interest;
>   b. in accordance with domestic legal procedures;
>   c. without discrimination;
>   d. against appropriate and effective compensation.
>
> 2. The compensation mentioned in paragraph 1 (d) of this Article shall be equivalent to the value of the expropriated investments at the time when expropriation is proclaimed, be convertible and freely transferable. The compensation shall be paid without unreasonable delay.

325. The Parties disagree as to whether a Chinese investor may have access to arbitration prior to having recourse to the competent courts of Laos. According to the Respondent, Article 8(2) means that the parties to the Treaty agreed that "no other forum was offered to hear Chinese investor claims, but Laotian local courts. The same would apply to Laotian investors' claims against China."[439] This reading of Article 8(2) would completely eliminate access to arbitration in respect of any dispute, including disputes in respect of the quantum of compensation provided for in Article 8(3).

326. The structure of Article 8 follows a logical sequence: first amicable negotiation, second recourse to the competent courts or on certain matters access to arbitration. Access to arbitration is optional; the dispute "may be submitted at the request of either party to an ad hoc arbitral tribunal." The investor or the State may submit a dispute to arbitration involving the amount of compensation if negotiation on this matter is not successful. Article 8(3) does not provide that access to arbitration by either party to the dispute on the amount of compensation is subject to prior recourse to the Laotian courts. Under Article 8(2), the Parties to the dispute are not obliged to submit their dispute to the local courts, they are simply "entitled" to do so. In any case, the investor or the State would be entitled to have recourse to the local courts irrespective of whether the Treaty provided for it.

327. The Parties disagree on the scope of Article 8(3) and on the relationship between Article 8 and Article 4. For the Respondent, Article 8 is clear: it limits access to arbitration in respect of "a dispute involving the amount of compensation for expropriation." The Respondent argues that its interpretation of Article 8(3) is further confirmed by the notification made by the PRC on 7 January 1993, pursuant to Article 24(5) of the ICSID Convention, as to the jurisdiction of

[439] Respondent's Reply on Jurisdiction, ¶ 47(2).

ICSID. According to that notification, the PRC "would only consider submitting to the jurisdiction of disputes over compensation resulting from expropriation and nationalization."[440]

328. As far as the notification is concerned, the Tribunal notes that it is settled case-law that such notification is for informative purposes only and cannot be considered as a legal obligation to narrow or broaden an otherwise accepted consent to jurisdiction.[441]

329. Looking then at the "ordinary meaning" of this disposition, as it has to do in accordance with the rules of interpretation of the VCLT, the Tribunal considers that the terms of Article 8(3) indicate that the jurisdiction of the Tribunal is more limited than the dispute clauses found in many BITs. Article 8(3) refers to "disputes involving the amount of compensation for expropriation" and it does not simply refer to disputes involving an expropriation. As a first impression the text of this provision would seem to restrict the jurisdiction of the Tribunal to matters related to the amount of compensation due in instances of expropriation. However, other readings are possible. The term "involving" has a wider meaning than other possible terms such as "limited to" which could have been used if the intention of the State Parties had been to limit the jurisdiction of the Tribunal exclusively to disputes on the amount of compensation. "To involve" means "to wrap", "to include", terms that are inclusive rather than exclusive. This wider reading of Article 8(3) would seem more consistent with the other provisions of the Treaty as we will see shortly. It is also consistent with how a similar provision was interpreted by the *Tza Yap Shum* tribunal.

330. The interpretation of this provision shall also take into account its "context". The Tribunal considers that the first sentence of Article 8(3) cannot be read in isolation, (a) from the sentence that follows, namely, "[t]he provisions of this paragraph shall not apply if the investor concerned has resorted to the procedure specified in the paragraph 2 of this Article"; (b) from Article 8(2) and (3) from the conditions to establish expropriation set forth in Article 4(1).

331. The second sentence of Article 8(3) denies access to arbitration if the party concerned has resorted to "the competent court of the Contracting State accepting the investment." The Respondent has argued that this sentence in Article 8(3) refers to recourse to the competent court for a dispute involving the amount of compensation for expropriation and not generally to

---

440 Respondent's Memorial on Jurisdiction, ¶ 150.

441 Schreuer, *The ICSID Convention: A Commentary* (2001) (Cambridge University Press), pp. 342-347: "[…] notifications under Art. 25(4) are for purposes of information only and are designed to avoid misunderstanding." (p. 344); see also *Tza Yap Shum*, ¶¶ 163-165; *PSEG v. Turkey*, ICSID Case No. ARB/02/5, Decision on Jurisdiction, June 4, 2004, ¶¶ 135-147; see also *Kaiser Bauxite v. Jamaica*, ICSID Case No. ARB/74/3, Decision on Jurisdiction, July 6, 1975, ¶¶ 23, 24.

recourse to a competent court. While this is arguably coherent in the context of Article 8, it is difficult to accommodate in the wider context of Article 4(1).

332. In accordance with Article 4(1), to establish whether an expropriation had taken place, a competent court would need to decide whether the action of Laos meets the four conditions set forth in that paragraph. The fourth condition is "appropriate and effective compensation." Thus if Articles 8 and Article 4(1) are read together, an investor who would have recourse to a competent court to determine whether an expropriation has occurred would be precluded from submitting the dispute on the amount of compensation to international arbitration because the competent court would have already determined the compensation. There is an overlap between the conditions to be met by an expropriation under the Treaty and the Respondent's reading of Article 8(3) in isolation of its context. The Respondent has ignored completely this overlap and has assumed that the jurisdiction may be split between the local courts and an arbitral tribunal. Indeed, the Respondent has argued that "[t]he liability/quantum split under Article 8(2) and (3) is consistent with the substantive split under Article 4(1) and 4(2)."[442] The alleged neat relationship between the two Articles ignores the result that emerges from the preceding analysis by the Tribunal.

333. The Respondent's interpretation would leave Article 8(3) without effect. The task of the Tribunal is to interpret the Treaty in such a way that all the provisions of the Treaty have effect even if specific provisions do not refer to each other. The principle of *effet utile* requires international courts and tribunals to interpret international rules "so as to give them their fullest weight and effect consistent with the normal sense of the words and with other parts of the text and in such a way that a reason and a meaning can be attributed to every part of the text."[443] This principle of interpretation has been applied by investment arbitration tribunals and other international tribunals.

334. To illustrate how the principle has been applied, the Tribunal refers to the decision of the ICSID tribunal in *Asian Agricultural Products Ltd. v. Republic of Sri Lanka*, which explained:

> Nothing is better settled, as a canon of interpretation in all systems of law than that a clause must be so interpreted as to give it a meaning rather than so as to deprive it of meaning.[444]

---

442 Respondent's Reply on Jurisdiction, ¶ 47(3).

443 Gardiner, *Treaty Interpretation* (2008) (Oxford University Press), p. 149.

444 *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award of June 27, 1990, ¶ 40.

335. It has since then been confirmed in a great number of investment awards, which refer to the:

> […] cardinal rule of the interpretation of treaties that each and every operative clause of a treaty is to be interpreted as meaningful rather than meaningless. It is equally well established in the jurisprudence of international law, particularly that of the Permanent Court of International Justice and the International Court of Justice, that treaties, and hence their clauses, are to be interpreted so as to render them effective rather than ineffective.[445]

336. Other arbitral tribunals have faced the task of interpreting similar treaty provisions and the Parties have adduced their decisions in this proceeding. As noted by the Respondent, there is a split among the awards that have interpreted such provisions. The Respondent has pointed out that in their Preambles, none of the BITs underlying the cases of *Tza Yap Shum*, *European Media Ventures* or *Renta 4* adduced by the Claimant in support of its arguments include the following sentence found in the Preamble of the Treaty: "to encourage, protect and create favorable conditions for investment by investors of one Contracting State in the territory of the other Contracting State based on *the principles of mutual respect for sovereignty, equality and mutual benefit* and for the purpose of the development of economic cooperation between both States." (Respondent's emphasis). The Respondent has emphasized the importance of these principles:

> When applied—how do we apply the principle of respect of sovereignty to international arbitration and international investment arbitration? Well, those principles, when applied to international investment law, and in particular dispute resolution, should and—when applied to international arbitration, foreign investor-State arbitration, push the Tribunal, oblige the Tribunal to respect the choice of domestic jurisdiction clause that is inserted in the Contract.[446]

337. Counsel to Respondent concluded by saying that "a purposive approach does not allow this Arbitral Tribunal to go beyond the wording of the Article 8(3) of the BITs."[447]

338. The Tribunal is not convinced that the reference to these principles in the Preamble of the Treaty is sufficient to explain the differences in the interpretation of the jurisdictional clause by the arbitral tribunals concerned. More importantly, the Tribunal is unconvinced that the

---

445 *Eureko B.V. v. Republic of Poland*, Partial Award (*Ad hoc*, 19 August 2005), ¶ 248; see also *e.g.*, Noble Ventures v. Romania, ICSID Case No. ARB/01/11, Award of October 12, 2005, ¶ 50; or *Pan American Energy LLC and BP Argentina Exploration Co. v. Argentina*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections of July 27, 2006, ¶ 132; *Cemex Caracas Investments B.V. and Cemex Caracas II Investments B.V. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/08/15, Decision on Jurisdiction of December 30, 2010, ¶¶ 104-114; *Tidewater Inc. and others v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Decision on Jurisdiction of February 8, 2013, ¶ 134.

446 Hearing Transcript, p. 42:16-23.

447 Hearing Transcript, p. 43:9-11.

presence of these principles in the Preamble of the Treaty may override the conclusions of the Tribunal in the analysis of the text of Article 8. In the instant case, to follow the reasoning of the Respondent would mean to justify leaving without effect a clause of the Treaty on the basis of the purpose of the Treaty.

339. The purpose and object of the Treaty covers two distinct aspects: the protection of investments and the development of economic cooperation between both States. The balance between these two aspects must be borne in mind by the Tribunal in the analysis of the text of the Treaty, but it does not mean that the Tribunal needs to give preponderance to one aspect over the meaning of a particular clause of the Treaty or leave a clause without effect. The purpose of a treaty as set forth in its preamble may be useful to resolve doubts in its interpretation but it would not justify leaving without effect a clause of the treaty.

340. To explain the different conclusions reached by arbitral tribunals, the existence or absence of fork-in-the-road clauses in the underlying BIT is, in the view of the Tribunal, a more relevant factor, and it is a factor taken into consideration by these tribunals. Indeed, in none of the BITs underlying the cases relied upon by the Respondent is there a fork-in-the-road clause that would limit the investor's access to arbitration if the investor had recourse first to the local courts to determine whether an expropriation had actually occurred. As stated in the opening statement of Claimant's counsel at the Hearing on Jurisdiction:

> Most importantly, I will note at the outset that none of them [of the cases relied on by the Respondent] involve—have fork-in-the-road clauses in their dispute-resolution clauses, and that makes an enormous difference because, as I've shown, having the fork-in-the-road clause makes it impossible for an investor to do what Laos says they want the Treaty says it ought to do, which is first bring a claim for expropriation to the Laos courts and then wholly bring the question of compensation/quantum to a Tribunal.[448]

341. As in the case of the Treaty, the Spain/Russia BIT and the PRC/Peru BIT include fork-in-the-road provisions. In reaching its decision on the meaning of the first sentence of Article 8(3) in the latter, the tribunal in *Tza Yap Shum* stated:

> In the opinion of the Tribunal to rule otherwise would eviscerate the provision relating to ICSID arbitration since, in accordance with the final sentence of Article 8(3), to have recourse to tribunals of the State recipient of the investment would definitely preclude the possibility to accede to arbitration under the ICSID Convention.[449]

[448] Hearing Transcript, pp. 129:21-130:3.

[449] *Tza Yap Shum*, ¶ 188 (CLA-70/RA-10) [English translation provided by the Tribunal. The English translation provided by the Claimant is inaccurate].

342. For the reasons explained above, the Tribunal shares this view and concludes that the Respondent has consented to arbitrate claims of expropriation under Article 8 of the Treaty.

(b) Whether the Respondent has consented to arbitrate Sanum's claims under Article 3(2)

343. The question before the Tribunal is whether the MFN clause in the Treaty grants an independent basis for the Tribunal to determine whether an expropriation has occurred and to determine whether the other substantive breaches of Treaty obligations claimed by Sanum have occurred. The Tribunal has already determined that it has jurisdiction as to whether an expropriation has occurred under Article 8 and need not further consider this matter under Article 3(2).

344. Article 3(2) reads as follows:

> The treatment and protection as mentioned in Paragraph 1 of this Article shall not be less favorable than that accorded to investments and activities associated with such investments of investors of a third State.

345. Article 3(1) provides:

> Investments and activities associated with investments of investors of either Contracting State shall be accorded fair and equitable treatment and shall enjoy protection in the territory of the other Contracting State.

346. The Parties disagree as to whether the sentence "shall be accorded fair and equitable treatment and shall enjoy protection in the territory of the other Contracting State" refers to the standard of fair and equitable treatment and full protection and security or whether it extends to all protections provided in the Treaty, including access to international arbitration.

347. On the one hand, the Respondent contends that "protection" refers to protection and security and not to all the substantive protections under the Treaty. On the other hand, the Claimant has argued that the most natural reading of the term "protection" is that "it extends to *all* of the protections provided in the Treaty."[450]

[450] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 300 (Claimant's emphasis).

348. The Claimant has also argued that "activities associated with such investments" include the management, maintenance, use, enjoyment, disposal of investments and the settlement of disputes involved in protecting such investments.[451] Claimant adduces multiple awards to support different aspects of this reading of "activities associated with such investments."[452] Respondent has not addressed this point in its Reply and has simply insisted that Article 3(1) refers to protection and security and bears no relation to access to international arbitration.

349. The interpretation of the MFN clause has been subject to discrepant views since the decision on jurisdiction of the *Maffezini* tribunal.[453] Therefore, it is not difficult for the parties to a dispute to find prior decisions in support of their conflicting positions. The Tribunal is not obliged to follow any particular prior decision but it cannot ignore the arguments of the Parties and the decisions they have used to support them. Therefore, before entering into the analysis of the MFN clause in the Treaty, the Tribunal considers it appropriate to make two general observations related to the cases of *RosInvest* and *Tza Yap Shum* that figure prominently in the Parties' arguments.

350. First, notwithstanding the variety of approaches adopted by arbitral tribunals, those tribunals show concern for the reach of their interpretations and seek to limit their effect.

351. Second, general pronouncements of arbitral tribunals need to be considered cautiously in the context of the cases in which they were made. For instance, in the series of cases involving Argentina, access to arbitration is subject first to submitting the dispute to the ordinary courts and after 18 months an investor may proceed to arbitration even if a court decided the dispute and the investor was dissatisfied with the result. The Respondent has distinguished the instant case from the Argentine cases because the underlying treaties contained broader arbitration clauses than the dispute resolution clause found here, and the tribunals merely remove threshold requirements for accessing arbitration"[454] The Tribunal agrees with the limited relevance of the Argentine cases.

---

[451] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 300.

[452] Claimant's Statement of Claim and Response on Jurisdiction, ¶ 300.

[453] *Maffezini* (CLA-46).

[454] Respondent's Memorial on Jurisdiction, ¶ 167.

352. Third, Claimant has drawn the attention of the Tribunal to the award on jurisdiction in the *RosInvest* case and to that tribunal's finding that the MFN clause permitted importation of a dispute resolution clause. However, this finding needs to be treated with some reservation in view of the caution the *RosInvest* tribunal showed when it considered the MFN clause. It stated:

> […] *without entering into the much more general question whether MFN-clauses can be used to transfer arbitration clauses from one treaty to another*, the Tribunal concludes that, for the specific wording of Article 3(1) of the UK-Soviet BIT, and for the specific purpose of arbitration with regard to expropriation, the wide wording of Article 8 of the Denmark-Russia BIT is not applicable.[455]

353. The tribunal reached this conclusion on the effect of an expropriation on the treatment of an investment and then continued to analyze a separate provision on the treatment of the investor and stated: "*Again limiting its considerations to the possible application of the MFN-clause to arbitration regarding expropriation*, the terms '*use*' and '*enjoyment*' in paragraph (2) lead the Tribunal to different conclusions from those reached with regard to paragraph (1)."[456]

354. Fourth, the tribunal in *Tza Yap Shum* conducted an extensive analysis of the history of MFN clauses and of the MFN clause in the PRC/Peru BIT. The dispute settlement clause in that treaty follows closely the text of Article 8 of the Treaty except that in Article 8(3) of the Peru/PRC BIT there is the following additional sentence: "Any dispute related to other matters between the investor of any Contracting Party and the other Contracting Party may be submitted to ICSID if the parties to the dispute so agree."[457] The *Tza Yap Shum* tribunal in its analysis of this Article 8(3) gave particular weight to the fact that the parties had contemplated in that article the possibility of submitting other matters to arbitration but only if the parties would agree beforehand. In view of the need for a further specific agreement, the tribunal rejected the claimant's arguments to extend through the MFN clause access to arbitration in respect of disputes over the other alleged breaches of the Peru/PRC BIT.[458]

---

455 *RosInvest*, ¶ 129 (emphasis added) (RA-19).

456 *RosInvest*, ¶ 130 (emphasis added) (RA-19).

457 [English translation from the Spanish provided by the Tribunal]

458 *Tza Yap Shum*, ¶ 216.

355. Before turning to the MFN clause in the Treaty it will be useful to recall the claims advanced by the Claimant under the Treaty MFN clause. In the Amended Notice, the Claimant has invoked its right under Article 3(2) of the Treaty:

> […] to receive treatment no less favorable than the Respondent has accorded to the investors of third States, such as the Netherlands, the Republic of Korea, France, Sweden, Switzerland, Denmark, the United Kingdom, Germany and Australia, in respect of its right to seek compensation for a breach of either the autonomous treaty standard of fair and equitable treatment or alternative standards of treatment no less favorable, such as Article 8 of the Laos-Germany BIT. Article 2(3) of the Laos-Sweden-BIT, or Article 6 of the Laos-Japan BIT, through recourse to binding, independent, international arbitration.
>
> In addition, and in the alternative, should Article 8(3) of the instant Treaty be construed in such a manner as to in any way curtail or limit the access that a Chinese investor would otherwise enjoy (had it been a national of the Netherlands, the Republic of Korea, France, Switzerland, the United Kingdom, Sweden, Denmark, Australia or Germany), including the availability of access to arbitration under the Treaty itself, Sanum hereby invokes its right to receive treatment no less favorable than the Respondent has accorded to these third country investors, under Article 3(2) of the Treaty, as well.[459]

356. The Tribunal observes that, in its Statement of Claim and Response on Jurisdiction, under the heading "Article 3(2) Grants Authority to the Tribunal To Hear All of Sanum's Claims", the Claimant analyzes Article 3(2) of the Treaty but it does not include any analysis of the dispute settlement clauses in the BITs through which allegedly the MFN clause would operate. There is no analysis or specific preference expressed for any of them. While the BITs referred to by the Claimant are part of the record before the Tribunal, it would have been of assistance to the Tribunal had the analysis of Article 3(2) been complemented by an analysis of the dispute settlement clauses in the BITs listed in the Amended Notice.

357. The MFN clause in Article 3(2) refers to the treatment and protection in Article 3(1). Article 3(1) provides for fair and equitable treatment and protection of investments and activities associated with investments of investors. The Claimant has argued in favor of a broad meaning of the term "protection" under Article 3(1). On the other hand, the Claimant seems to realize that the term "protection" as used in Article 3(1) of the Treaty has a limited meaning. Indeed, the Claimant argues that, under the BITs of Laos with Germany, Korea and the United Kingdom, Laos has agreed to accord "full protection and security" and this obligation offers investors broader protection than that afforded under Article 3(1) of the Treaty. The Claimant does not discuss the implications of this statement for its reading of Article 3(1). In the view of

[459] Amended Notice, ¶¶ 122-123.

the Tribunal, this argument shows that the Claimant considers it necessary to have recourse to the MFN clause to reach the level of protection afforded by the addition of the terms "full" and "security". In other words, the Claimant's argument on the application of the MFN clause contradicts the Claimant's broad reading of the term "protection" in Article 3(1) as including all protections under the Treaty. If this were the case, there would be no need to have recourse to the MFN clause to enjoy wider protection.

358. Thus, the position advanced by the Claimant requires the Tribunal, to (a) extend "protection" under Article 3(1) to all protections provided for in the Treaty; (b) extend through Article 3(2) the reach of Article 3(1); and, (c) go a step further and extend the reach of this clause to include access to arbitration in respect of disputes over a breach of all protections under the Treaty. Article 3(1) is limited in its scope and does not include the traditional formula of *full* protection and *security*, as the Claimant itself recognizes. In addition, to read into that clause a dispute settlement provision to cover all protections under the Treaty when the Treaty itself provides for very limited access to international arbitration would result in a substantial re-write of the Treaty and an extension of the States Parties' consent to arbitration beyond what may be assumed to have been their intention, given the limited reach of the Treaty protection and dispute settlement clauses. Therefore, the Tribunal finds that it has no jurisdiction for claims submitted under Article 3(2) of the Treaty.

5. Whether the Doctrines of *Lis Pendens* and Against the Abuse of Process Bar the Claims of the Claimant

359. The Respondent contends that the Claimant has committed an abuse of process by submitting, as part of the Amended Notice, claims already made before in the Lao Holdings Arbitration. The Respondent further argues that these claims are inadmissible on grounds of *lis pendens*. The Respondent has requested that the Tribunal reject the amendments the Claimant has made in its Statement of Claim and Response on Jurisdiction on the basis of Articles 17 and 22 of the 2010 UNCITRAL Arbitration Rules.

360. According to Article 17(1) of the Rules:

> […] the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at an appropriate stage of the proceedings each party is given a reasonable opportunity of presenting its case. The arbitral tribunal, in exercising its discretion, shall conduct the proceedings so as to avoid unnecessary delay and expense and to provide a fair and efficient process for resolving the parties' dispute.

361. Article 22 reads as follows:

> During the course of the arbitral proceedings, a party may amend or supplement its claim or defense, including a counterclaim or a claim for the purpose of a set-off, unless the arbitral tribunal considers it inappropriate to allow such amendment or supplement having regard to the delay in making it or prejudice to other parties or any other circumstances. However, a claim or defense, including a counterclaim or a claim for the purpose of a set-off, may not be amended or supplemented in such a manner that the amended or supplemented claim or defense falls outside the jurisdiction of the arbitral tribunal.

362. The Tribunal will address whether there have been delays or prejudice caused by the Amended Notice; whether the Respondent had the opportunity to present its case; whether *lis pendens* is an obstacle to admission of the claims in the Amended Notice; whether the amended claims are within the jurisdiction of the Tribunal; and, whether the Claimant has abused the process.

363. Is the Amended Notice a cause for delay? Procedural Order No. 1 provided for the filing of an Amended Notice within ten days of the date of that order. The Amended Notice was filed on June 7, 2013 within the prescribed time. Therefore, it is self-evident that the Tribunal may not consider the Amended Notice to have caused any inappropriate delay.

364. Has each Party had the opportunity to present its case? Suffice it to say here that the Amended Notice not only was filed in good time but also was filed nearly two months before the Statement of Claim and the Respondent's Memorial on Jurisdiction.

365. Has the Amended Notice caused prejudice? It is undisputed that the Claimant offered to consolidate the two proceedings and the Respondent refused. Whatever the reasons for the Respondent's refusal, the Respondent is now precluded from claiming that it has been prejudiced. Whether it has or not is not a matter for the Tribunal to elucidate since consolidation was an option available to the Respondent.

366. Are the claims introduced in the Amended Notice inadmissible on the grounds of *lis pendens* since they are the subject of a parallel proceeding? The Lao Holdings Arbitration is based on a different BIT and the claimant parties are related but different. The mere fact that the subject matter of the dispute may in some aspects overlap with these proceedings is not sufficient reason to reject the claims as inadmissible. As to the jurisdiction of the Tribunal, to the extent that the Tribunal has determined that it has jurisdiction to consider only the expropriation claims before it, that jurisdiction encompasses only the expropriation claims that may be before the Lao Holdings tribunal.

367. Does the pursuit of overlapping claims in two different arbitral tribunals established under two different BITs by different parties constitute an abuse of process? As already observed above, it is undisputed that the Respondent refused to consolidate this proceeding and the Lao Holdings Arbitration. This fact is sufficient ground for the Tribunal to consider that there is no abuse of process.

368. To conclude, the Tribunal determines that the expropriation claims in the Amended Notice are properly before this Tribunal.

VIII. COSTS

369. Each Party has requested that the costs of the proceedings, including its own costs, be borne by the other. The Tribunal reserves this question for consideration and decision along with the merits of the dispute.

IX. DECISION

370. For the reasons set out above the Tribunal decides:

i) That the PRC/Laos BIT does apply to the Macao SAR.

ii) That Sanum is a protected investor under the BIT and its claims are investment-related.

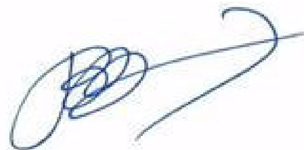
iii) That the Tribunal has jurisdiction to arbitrate only the expropriation claims of Sanum under Article 8(3) of the BIT.

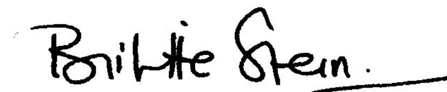
iv) That it has no jurisdiction to arbitrate Sanum's other claims by application of Article 3(2) of the BIT.

v) To reject the Respondent's request to dismiss claims introduced by the Amended Notice which allegedly duplicate claims made in the Laos Holdings Arbitration.

vi) To consider and decide the Parties' requests in respect of costs together with the merits of the dispute.

Dated this 13th day of December 2013, Singapore:





Professor Bernard Hanotiau
Arbitrator

Professor Brigitte Stern
Arbitrator

Dr. Andrés Rigo Sureda
Presiding Arbitrator

ANNEX 4

LAO PEOPLE' S DEMOCRATIC REPUBLIC

Peace Independence Democracy Unity Prosperity

Ministry of Foreign Affairs

00058
No. ____/AE.TD.4

The Ministry of Foreign Affairs of the Lao People's Democratic Republic presents its compliments to the Embassy of the People's Republic of China and, with reference to the meeting between His Excellency Mr. Alounkeo Kittikhoun, Vice-Minister of Foreign Affairs and His Excellency Mr. Guan Huabing, Ambassador Extraordinary and Plenipotentiary of the People's Republic of China to the Lao People's Democratic Republic on January 3rd, 2014 and the meeting between the Director General of the Department of Treaties and Law, Ministry of Foreign Affairs with the Counselor, Deputy Chief of Mission of the Embassy of the People's Republic of China on December 27th, 2013, has the honour to seek views of the Government of the People's Republic of China regarding the status of the Agreement between the Government of the Lao People's Democratic Republic and the Government of the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investment signed on January 31st, 1993 (the Agreement) in relation to Macau Special Administrative Region.

The Ministry of Foreign Affairs has the further honour to inform the Embassy that the Lao Government is of the view that the Agreement does not extend to Macau Special Administrative Region for the reasons based on the People's Republic of China's policy of one country, two systems, its constitutional and legal framework, the Basic Law of Macau Special Administrative Region as well as the fact that the Agreement itself is silent on its extension to Macau Special Administrative Region, which returned to the sovereignty of the People's Republic of China in 1999, six years after the signing of the Agreement.

It would be highly appreciated if the Embassy would communicate this request to the agencies concerned of the People's Republic of China and could provide a response in due course.

The Ministry of Foreign Affairs of the Lao People's Democratic Republic avails itself of this opportunity to renew to the Embassy of the People's Republic of China the assurances of its highest consideration.

Vientiane, 7 January 2014

The Embassy of the People's Republic of China

Vientiane

ANNEX 5

中 华 人 民 共 和 国 大 使 馆

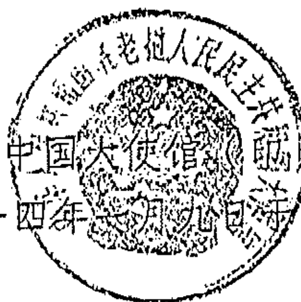
第 003/14 号

中华人民共和国大使馆向老挝人民民主共和国外交部致意，并谨就外交部 00058/AE.TD.4 号照会答复如下：

根据《中华人民共和国澳门特别行政区基本法》，经中央人民政府具体授权，澳门特别行政区政府可自行与外国和地区签订和履行投资协定；中央人民政府缔结的双边投资协定原则上不适用于澳门特别行政区，除非在征询特别行政区政府意见、并同有关缔约方协商后另行做出安排。

鉴此，1993 年 1 月 31 日在万象签订的《中华人民共和国政府和老挝人民民主共和国政府关于鼓励和相互保护投资协定》不适用于澳门特别行政区，除非中老双方将来另行作出安排。

顺致最崇高的敬意。



中国大使馆

二〇一四年[illegible]月[illegible]日于万象

(Logo of the Embassy of the People's Republic of China)

Embassy of the People's Republic of China

No. 003/14

The Embassy of the People's Republic of China hereby replies to the note (ref 00058/AB.TD.4) received from the Ministry of Foreign Affairs of Lao People's Democratic Republic (Lao PDR) as follows:

According to the Basic Law of the Macao Special Administrative Region (MCSAR), subject to specific authorization by the Central People's Government, the government of the MCSAR may by itself enter into and fulfil investment agreements with foreign and regional entities; bilateral investment agreements entered into by the Central People's Government are in principle not applicable to the MCSAR save where otherwise arranged after consultation with the government of the MCSAR and negotiations with the parties to the agreement.

Consequently, the Agreement between the Government of the People's Republic of China and the Government of the Lao People's Democratic Republic on Encouragement and Mutual Protection of Investments concluded in Vientiane on 31 January, 1993 is not applicable to the MCSAR unless agreed otherwise between both parties hereafter.

With our highest regards,

(seal of the Embassy of the People's Republic of China
in the Lao People's Democratic Republic)

January 9, 2014, Vientiane

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

ANNEX 6

[葡文版本]

中華人民共和國澳門特別行政區基本法

（1993年3月31日第八屆全國人民代表大會第一次會議通過－1993年3月31日中華人民共和國主席令第3號公佈自1999年12月20日起實施）

目錄

序言
第一章－總則
第二章－中央和澳門特別行政區的關係
第三章－居民的基本權利和義務
第四章－政治體制

- 第一節－行政長官
- 第二節－行政機關
- 第三節－立法機關
- 第四節－司法機關
- 第五節－市政機構
- 第六節－公務人員
- 第七節－宣誓效忠

第五章－經濟
第六章－文化和社會事務
第七章－對外事務
第八章－本法的解釋和修改
第九章－附則
附件一：澳門特別行政區行政長官的產生辦法
附件二：澳門特別行政區立法會的產生辦法
附件三：在澳門特別行政區實施的全國性法律

序言

澳門，包括澳門半島、氹仔島和路環島，自古以來就是中國的領土，十六世紀中葉以後被葡萄牙逐步佔領。一九八七年四月十三日，中葡兩國政府簽署了關於澳門問題的聯合聲明，確認中華人民共和國政府於一九九九年十二月二十日恢復對澳門行使主權，從而實現了長期以來中國人民收回澳門的共同願望。

為了維護國家的統一和領土完整，有利於澳門的社會穩定和經濟發展，考慮到澳門的歷史和現實情況，國家決定，在對澳門恢復行使主權時，根據中華人民共和國憲法第三十一條的規定，設立澳門特別行政區，並按照“一個國家，兩種制度”的方針，不在澳門實行社會主義的制度和政策。國家對澳門的基本方針政策，已由中國政府在中葡聯合聲明中予以闡明。

根據中華人民共和國憲法，全國人民代表大會特制定中華人民共和國澳門特別行政區基本法，規定澳門特別行政區實行的制度，以保障國家對澳門的基本方針政策的實施。

第一章

總則

第一條

澳門特別行政區是中華人民共和國不可分離的部分。

第二條

中華人民共和國全國人民代表大會授權澳門特別行政區依照本法的規定實行高度自治，享有行政管理權、立法權、獨立的司法權和終審權。

第三條

澳門特別行政區的行政機關和立法機關由澳門特別行政區永久性居民依照本法有關規定組成。

第四條

澳門特別行政區依法保障澳門特別行政區居民和其他人的權利和自由。

第五條

澳門特別行政區不實行社會主義的制度和政策，保持原有的資本主義制度和生活方式，五十年不變。

第六條

澳門特別行政區以法律保護私有財產權。

第七條

澳門特別行政區境內的土地和自然資源，除在澳門特別行政區成立前已依法確認的私有土地外，屬於國家所有，由澳門特別行政區政府負責管理、使用、開發、出租或批給個人、法人使用或開發，其收入全部歸澳門特別行政區政府支配。

第八條

澳門原有的法律、法令、行政法規和其他規範性文件，除同本法相抵觸或經澳門特別行政區的立法機關或其他有關機關依照法定程序作出修改者外，予以保留。

第九條

澳門特別行政區的行政機關、立法機關和司法機關，除使用中文外，還可使用葡文，葡文也是正式語文。

第十條

澳門特別行政區除懸掛和使用中華人民共和國國旗和國徽外，還可懸掛和使用澳門特別行政區區旗和區徽。

澳門特別行政區的區旗是繪有五星、蓮花、大橋、海水圖案的綠色旗幟。

澳門特別行政區的區徽，中間是五星、蓮花、大橋、海水，周圍寫有“中華人民共和國澳門特別行政區”和葡文“澳門”。

第十一條

根據中華人民共和國憲法第三十一條，澳門特別行政區的制度和政策，包括社會、經濟制度，有關保障居民的基本權利和自由的制度，行政管理、立法和司法方面的制度，以及有關政策，均以本法的規定為依據。

澳門特別行政區的任何法律、法令、行政法規和其他規範性文件均不得同本法相抵觸。

第二章

中央和澳門特別行政區的關係

第十二條

澳門特別行政區是中華人民共和國的一個享有高度自治權的地方行政區域，直轄於中央人民政府。

第十三條

中央人民政府負責管理與澳門特別行政區有關的外交事務。

中華人民共和國外交部在澳門設立機構處理外交事務。

中央人民政府授權澳門特別行政區依照本法自行處理有關的對外事務。

第十四條

中央人民政府負責管理澳門特別行政區的防務。

澳門特別行政區政府負責維持澳門特別行政區的社會治安。

第十五條

中央人民政府依照本法有關規定任免澳門特別行政區行政長官、政府主要官員和檢察長。

第十六條

澳門特別行政區享有行政管理權，依照本法有關規定自行處理澳門特別行政區的行政事務。

第十七條

澳門特別行政區享有立法權。

澳門特別行政區的立法機關制定的法律須報全國人民代表大會常務委員會備案。備案不影響該法律的生效。

全國人民代表大會常務委員會在徵詢其所屬的澳門特別行政區基本法委員會的意見後，如認為澳門特別行政區立法機關制定的任何法律不符合本法關於中央管理的事務及中央和澳門特別行政區關係的條款，可將有關法律發回，但不作修改。經全國人民代表大會常務委員會發回的法律立即失效。該法律的失效，除澳門特別行政區的法律另有規定外，無溯及力。

第十八條

在澳門特別行政區實行的法律為本法以及本法第八條規定的澳門原有法律和澳門特別行政區立法機關制定的法律。

全國性法律除列於本法附件三者外，不在澳門特別行政區實施。凡列於本法附件三的法律，由澳門特別行政區在當地公佈或立法實施。

全國人民代表大會常務委員會在徵詢其所屬的澳門特別行政區基本法委員會和澳門特別行政區政府的意見後，可對列於本法附件三的法律作出增減。列入附件三的法律應限於有關國防、外交和其他依照本法規定不屬於澳門特別行政區自治範圍的法律。

在全國人民代表大會常務委員會決定宣佈戰爭狀態或因澳門特別行政區內發生澳門特別行政區政府不能控制的危及國家統一或安全的動亂而決定澳門特別行政區進入緊急狀態時，中央人民政府可發佈命令將有關全國性法律在澳門特別行政區實施。

第十九條

澳門特別行政區享有獨立的司法權和終審權。

澳門特別行政區法院除繼續保持澳門原有法律制度和原則對法院審判權所作的限制外，對澳門特別行政區所有的案件均有審判權。

澳門特別行政區法院對國防、外交等國家行為無管轄權。澳門特別行政區法院在審理案件中遇有涉及國防、外交等國家行為的事實問題，應取得行政長官就該等問題發出的證明文件，上述文件對法院有約束力。行政長官在發出證明文件前，須取得中央人民政府的證明書。

第二十條

澳門特別行政區可享有全國人民代表大會、全國人民代表大會常務委員會或中央人民政府授予的其他權力。

第二十一條

澳門特別行政區居民中的中國公民依法參與國家事務的管理。

根據全國人民代表大會確定的代表名額和代表產生辦法，由澳門特別行政區居民中的中國公民在澳門選出澳門特別行政區的全國人民代表大會代表，參加最高國家權力機關的工作。

第二十二條

中央人民政府所屬各部門、各省、自治區、直轄市均不得干預澳門特別行政區依照本法自行管理的事務。

中央各部門、各省、自治區、直轄市如需在澳門特別行政區設立機構，須徵得澳門特別行政區政府同意並經中央人民政府批准。

中央各部門、各省、自治區、直轄市在澳門特別行政區設立的一切機構及其人員均須遵守澳門特別行政區的法律。

各省、自治區、直轄市的人進入澳門特別行政區須辦理批准手續，其中進入澳門特別行政區定居的人數由中央人民政府主管部門徵求澳門特別行政區政府的意見後確定。

澳門特別行政區可在北京設立辦事機構。

第二十三條

澳門特別行政區應自行立法禁止任何叛國、分裂國家、煽動叛亂、顛覆中央人民政府及竊取國家機密的行為，禁止外國的政治性組織或團體在澳門特別行政區進行政治活動，禁止澳門特別行政區的政治性組織或團體與外國的政治性組織或團體建立聯繫。

第三章

居民的基本權利和義務

第二十四條

澳門特別行政區居民，簡稱澳門居民，包括永久性居民和非永久性居民。

澳門特別行政區永久性居民為：

（一）在澳門特別行政區成立以前或以後在澳門出生的中國公民及其在澳門以外所生的中國籍子女；

（二）在澳門特別行政區成立以前或以後在澳門通常居住連續七年以上的中國公民及在其成為永久性居民後在澳門以外所生的中國籍子女；

（三）在澳門特別行政區成立以前或以後在澳門出生並以澳門為永久居住地的葡萄牙人；

（四）在澳門特別行政區成立以前或以後在澳門通常居住連續七年以上並以澳門為永久居住地的葡萄牙人；

（五）在澳門特別行政區成立以前或以後在澳門通常居住連續七年以上並以澳門為永久居住地的其他人；

（六）第（五）項所列永久性居民在澳門特別行政區成立以前或以後在澳門出生的未滿十八周歲的子女。

以上居民在澳門特別行政區享有居留權並有資格領取澳門特別行政區永久性居民身份證。

澳門特別行政區非永久性居民為：有資格依照澳門特別行政區法律領取澳門居民身份證，但沒有居留權的人。

第二十五條

澳門居民在法律面前一律平等，不因國籍、血統、種族、性別、語言、宗教、政治或思想信仰、文化程度、經濟狀況或社會條件而受到歧視。

第二十六條

澳門特別行政區永久性居民依法享有選舉權和被選舉權。

第二十七條

澳門居民享有言論、新聞、出版的自由，結社、集會、游行、示威的自由，組織和參加工會、罷工的權利和自由。

第二十八條

澳門居民的人身自由不受侵犯。

澳門居民不受任意或非法的逮捕、拘留、監禁。對任意或非法的拘留、監禁，居民有權向法院申請頒發人身保護令。

禁止非法搜查居民的身體、剝奪或者限制居民的人身自由。

禁止對居民施行酷刑或予以非人道的對待。

第二十九條

澳門居民除其行為依照當時法律明文規定為犯罪和應受懲處外，不受刑罰處罰。

澳門居民在被指控犯罪時，享有盡早接受法院審判的權利，在法院判罪之前均假定無罪。

第三十條

澳門居民的人格尊嚴不受侵犯。禁止用任何方法對居民進行侮辱、誹謗和誣告陷害。

澳門居民享有個人的名譽權、私人生活和家庭生活的隱私權。

第三十一條

澳門居民的住宅和其他房屋不受侵犯。禁止任意或非法搜查、侵入居民的住宅和其他房屋。

第三十二條

澳門居民的通訊自由和通訊秘密受法律保護。除因公共安全和追查刑事犯罪的需要，由有關機關依照法律規定對通訊進行檢查外，任何部門或個人不得以任何理由侵犯居民的通訊自由和通訊秘密。

第三十三條

澳門居民有在澳門特別行政區境內遷徙的自由，有移居其他國家和地區的自由。澳門居民有旅行和出入境的自由，有依照法律取得各種旅行證件的權利。有效旅行證件持有人，除非受到法律制止，可自由離開澳門特別行政區，無需特別批准。

第三十四條

澳門居民有信仰的自由。

澳門居民有宗教信仰的自由，有公開傳教和舉行、參加宗教活動的自由。

第三十五條

澳門居民有選擇職業和工作的自由。

第三十六條

澳門居民有權訴諸法律，向法院提起訴訟，得到律師的幫助以保護自己的合法權益，以及獲得司法補救。

澳門居民有權對行政部門和行政人員的行為向法院提起訴訟。

第三十七條

澳門居民有從事教育、學術研究、文學藝術創作和其他文化活動的自由。

第三十八條

澳門居民的婚姻自由、成立家庭和自願生育的權利受法律保護。

婦女的合法權益受澳門特別行政區的保護。

未成年人、老年人和殘疾人受澳門特別行政區的關懷和保護。

第三十九條

澳門居民有依法享受社會福利的權利。勞工的福利待遇和退休保障受法律保護。

第四十條

《公民權利和政治權利國際公約》、《經濟、社會與文化權利的國際公約》和國際勞工公約適用於澳門的有關規定繼續有效，通過澳門特別行政區的法律予以實施。

澳門居民享有的權利和自由，除依法規定外不得限制，此種限制不得與本條第一款規定抵觸。

第四十一條

澳門居民享有澳門特別行政區法律保障的其他權利和自由。

第四十二條

在澳門的葡萄牙後裔居民的利益依法受澳門特別行政區的保護，他們的習俗和文化傳統應受尊重。

第四十三條

在澳門特別行政區境內的澳門居民以外的其他人，依法享有本章規定的澳門居民的權利和自由。

第四十四條

澳門居民和在澳門的其他人有遵守澳門特別行政區實行的法律的義務。

第四章

政治體制

第一節

行政長官

第四十五條

澳門特別行政區行政長官是澳門特別行政區的首長，代表澳門特別行政區。

澳門特別行政區行政長官依照本法規定對中央人民政府和澳門特別行政區負責。

第四十六條

澳門特別行政區行政長官由年滿四十周歲，在澳門通常居住連續滿二十年的澳門特別行政區永久性居民中的中國公民擔任。

第四十七條

澳門特別行政區行政長官在當地通過選舉或協商產生，由中央人民政府任命。

行政長官的產生辦法由附件一《澳門特別行政區行政長官的產生辦法》規定。

第四十八條

澳門特別行政區行政長官任期五年，可連任一次。

第四十九條

澳門特別行政區行政長官在任職期內不得具有外國居留權，不得從事私人贏利活動。行政長官就任時應向澳門特別行政區終審法院院長申報財產，記錄在案。

第五十條

澳門特別行政區行政長官行使下列職權：

（一）領導澳門特別行政區政府；

（二）負責執行本法和依照本法適用於澳門特別行政區的其他法律；

（三）簽署立法會通過的法案，公佈法律；

簽署立法會通過的財政預算案，將財政預算、決算報中央人民政府備案；

（四）決定政府政策，發佈行政命令；

（五）制定行政法規並頒佈執行；

（六）提名並報請中央人民政府任命下列主要官員：各司司長、廉政專員、審計長、警察部門主要負責人和海關主要負責人；建議中央人民政府免除上述官員職務；

（七）委任部分立法會議員；

（八）任免行政會委員；

（九）依照法定程序任免各級法院院長和法官，任免檢察官；

（十）依照法定程序提名並報請中央人民政府任命檢察長，建議中央人民政府免除檢察長的職務；

（十一）依照法定程序任免公職人員；

（十二）執行中央人民政府就本法規定的有關事務發出的指令；

（十三）代表澳門特別行政區政府處理中央授權的對外事務和其他事務；

（十四）批准向立法會提出有關財政收入或支出的動議；

（十五）根據國家和澳門特別行政區的安全或重大公共利益的需要，決定政府官員或其他負責政府公務的人員是否向立法會或其所屬的委員會作證和提供證據；

（十六）依法頒授澳門特別行政區獎章和榮譽稱號；

（十七）依法赦免或減輕刑事罪犯的刑罰；

（十八）處理請願、申訴事項。

第五十一條

澳門特別行政區行政長官如認為立法會通過的法案不符合澳門特別行政區的整體利益，可在九十日內提出書面理由並將法案發回立法會重議。立法會如以不少於全體議員三分之二多數再次通過原案，行政長官必須在三十日內簽署公佈或依照本法第五十二條的規定處理。

第五十二條

澳門特別行政區行政長官遇有下列情況之一時，可解散立法會：

（一）行政長官拒絕簽署立法會再次通過的法案；

（二）立法會拒絕通過政府提出的財政預算案或行政長官認為關係到澳門特別行政區整體利益的法案，經協商仍不能取得一致意見。

行政長官在解散立法會前，須徵詢行政會的意見，解散時應向公眾說明理由。

行政長官在其一任任期內只能解散立法會一次。

第五十三條

澳門特別行政區行政長官在立法會未通過政府提出的財政預算案時，可按上一財政年度的開支標準批准臨時短期撥款。

第五十四條

澳門特別行政區行政長官如有下列情況之一者必須辭職：

（一）因嚴重疾病或其他原因無力履行職務；

（二）因兩次拒絕簽署立法會通過的法案而解散立法會，重選的立法會仍以全體議員三分之二多數通過所爭議的原案，而行政長官在三十日內拒絕簽署；

（三）因立法會拒絕通過財政預算案或關係到澳門特別行政區整體利益的法案而解散立法會，重選的立法會仍拒絕通過所爭議的原案。

第五十五條

澳門特別行政區行政長官短期不能履行職務時，由各司司長按各司的排列順序臨時代理其職務。各司的排列順序由法律規定。

行政長官出缺時，應在一百二十日內依照本法第四十七條的規定產生新的行政長官。行政長官出缺期間的職務代理，依照本條第一款規定辦理，並報中央人民政府批准。代理行政長官應遵守本法第四十九條的規定。

第五十六條

澳門特別行政區行政會是協助行政長官決策的機構。

第五十七條

澳門特別行政區行政會的委員由行政長官從政府主要官員、立法會議員和社會人士中委任，其任免由行政長官決定。行政會委員的任期不超過委任他的行政長官的任期，但在新的行政長官就任前，原行政會委員暫時留任。

澳門特別行政區行政會委員由澳門特別行政區永久性居民中的中國公民擔任。

行政會委員的人數為七至十一人。行政長官認為必要時可邀請有關人士列席行政會會議。

第五十八條

澳門特別行政區行政會由行政長官主持。行政會的會議每月至少舉行一次。行政長官在作出重要決策、向立法會提交法案、制定行政法規和解散立法會前，須徵詢行政會的意見，但人事任免、紀律制裁和緊急情況下採取的措施除外。

行政長官如不採納行政會多數委員的意見，應將具體理由記錄在案。

第五十九條

澳門特別行政區設立廉政公署，獨立工作。廉政專員對行政長官負責。

第六十條

澳門特別行政區設立審計署，獨立工作。審計長對行政長官負責。

第二節

行政機關

第六十一條

澳門特別行政區政府是澳門特別行政區的行政機關。

第六十二條

澳門特別行政區政府的首長是澳門特別行政區行政長官。澳門特別行政區政府設司、局、廳、處。

第六十三條

澳門特別行政區政府的主要官員由在澳門通常居住連續滿十五年的澳門特別行政區永久性居民中的中國公民擔任。

澳門特別行政區主要官員就任時應向澳門特別行政區終審法院院長申報財產，記錄在案。

第六十四條

澳門特別行政區政府行使下列職權：

（一）制定並執行政策；

（二）管理各項行政事務；

（三）辦理本法規定的中央人民政府授權的對外事務；

（四）編制並提出財政預算、決算；

（五）提出法案、議案，草擬行政法規；

（六）委派官員列席立法會會議聽取意見或代表政府發言。

第六十五條

澳門特別行政區政府必須遵守法律，對澳門特別行政區立法會負責：執行立法會通過並已生效的法律；定期向立法會作施政報告；答覆立法會議員的質詢。

第六十六條

澳門特別行政區行政機關可根據需要設立諮詢組織。

第三節

立法機關

第六十七條

澳門特別行政區立法會是澳門特別行政區的立法機關。

第六十八條

澳門特別行政區立法會議員由澳門特別行政區永久性居民擔任。

立法會多數議員由選舉產生。

立法會的產生辦法由附件二《澳門特別行政區立法會的產生辦法》規定。

立法會議員就任時應依法申報經濟狀況。

第六十九條

澳門特別行政區立法會除第一屆另有規定外，每屆任期四年。

第七十條

澳門特別行政區立法會如經行政長官依照本法規定解散，須於九十日內依照本法第六十八條的規定重新產生。

第七十一條

澳門特別行政區立法會行使下列職權：

（一）依照本法規定和法定程序制定、修改、暫停實施和廢除法律；

（二）審核、通過政府提出的財政預算案；審議政府提出的預算執行情況報告；

（三）根據政府提案決定稅收，批准由政府承擔的債務；

（四）聽取行政長官的施政報告並進行辯論；

（五）就公共利益問題進行辯論；

（六）接受澳門居民申訴並作出處理；

（七）如立法會全體議員三分之一聯合動議，指控行政長官有嚴重違法或瀆職行為而不辭職，經立法會通過決議，可委托終審法院院長負責組成獨立的調查委員會進行調查。調查委員會如認為有足夠證據構成上述指控，立法會以全體議員三分之二多數通過，可提出彈劾案，報請中央人民政府決定；

（八）在行使上述各項職權時，如有需要，可傳召和要求有關人士作證和提供證據。

第七十二條

澳門特別行政區立法會設主席、副主席各一人。主席、副主席由立法會議員互選產生。

澳門特別行政區立法會主席、副主席由在澳門通常居住連續滿十五年的澳門特別行政區永久性居民中的中國公民擔任。

第七十三條

澳門特別行政區立法會主席缺席時由副主席代理。

澳門特別行政區立法會主席或副主席出缺時，另行選舉。

第七十四條

澳門特別行政區立法會主席行使下列職權：

（一）主持會議；

（二）決定議程，應行政長官的要求將政府提出的議案優先列入議程；

（三）決定開會日期；

（四）在休會期間可召開特別會議；

（五）召開緊急會議或應行政長官的要求召開緊急會議；

（六）立法會議事規則所規定的其他職權。

第七十五條

澳門特別行政區立法會議員依照本法規定和法定程序提出議案。凡不涉及公共收支、政治體制或政府運作的議案，可由立法會議員個別或聯名提出。凡涉及政府政策的議案，在提出前必須得到行政長官的書面同意。

第七十六條

澳門特別行政區立法會議員有權依照法定程序對政府的工作提出質詢。

請查閱：《對政府工作的質詢程序》

第七十七條

澳門特別行政區立法會舉行會議的法定人數為不少於全體議員的二分之一。除本法另有規定外，立法會的法案、議案由全體議員過半數通過。

立法會議事規則由立法會自行制定，但不得與本法相抵觸。

第七十八條

澳門特別行政區立法會通過的法案，須經行政長官簽署、公佈，方能生效。

第七十九條

澳門特別行政區立法會議員在立法會會議上的發言和表決，不受法律追究。

第八十條

澳門特別行政區立法會議員非經立法會許可不受逮捕，但現行犯不在此限。

第八十一條

澳門特別行政區立法會議員如有下列情況之一，經立法會決定，即喪失其立法會議員的資格：

（一）因嚴重疾病或其他原因無力履行職務；

（二）擔任法律規定不得兼任的職務；

（三）未得到立法會主席同意，連續五次或間斷十五次缺席會議而無合理解釋；

（四）違反立法會議員誓言；

（五）在澳門特別行政區區內或區外犯有刑事罪行，被判處監禁三十日以上。

第四節

司法機關

第八十二條

澳門特別行政區法院行使審判權。

第八十三條

澳門特別行政區法院獨立進行審判，祇服從法律，不受任何干涉。

第八十四條

澳門特別行政區設立初級法院、中級法院和終審法院。

澳門特別行政區終審權屬於澳門特別行政區終審法院。

澳門特別行政區法院的組織、職權和運作由法律規定。

第八十五條

澳門特別行政區初級法院可根據需要設立若干專門法庭。

原刑事起訴法庭的制度繼續保留。

第八十六條

澳門特別行政區設立行政法院。行政法院是管轄行政訴訟和稅務訴訟的法院。不服行政法院裁決者，可向中級法院上訴。

第八十七條

澳門特別行政區各級法院的法官，根據當地法官、律師和知名人士組成的獨立委員會的推薦，由行政長官任命。法官的選用以其專業資格為標準，符合標準的外籍法官也可聘用。

法官祇有在無力履行其職責或行為與其所任職務不相稱的情況下，行政長官才可根據終審法院院長任命的不少於三名當地法官組成的審議庭的建議，予以免職。

終審法院法官的免職由行政長官根據澳門特別行政區立法會議員組成的審議委員會的建議決定。

終審法院法官的任命和免職須報全國人民代表大會常務委員會備案。

第八十八條

澳門特別行政區各級法院的院長由行政長官從法官中選任。

終審法院院長由澳門特別行政區永久性居民中的中國公民擔任。

終審法院院長的任命和免職須報全國人民代表大會常務委員會備案。

第八十九條

澳門特別行政區法官依法進行審判，不聽從任何命令或指示，但本法第十九條第三款規定的情況除外。

法官履行審判職責的行為不受法律追究。

法官在任職期間，不得兼任其他公職或任何私人職務，也不得在政治性團體中擔任任何職務。

第九十條

澳門特別行政區檢察院獨立行使法律賦予的檢察職能，不受任何干涉。

澳門特別行政區檢察長由澳門特別行政區永久性居民中的中國公民擔任，由行政長官提名，報中央人民政府任命。

檢察官經檢察長提名，由行政長官任命。

檢察院的組織、職權和運作由法律規定。

第九十一條

原在澳門實行的司法輔助人員的任免制度予以保留。

第九十二條

澳門特別行政區政府可參照原在澳門實行的辦法，作出有關當地和外來的律師在澳門特別行政區執業的規定。

第九十三條

澳門特別行政區可與全國其他地區的司法機關通過協商依法進行司法方面的聯繫和相互提供協助。

第九十四條

在中央人民政府協助和授權下，澳門特別行政區可與外國就司法互助關係作出適當安排。

第五節

市政機構

第九十五條

澳門特別行政區可設立非政權性的市政機構。市政機構受政府委托為居民提供文化、康樂、環境衛生等方面的服務，並就有關上述事務向澳門特別行政區政府提供諮詢意見。

第九十六條

市政機構的職權和組成由法律規定。

第六節

公務人員

第九十七條

澳門特別行政區的公務人員必須是澳門特別行政區永久性居民。本法第九十八條和九十九條規定的公務人員，以及澳門特別行政區聘用的某些專業技術人員和初級公務人員除外。

第九十八條

澳門特別行政區成立時，原在澳門任職的公務人員，包括警務人員和司法輔助人員，均可留用，繼續工作，其薪金、津貼、福利待遇不低於原來的標準，原來享有的年資予以保留。

依照澳門原有法律享有退休金和贍養費待遇的留用公務人員，在澳門特別行政區成立後退休的，不論其所屬國籍或居住地點，澳門特別行政區向他們或其家屬支付不低於原來標準的應得的退休金和贍養費。

第九十九條

澳門特別行政區可任用原澳門公務人員中的或持有澳門特別行政區永久性居民身份證的葡籍和其他外籍人士擔任各級公務人員，但本法另有規定者除外。

澳門特別行政區有關部門還可聘請葡籍和其他外籍人士擔任顧問和專業技術職務。

上述人員祇能以個人身份受聘，並對澳門特別行政區負責。

第一百條

公務人員應根據其本人的資格、經驗和才能予以任用和提昇。澳門原有關於公務人員的錄用、紀律、提昇和正常晉級制度基本不變，但得根據澳門社會的發展加以改進。

第七節

宣誓效忠

第一百零一條

澳門特別行政區行政長官、主要官員、行政會委員、立法會議員、法官和檢察官，必須擁護中華人民共和國澳門特別行政區基本法，盡忠職守，廉潔奉公，效忠中華人民共和國澳門特別行政區，並依法宣誓。

第一百零二條

澳門特別行政區行政長官、主要官員、立法會主席、終審法院院長、檢察長在就職時，除按本法第一百零一條的規定宣誓外，還必須宣誓效忠中華人民共和國。

第五章

經濟

第一百零三條

澳門特別行政區依法保護私人和法人財產的取得、使用、處置和繼承的權利，以及依法徵用私人和法人財產時被徵用財產的所有人得到補償的權利。

徵用財產的補償應相當於該財產當時的實際價值，可自由兌換，不得無故遲延支付。

企業所有權和外來投資均受法律保護。

第一百零四條

澳門特別行政區保持財政獨立。

澳門特別行政區財政收入全部由澳門特別行政區自行支配，不上繳中央人民政府。

中央人民政府不在澳門特別行政區徵稅。

第一百零五條

澳門特別行政區的財政預算以量入為出為原則，力求收支平衡，避免赤字，並與本地生產總值的增長率相適應。

第一百零六條

澳門特別行政區實行獨立的稅收制度。

澳門特別行政區參照原在澳門實行的低稅政策，自行立法規定稅種、稅率、稅收寬免和其他稅務事項。專營稅制由法律另作規定。

第一百零七條

澳門特別行政區的貨幣金融制度由法律規定。

澳門特別行政區政府自行制定貨幣金融政策，保障金融市場和各種金融機構的經營自由，並依法進行管理和監督。

第一百零八條

澳門元為澳門特別行政區的法定貨幣，繼續流通。

澳門貨幣發行權屬於澳門特別行政區政府。澳門貨幣的發行須有百分之百的準備金。澳門貨幣的發行制度和準備金制度，由法律規定。

澳門特別行政區政府可授權指定銀行行使或繼續行使發行澳門貨幣的代理職能。

第一百零九條

澳門特別行政區不實行外匯管制政策。澳門元自由兌換。

澳門特別行政區的外匯儲備由澳門特別行政區政府依法管理和支配。

澳門特別行政區政府保障資金的流動和進出自由。

第一百一十條

澳門特別行政區保持自由港地位，除法律另有規定外，不徵收關稅。

第一百一十一條

澳門特別行政區實行自由貿易政策，保障貨物、無形財產和資本的流動自由。

第一百一十二條

澳門特別行政區為單獨的關稅地區。

澳門特別行政區可以“中國澳門”的名義參加《關稅和貿易總協定》、關於國際紡織品貿易安排等有關國際組織和國際貿易協定，包括優惠貿易安排。

澳門特別行政區取得的和以前取得仍繼續有效的出口配額、關稅優惠和其他類似安排，全由澳門特別行政區享有。

第一百一十三條

澳門特別行政區根據當時的產地規則，可對產品簽發產地來源證。

第一百一十四條

澳門特別行政區依法保護工商企業的自由經營，自行制定工商業的發展政策。

澳門特別行政區改善經濟環境和提供法律保障，以促進工商業的發展，鼓勵投資和技術進步，並開發新產業和新市場。

第一百一十五條

澳門特別行政區根據經濟發展的情況，自行制定勞工政策，完善勞工法律。

澳門特別行政區設立由政府、僱主團體、僱員團體的代表組成的諮詢性的協調組織。

第一百一十六條

澳門特別行政區保持和完善原在澳門實行的航運經營和管理體制，自行制定航運政策。

澳門特別行政區經中央人民政府授權可進行船舶登記，並依照澳門特別行政區的法律以“中國澳門”的名義頒發有關證件。

除外國軍用船隻進入澳門特別行政區須經中央人民政府特別許可外，其他船舶可依照澳門特別行政區的法律進出其港口。

澳門特別行政區的私營的航運及與航運有關的企業和碼頭可繼續自由經營。

第一百一十七條

澳門特別行政區政府經中央人民政府具體授權可自行制定民用航空的各項管理制度。

第一百一十八條

澳門特別行政區根據本地整體利益自行制定旅游娛樂業的政策。

第一百一十九條

澳門特別行政區政府依法實行環境保護。

第一百二十條

澳門特別行政區依法承認和保護澳門特別行政區成立前已批出或決定的年期超過一九九九年十二月十九日的合法土地契約和與土地契約有關的一切權利。

澳門特別行政區成立後新批或續批土地，按照澳門特別行政區有關的土地法律及政策處理。

第六章

文化和社會事務

第一百二十一條

澳門特別行政區政府自行制定教育政策，包括教育體制和管理、教學語言、經費分配、考試制度、承認學歷和學位等政策，推動教育的發展。

澳門特別行政區政府依法推行義務教育。

社會團體和私人可依法舉辦各種教育事業。

第一百二十二條

澳門原有各類學校均可繼續開辦。澳門特別行政區各類學校均有辦學的自主性，依法享有教學自由和學術自由。

各類學校可以繼續從澳門特別行政區以外招聘教職員和選用教材。學生享有選擇院校和在澳門特別行政區以外求學的自由。

第一百二十三條

澳門特別行政區政府自行制定促進醫療衛生服務和發展中西醫藥的政策。社會團體和私人可依法提供各種醫療衛生服務。

第一百二十四條

澳門特別行政區政府自行制定科學技術政策，依法保護科學技術的研究成果、專利和發明創造。

澳門特別行政區政府自行確定適用於澳門的各類科學技術標準和規格。

第一百二十五條

澳門特別行政區政府自行制定文化政策，包括文學藝術、廣播、電影、電視等政策。

澳門特別行政區政府依法保護作者的文學藝術及其他的創作成果和合法權益。

澳門特別行政區政府依法保護名勝、古蹟和其他歷史文物，並保護文物所有者的合法權益。

第一百二十六條

澳門特別行政區政府自行制定新聞、出版政策。

第一百二十七條

澳門特別行政區政府自行制定體育政策。民間體育團體可依法繼續存在和發展。

第一百二十八條

澳門特別行政區政府根據宗教信仰自由的原則，不干預宗教組織的內部事務，不干預宗教組織和教徒同澳門以外地區的宗教組織和教徒保持及發展關係，不限制與澳門特別行政區法律沒有抵觸的宗教活動。

宗教組織可依法開辦宗教院校和其他學校、醫院和福利機構以及提供其他社會服務。宗教組織開辦的學校可以繼續提供宗教教育，包括開設宗教課程。

宗教組織依法享有財產的取得、使用、處置、繼承以及接受捐獻的權利。宗教組織在財產方面的原有權益依法受到保護。

第一百二十九條

澳門特別行政區政府自行確定專業制度，根據公平合理的原則，制定有關評審和頒授各種專業和執業資格的辦法。

在澳門特別行政區成立以前已經取得專業資格和執業資格者，根據澳門特別行政區的有關規定可保留原有的資格。

澳門特別行政區政府根據有關規定承認在澳門特別行政區成立以前已被承認的專業和專業團體，並可根據社會發展需要，經諮詢有關方面的意見，承認新的專業和專業團體。

第一百三十條

澳門特別行政區政府在原有社會福利制度的基礎上，根據經濟條件和社會需要自行制定有關社會福利的發展和改進的政策。

第一百三十一條

澳門特別行政區的社會服務團體，在不抵觸法律的情況下，可以自行決定其服務方式。

第一百三十二條

澳門特別行政區政府根據需要和可能逐步改善原在澳門實行的對教育、科學、技術、文化、體育、康樂、醫療衛生、社會福利、社會工作等方面的民間組織的資助政策。

第一百三十三條

澳門特別行政區的教育、科學、技術、文化、新聞、出版、體育、康樂、專業、醫療衛生、勞工、婦女、青年、歸僑、社會福利、社會工作等方面的民間團體和宗教組織同全國其他地區相應的團體和組織的關係，以互不隸屬、互不干涉、互相尊重的原則為基礎。

第一百三十四條

澳門特別行政區的教育、科學、技術、文化、新聞、出版、體育、康樂、專業、醫療衛生、勞工、婦女、青年、歸僑、社會福利、社會工作等方面的民間團體和宗教組織可同世界各國、各地區及國際的有關團體和組織保持和發展關係，各該團體和組織可根據需要冠用“中國澳門”的名義，參與有關活動。

第七章

對外事務

第一百三十五條

澳門特別行政區政府的代表，可作為中華人民共和國政府代表團的成員，參加由中央人民政府進行的同澳門特別行政區直接有關的外交談判。

第一百三十六條

澳門特別行政區可在經濟、貿易、金融、航運、通訊、旅游、文化、科技、體育等適當領域以“中國澳門”的名義，單獨地同世界各國、各地區及有關國際組織保持和發展關係，簽訂和履行有關協議。

第一百三十七條

對以國家為單位參加的、同澳門特別行政區有關的、適當領域的國際組織和國際會議，澳門特別行政區政府可派遣代表作為中華人民共和國代表團的成員或以中央人民政府和上述有關國際組織或國際會議允許的身份參加，並以“中國澳門”的名義發表意見。

澳門特別行政區可以“中國澳門”的名義參加不以國家為單位參加的國際組織和國際會議。

對中華人民共和國已參加而澳門也以某種形式參加的國際組織，中央人民政府將根據情況和澳門特別行政區的需要採取措施，使澳門特別行政區以適當形式繼續保持在這些組織中的地位。

對中華人民共和國尚未參加而澳門已以某種形式參加的國際組織，中央人民政府將根據情況和需要使澳門特別行政區以適當形式繼續參加這些組織。

第一百三十八條

中華人民共和國締結的國際協議，中央人民政府可根據情況和澳門特別行政區的需要，在徵詢澳門特別行政區政府的意見後，決定是否適用於澳門特別行政區。

中華人民共和國尚未參加但已適用於澳門的國際協議仍可繼續適用。中央人民政府根據情況和需要授權或協助澳門特別行政區政府作出適當安排，使其他與其有關的國際協議適用於澳門特別行政區。

第一百三十九條

中央人民政府授權澳門特別行政區政府依照法律給持有澳門特別行政區永久性居民身份證的中國公民簽發中華人民共和國澳門特別行政區護照，給在澳門特別行政區的其他合法居留者簽發中華人民共和國澳門特別行政區的其他旅行證件。上述護照和旅行證件，前往各國和各地區有效，並載明持有人有返回澳門特別行政區的權利。

對世界各國或各地區的人入境、逗留和離境，澳門特別行政區政府可實行出入境管制。

第一百四十條

中央人民政府協助或授權澳門特別行政區政府同有關國家和地區談判和簽訂互免簽證協議。

第一百四十一條

澳門特別行政區可根據需要在外國設立官方或半官方的經濟和貿易機構，報中央人民政府備案。

第一百四十二條

外國在澳門特別行政區設立領事機構或其他官方、半官方機構，須經中央人民政府批准。

已同中華人民共和國建立正式外交關係的國家在澳門設立的領事機構和其他官方機構，可予保留。

尚未同中華人民共和國建立正式外交關係的國家在澳門設立的領事機構和其他官方機構，可根據情況予以保留或改為半官方機構。

尚未為中華人民共和國承認的國家，祇能在澳門特別行政區設立民間機構。

第八章

本法的解釋和修改

第一百四十三條

本法的解釋權屬於全國人民代表大會常務委員會。

全國人民代表大會常務委員會授權澳門特別行政區法院在審理案件時對本法關於澳門特別行政區自治範圍內的條款自行解釋。

澳門特別行政區法院在審理案件時對本法的其他條款也可解釋。但如澳門特別行政區法院在審理案件時需要對本法關於中央人民政府管理的事務或中央和澳門特別行政區關係的條款進行解釋，而該條款的解釋又影響到案件的判決，在對該案件作出不可上訴的終局判決前，應由澳門特別行政區終審法院提請全國人民代表大會常務委員會對有關條款作出解釋。如全國人民代表大會常務委員會作出解釋，澳門特別行政區法院在引用該條款時，應以全國人民代表大會常務委員會的解釋為準。但在此以前作出的判決不受影響。

全國人民代表大會常務委員會在對本法進行解釋前，徵詢其所屬的澳門特別行政區基本法委員會的意見。

第一百四十四條

本法的修改權屬於全國人民代表大會。

本法的修改提案權屬於全國人民代表大會常務委員會、國務院和澳門特別行政區。澳門特別行政區的修改議案，須經澳門特別行政區的全國人民代表大會代表三分之二多數、澳門特別行政區立法會全體議員三分之二多數和澳門特別行政區行政長官同意後，交由澳門特別行政區出席全國人民代表大會的代表團向全國人民代表大會提出。

本法的修改議案在列入全國人民代表大會的議程前、先由澳門特別行政區基本法委員會研究並提出意見。

本法的任何修改，均不得同中華人民共和國對澳門既定的基本方針政策相抵觸。

第九章

附　則

第一百四十五條

澳門特別行政區成立時，澳門原有法律除由全國人民代表大會常務委員會宣佈為同本法抵觸者外，採用為澳門特別行政區法律，如以後發現有的法律與本法抵觸，可依照本法規定和法定程序修改或停止生效。

根據澳門原有法律取得效力的文件、證件、契約及其所包含的權利和義務，在不抵觸本法的前提下繼續有效，受澳門特別行政區的承認和保護。

原澳門政府所簽訂的有效期超過一九九九年十二月十九日的契約，除中央人民政府授權的機構已公開宣佈為不符合中葡聯合聲明關於過渡時期安排的規定，須經澳門特別行政區政府重新審查者外，繼續有效。

附件一

澳門特別行政區行政長官的產生辦法

一、行政長官由一個具有廣泛代表性的選舉委員會依照本法選出，由中央人民政府任命。

二、選舉委員會委員共300人，由下列各界人士組成：

工商、金融界	100人
文化、教育、專業等界	80人
勞工、社會服務、宗教等界	80人
立法會議員的代表、市政機構成員的代表、澳門地區全國人大代表、澳門地區全國政協委員的代表	40人

選舉委員會每屆任期五年。

三、各個界別的劃分，以及每個界別中何種組織可以產生選舉委員會委員的名額，由澳門特別行政區根據民主、開放的原則制定選舉法加以規定。

各界別法定團體根據選舉法規定的分配名額和選舉辦法自行選出選舉委員會委員。

選舉委員會委員以個人身份投票。

四、不少於50名的選舉委員會委員可聯合提名行政長官候選人。每名委員衹可提出一名候選人。

五、選舉委員會根據提名的名單，經一人一票無記名投票選出行政長官候任人。具體選舉辦法由選舉法規定。

六、第一任行政長官按照《全國人民代表大會關於澳門特別行政區第一屆政府、立法會和司法機關產生辦法的決定》產生。

七、二零零九年及以後行政長官的產生辦法如需修改，須經立法會全體議員三分之二多數通過，行政長官同意，並報全國人民代表大會常務委員會批准。

———

中華人民共和國澳門特別行政區基本法附件一澳門特別行政區行政長官的產生辦法修正案*

（2012年6月30日第十一屆全國人民代表大會常務委員會第二十七次會議批准）

一、2014年選舉第四任行政長官人選的選舉委員會共400人，由下列各界人士組成：

工商、金融界	120人
文化、教育、專業等界	115人
勞工、社會服務、宗教等界	115人
立法會議員的代表、市政機構成員的代表、澳門地區全國人大代表、澳門地區全國政協委員的代表	50人

選舉委員會每屆任期五年。

二、不少於66名的選舉委員會委員可聯合提名行政長官候選人。每名委員只可提出一名候選人。

三、第五任及以後各任行政長官產生辦法，在依照法定程序作出進一步修改前，按本修正案的規定執行。

*** 請查閱：**

- **第21/2012號行政長官公告** - 命令公佈“全國人民代表大會常務委員會關於《中華人民共和國澳門特別行政區基本法》附件一第七條和附件二第三條的解釋”。
- **第22/2012號行政長官公告** - 命令公佈《全國人民代表大會常務委員會關於澳門特別行政區2013年立法會產生辦法和2014年行政長官產生辦法有關問題的決定》。
- **第39/2012號行政長官公告** - 命令公佈全國人民代表大會常務委員會關於批准《中華人民共和國澳門特別行政區基本法附件一澳門特別行政區行政長官的產生辦法修正案》的決定，及中華人民共和國澳門特別行政區基本法附件一澳門特別行政區行政長官的產生辦法修正案。
- **第1/2012號決議** - 通過《中華人民共和國澳門特別行政區基本法附件一澳門特別行政區行政長官的產生辦法修正案（草案）》。

附件二

澳門特別行政區立法會的產生辦法

一、澳門特別行政區第一屆立法會按照《全國人民代表大會關於澳門特別行政區第一屆政府、立法會和司法機關產生辦法的決定》產生。

第二屆立法會由27人組成，其中：

直接選舉的議員	10人
間接選舉的議員	10人
委任的議員	7人

第三屆及以後各屆立法會由29人組成，其中：

直接選舉的議員	12人
間接選舉的議員	10人
委任的議員	7人

二、議員的具體選舉辦法，由澳門特別行政區政府提出並經立法會通過的選舉法加以規定。

三、二零零九年及以後澳門特別行政區立法會的產生辦法如需修改，須經立法會全體議員三分之二多數通過，行政長官同意，並報全國人民代表大會常務委員會備案。

———

中華人民共和國澳門特別行政區基本法附件二澳門特別行政區立法會的產生辦法修正案*

（2012年6月30日第十一屆全國人民代表大會常務委員會第二十七次會議予以備案）

一、2013年第五屆立法會由33人組成，其中：

直接選舉的議員	14人
間接選舉的議員	12人
委任的議員	7人

二、第六屆及以後各屆立法會的產生辦法，在依照法定程序作出進一步修改前，按本修正案的規定執行。

* 請查閱：

- **第21/2012**號行政長官公告 - 命令公佈"全國人民代表大會常務委員會關於《中華人民共和國澳門特別行政區基本法》附件一第七條和附件二第三條的解釋"。
- **第22/2012**號行政長官公告 - 命令公佈《全國人民代表大會常務委員會關於澳門特別行政區2013年立法會產生辦法和2014年行政長官產生辦法有關問題的決定》。
- **第40/2012**號行政長官公告 - 命令公佈全國人民代表大會常務委員會公告，及中華人民共和國澳門特別行政區基本法附件二澳門特別行政區立法會的產生辦法修正案。
- **第2/2012**號決議 - 通過《中華人民共和國澳門特別行政區基本法附件二澳門特別行政區立法會的產生辦法修正案（草案）》。

附件三

在澳門特別行政區實施的全國性法律

下列全國性法律，自一九九九年十二月二十日起由澳門特別行政區在當地公佈或立法實施。

一、《關於中華人民共和國國都、紀年、國歌、國旗的決議》；

二、《關於中華人民共和國國慶日的決議》；

三、《中華人民共和國國籍法》；

四、《中華人民共和國外交特權與豁免條例》；

五、《中華人民共和國領事特權與豁免條例》；

六、《中華人民共和國國旗法》；

七、《中華人民共和國國徽法》；

八、《中華人民共和國領海及毗連區法》；

九、《中華人民共和國專屬經濟區和大陸架法》；

十、《中華人民共和國澳門特別行政區駐軍法》；

十一、《中華人民共和國外國中央銀行財產司法強制措施豁免法》。*

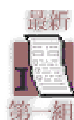
* 已更改 - 請查閱：**第10/2006**號行政長官公告

中華人民共和國澳門特別行政區區旗圖案

中華人民共和國澳門特別行政區區徽圖案

第5/1999號行政長官公告

[葡文版本]



印務局
澳門官印局街
電話:(853) 2857 3822 - 圖文傳真:(853) 2859 6802
電子郵件:info@io.gov.mo

© 1996- 2014 - 印務局-更新資料日期： 3/13/2014 - a.u.

Basic Law of Macao Special Administrative Region (MCSAR) of the People's Republic of China

Part of Preamble

…Upholding national unity and territorial integrity, contributing to social stability and economic development, and taking account of its history and realities, the People's Republic of China has decided that upon China's resumption of the exercise of sovereignty over Macau, a Macau Special Administrative Region will be established in accordance with the provisions of Article 31 of the Constitution of the People's Republic of China, and that under the principle of "one country, two systems", the socialist system and policies will not be practiced in Macau….

Article 138

The Central People's Government may, in accordance with the circumstance and needs of the MCSAR, and after consultation with the government of the MCSAR, decide on whether or not an international agreement(s) entered into by the People's Republic of China applies to the MCSAR.

International agreements to which the People's Republic of China is not a party but which are implemented in Macao may continue to be implemented in the MCSAR. The Central People's Government shall, based on the circumstance, authorize or assist the government of the MCSAR to make appropriate arrangements for the application to the MCSAR of other international agreements relevant to the MCSAR.

Article 143

The power of interpretation of this Law shall be vested in the Standing Committee of the National People's Congress.

The Standing Committee of the National People's Congress shall authorize the courts of the MCSAR to interpret on their own, when adjudicating cases,

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

the provisions of this Law which are within the limits of the autonomy of the MCSAR.

The courts of the MCSAR may also interpret other provisions of this Law when adjudicating cases. However, if the courts of the MCSAR, when adjudicating cases, need to interpret the provisions of this Law concerning affairs which are the responsibility of the Central People's Government, or concerning the relationship between the Central Authorities and the MCSAR, and if such interpretation will affect the judgments in the cases, the courts of the MCSAR shall, before making their final judgments which are not appealable, seek an interpretation of the relevant provisions from the Standing Committee of the National People's Congress through the Court of Final Appeal of the MCSAR. When the Standing Committee makes an interpretation of the provisions concerned, the courts of the MCSAR, in applying those provisions, shall follow the interpretation of the Standing Committee. However, judgments previously rendered shall not be affected.

The Standing Committee of the National People's Congress shall consult its Committee for the Basic Law of the MCSAR before giving an interpretation of this Law.

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

ANNEX 7

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
UNCTAD

WORLD INVESTMENT REPORT 2013

GLOBAL VALUE CHAINS: INVESTMENT AND TRADE FOR DEVELOPMENT

UNITED NATIONS
New York and Geneva, 2013

NOTE

The Division on Investment and Enterprise of UNCTAD is a global centre of excellence, dealing with issues related to investment and enterprise development in the United Nations System. It builds on four decades of experience and international expertise in research and policy analysis, intergovernmental consensus-building, and provides technical assistance to over 150 countries.

The terms country/economy as used in this *Report* also refer, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgment about the stage of development reached by a particular country or area in the development process. The major country groupings used in this *Report* follow the classification of the United Nations Statistical Office. These are:

Developed countries: the member countries of the OECD (other than Chile, Mexico, the Republic of Korea and Turkey), plus the new European Union member countries which are not OECD members (Bulgaria, Cyprus, Latvia, Lithuania, Malta and Romania), plus Andorra, Bermuda, Liechtenstein, Monaco and San Marino.

Transition economies: South-East Europe, the Commonwealth of Independent States and Georgia.

Developing economies: in general all economies not specified above. For statistical purposes, the data for China do not include those for Hong Kong Special Administrative Region (Hong Kong SAR), Macao Special Administrative Region (Macao SAR) and Taiwan Province of China.

Reference to companies and their activities should not be construed as an endorsement by UNCTAD of those companies or their activities.

The boundaries and names shown and designations used on the maps presented in this publication do not imply official endorsement or acceptance by the United Nations.

The following symbols have been used in the tables:

- Two dots (..) indicate that data are not available or are not separately reported. Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;
- A dash (–) indicates that the item is equal to zero or its value is negligible;
- A blank in a table indicates that the item is not applicable, unless otherwise indicated;
- A slash (/) between dates representing years, e.g., 1994/95, indicates a financial year;
- Use of a dash (–) between dates representing years, e.g., 1994–1995, signifies the full period involved, including the beginning and end years;
- Reference to “dollars” ($) means United States dollars, unless otherwise indicated;
- Annual rates of growth or change, unless otherwise stated, refer to annual compound rates;

Details and percentages in tables do not necessarily add to totals because of rounding.

The material contained in this study may be freely quoted with appropriate acknowledgement.

UNITED NATIONS PUBLICATION
Sales No. E.13.II.D.5
ISBN 978-92-1-112868-0
eISBN 978-92-1-056212-6
Copyright © United Nations, 2013
All rights reserved
Printed in Switzerland

PREFACE

The 2013 *World Investment Report* comes at an important moment. The international community is making a final push to achieve the Millennium Development Goals by the target date of 2015. At the same time, the United Nations is working to forge a vision for the post-2015 development agenda. Credible and objective information on foreign direct investment (FDI) can contribute to success in these twin endeavours.

Global FDI declined in 2012, mainly due to continued macroeconomic fragility and policy uncertainty for investors, and it is forecast to rise only moderately over the next two years.

Yet as this report reveals, the global picture masks a number of major dynamic developments. In 2012 – for the first time ever – developing economies absorbed more FDI than developed countries, with four developing economies ranked among the five largest recipients in the world. Developing countries also generated almost one third of global FDI outflows, continuing an upward trend that looks set to continue.

This year's *World Investment Report* provides an in-depth analysis, strategic development options and practical advice for policymakers and others on how to maximize the benefits and minimize the risks associated with global value chains. This is essential to ensure more inclusive growth and sustainable development.

I commend the *World Investment Report 2013* to the international investment and development community as a source of reflection and inspiration for meeting today's development challenges.

BAN Ki-moon
Secretary-General of the United Nations

ACKNOWLEDGEMENTS

The *World Investment Report 2013* (*WIR13*) was prepared by a team led by James Zhan. The team members included Richard Bolwijn, Bruno Casella, Joseph Clements, Hamed El Kady, Kumi Endo, Masataka Fujita, Noelia Garcia Nebra, Thomas van Giffen, Axèle Giroud, Ariel Ivanier, Joachim Karl, Guoyong Liang, Anthony Miller, Hafiz Mirza, Nicole Moussa, Shin Ohinata, Davide Rigo, Sergey Ripinsky, William Speller, Astrit Sulstarova, Claudia Trentini, Elisabeth Tuerk, Jörg Weber and Kee Hwee Wee.

WIR13 benefited from the advice of Carlo Altomonte, Richard Baldwin, Carlos Braga, Peter Buckley, Lorraine Eden, Gary Gereffi, John Humphrey, Bart Los and Pierre Sauvé.

Research and statistical assistance was provided by Bradley Boicourt and Lizanne Martinez. Contributions were also made by Wolfgang Alschner, Amare Bekele, Hector Dip, Ventzislav Kotetzov, Mathabo Le Roux, Kendra Magraw, Abraham Negash, Naomi Rosenthal, Diana Rosert, John Sasuya, Teerawat Wongkaew and Youngjun Yoo, as well as interns Alexandre Genest, Jessica Mullins and Thomas Turner.

The manuscript was copy-edited by Lise Lingo and typeset by Laurence Duchemin and Teresita Ventura. Sophie Combette designed the cover.

Production and dissemination of WIR13 was supported by Elisabeth Anodeau-Mareschal, Evelyn Benitez, Nathalie Eulaerts, Severine Excoffier, Rosalina Goyena, Natalia Meramo-Bachayani and Katia Vieu.

At various stages of preparation, in particular during the review meetings organized to discuss drafts of *WIR13*, the team benefited from comments and inputs received from external experts: Rolf Adlung, Michael Bratt, Tomer Broude, Jeremy Clegg, Lorenzo Cotula, Michael Ewing-Chow, Masuma Farooki, Karina Fernandez-Stark, Stephen Gelb, Stine Haakonsson, Inge Ivarsson, Keiichiro Kanemoto, Lise Johnson, Raphie Kaplinsky, Nagesh Kumar, Sarianna Lundan, Bo Meng, Daniel Moran, Michael Mortimore, Ram Mudambi, Rajneesh Narula, Lizbeth Navas-Aleman, Christos Pitelis, William Powers, Zhengzheng Qu, Alexander Raabe, Rajah Rasiah, Arianna Rossi, Armando Rungi, Emily Sims, Gabriele Suder, Tim Sturgeon, Fan Wenjie, Deborah Winkler and Robert Yuskavage. Comments and inputs were also received from many UNCTAD colleagues, including Alfredo Calcagno, Torbjorn Fredriksson, Marco Fugazza, Ebru Gokce, Kalman Kalotay, Joerg Mayer, Alessandro Nicita, Victor Ognivtsev, Celia Ortega Sotes, Yongfu Ouyang, Ralf Peters, Miho Shirotori, Guillermo Valles and Paul Wessendorp.

UNCTAD wishes to thank the Eora project team members for their kind collaboration.

Numerous officials of central banks, government agencies, international organizations and non-governmental organizations also contributed to *WIR13*. The financial support of the Governments of Finland, Norway and Sweden is gratefully acknowledged.

TABLE OF CONTENTS

PREFACE iii

ACKNOWLEDGEMENTS iv

ABBREVIATIONS viii

KEY MESSAGES ix

OVERVIEW xi

CHAPTER I. GLOBAL INVESTMENT TRENDS 1

A. GLOBAL TRENDS: THE FDI RECOVERY FALTERS 2

1. Current trends 2
   a. FDI by geographical distribution 2
   b. FDI by mode and sector/industry 7
   c. FDI by selected types of investors 10
   d. FDI and offshore finance 15
2. Global FDI prospects in 2013–2015 18
   a. General FDI prospects 18
   b. FDI prospects by sector/industry 20
   c. FDI prospects by home region 21
   d. FDI prospects by host region 22

B. INTERNATIONAL PRODUCTION 23

1. Overall trends 23
2. Repositioning: the strategic divestment, relocation and reshoring of foreign operations 26

C. FDI INCOME AND RATES OF RETURN 31

1. Trends in FDI income 32
   a. General trends 32
   b. Rates of return 32
   c. Reinvested earnings versus repatriated earnings 33
2. Impacts of FDI income on the balance of payments of host countries 34
3. Policy implications 36

CHAPTER II. REGIONAL TRENDS IN FDI 37

INTRODUCTION 38

A. REGIONAL TRENDS 39

1. Africa 39
2. East and South-East Asia 44

3. South Asia 49
4. West Asia 53
5. Latin America and the Caribbean 57
6. Transition economies 63
7. Developed countries 67

B. TRENDS IN STRUCTURALLY WEAK, VULNERABLE AND SMALL ECONOMIES 73

1. Least developed countries 73
2. Landlocked developing countries 78
3. Small island developing States 84

CHAPTER III. RECENT POLICY DEVELOPMENTS 91

A. NATIONAL INVESTMENT POLICIES 92

1. Overall trends 92
2. Industry-specific investment policies 94
   a. Services sector 94
   b. Strategic industries 95
3. Screening of cross-border M&As 96
4. Risk of investment protectionism 100

B. INTERNATIONAL INVESTMENT POLICIES 101

1. Ttrends in the conclusion of IIAs 101
   a. Continued decline in treaty-making 101
   b. Factoring in sustainable development 102
2. Trends in the negotiation of IIAs 103
   a. Regionalism on the rise 103
   b. Systemic issues arising from regionalism 105
3. IIA regime in transition 107
   a. Options to improve the IIA regime 107
   b. Treaty expirations 108
4. Investor–State arbitration: options for reform 110
   a. ISDS cases continue to grow 110
   b. Mapping five paths for reform 111

CHAPTER IV. GLOBAL VALUE CHAINS: INVESTMENT AND TRADE FOR DEVELOPMENT 121

INTRODUCTION 122

A. GVCS AND PATTERNS OF VALUE ADDED TRADE AND INVESTMENT 123

1. Value added trade patterns in the global economy 123
2. Value added trade patterns in the developing world 133

3. FDI and the role of TNCs in shaping GVCs 134

B. GVC GOVERNANCE AND LOCATIONAL DETERMINANTS 140

1. GVC governance: the orchestration of fragmented and internationally dispersed operations 141
2. Locational determinants of GVC activities 144

C. DEVELOPMENT IMPLICATIONS OF GVCS 148

1. Local value capture 148
   a. GVC contribution to GDP and growth 151
   b. Domestic value added in trade and business linkages 152
   c. Foreign affiliates and value added retention for the local economy 154
   d GVCs and transfer pricing 155
2. Job creation, income generation and employment quality 156
   a. GVC participation, job creation and income generation 156
   b. GVCs and the quality of employment 157
3. Technology dissemination and skills building 159
   a. Technology dissemination and learning under different GVC governance structures 159
   b. Learning in GVCs: challenges and pitfalls 161
4. Social and environmental impacts 161
   a. CSR challenges in GVCs 162
   b Offshoring emissions: GVCs as a transfer mechanism of environmental impact 164
5. Upgrading and industrial development 164
   a. Upgrading dynamically at the firm level 165
   b. Upgrading at the country level and GVC development paths 169

D. POLICY IMPLICATIONS OF GVCS 175

1. Embedding GVCs in development strategy 177
2. Enabling participation in GVCs 180
3. Building domestic productive capacity 183
4. Providing a strong environmental, social and governance framework 185
   a. Social, environmental and safety and health issues 185
   b Transforming EPZs into centres of excellence for sustainable business 186
   c Other concerns and good governance issues in GVCs 189
5. Synergizing trade and investment policies and institutions 190
   a. Ensuring coherence between trade and investment policies 190
   b Synergizing trade and investment promotion and facilitation 193
   c Regional Industrial Development Compacts 195

CONCLUDING REMARKS: GVC POLICY DEVELOPMENT – TOWARDS A SOUND STRATEGIC FRAMEWORK 196

REFERENCES 203

ANNEX TABLES 211

ABBREVIATIONS

ADR	alternative dispute resolution
AGOA	African Growth and Opportunity Act
APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BIT	bilateral investment treaty
CETA	Comprehensive Economic and Trade Agreement
CIS	Commonwealth of Independent States
COMESA	Common Market for Eastern and Southern Africa
CSR	corporate social responsibility
DCFTA	Deep and Comprehensive Free Trade Agreement
DPP	dispute prevention policy
EPZ	export processing zone
FDI	foreign direct investment
FTA	free trade agreement
GAP	good agricultural practices
GATS	General Agreement on Trade in Services
GCC	Gulf Cooperation Council
GSP	Generalized System of Preferences
GVC	global value chain
IIA	international investment agreement
IP	intellectual property
IPA	investment promotion agency
IPFSD	Investment Policy Framework for Sustainable Development
IRS	United States Internal Revenue Service
ISDS	investor–State dispute settlement
ISO	International Organization for Standardization
LBO	leveraged buy-out
LDC	least developed countries
LLDC	landlocked developing countries
MFN	most favoured nation
MRIO	multi-region input-output
NAFTA	North American Free Trade Agreement
NAICS	North American Industry Classification System
NEM	non-equity mode
OFC	offshore financial centre
PPP	public-private partnership
PRAI	Principles for Responsible Agricultural Investment
PTA	preferential trade agreement
SEZ	special economic zone
SIC	standard industrial classification
SIDS	small island developing States
SME	small and medium-sized enterprise
SOE	State-owned enterprise
SPE	special purpose entity
SWF	sovereign wealth fund
TNC	transnational corporation
TPO	trade promotion organization
TPP	Trans-Pacific Partnership Agreement
TRIMS	Trade-Related Investment Measures
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
WIPS	World Investment Prospects Survey
WTO	World Trade Organization

KEY MESSAGES

Global and regional investment trends

The road to foreign direct investment (FDI) recovery is bumpy. Global FDI fell by 18 per cent to $1.35 trillion in 2012. The recovery will take longer than expected, mostly because of global economic fragility and policy uncertainty. UNCTAD forecasts FDI in 2013 to remain close to the 2012 level, with an upper range of $1.45 trillion. As investors regain confidence in the medium term, flows are expected to reach levels of $1.6 trillion in 2014 and $1.8 trillion in 2015. However, significant risks to this growth scenario remain.

Developing countries take the lead. In 2012 – for the first time ever – developing economies absorbed more FDI than developed countries, accounting for 52 per cent of global FDI flows. This is partly because the biggest fall in FDI inflows occurred in developed countries, which now account for only 42 per cent of global flows. Developing economies also generated almost one third of global FDI outflows, continuing a steady upward trend.

FDI outflows from developed countries dropped to a level close to the trough of 2009. The uncertain economic outlook led transnational corporations (TNCs) in developed countries to maintain their wait-and-see approach towards new investments or to divest foreign assets, rather than undertake major international expansion. In 2012, 22 of the 38 developed countries experienced a decline in outward FDI, leading to a 23 per cent overall decline.

Investments through offshore financial centres (OFCs) and special purpose entities (SPEs) remain a concern. Financial flows to OFCs are still close to their peak level of 2007. Although most international efforts to combat tax evasion have focused on OFCs, financial flows through SPEs were almost seven times more important in 2011. The number of countries offering favourable tax conditions for SPEs is also increasing.

Reinvested earnings can be an important source of finance for long-term investment. FDI income amounted to $1.5 trillion in 2011 on a stock of $21 trillion. The rates of return on FDI are 7 per cent globally, and higher in both developing (8 per cent) and transition economies (13 per cent) than in developed ones (5 per cent). Nearly one third of global FDI income was retained in host economies, and two thirds were repatriated (representing on average 3.4 per cent of the current account payments). The share of retained earnings is highest in developing countries; at about 40 per cent of FDI income it represents an important source of financing.

FDI flows to developing regions witnessed a small overall decline in 2012, but there were some bright spots. *Africa* bucked the trend with a 5 per cent increase in FDI inflows to $50 billion. This growth was driven partly by FDI in extractive industries, but investment in consumer-oriented manufacturing and service industries is also expanding. FDI flows to *developing Asia* fell 7 per cent, to $407 billion, but remained at a high level. Driven by continued intraregional restructuring, lower-income countries such as Cambodia, Myanmar and Viet Nam are bright spots for labour-intensive FDI. In *Latin America and the Caribbean*, FDI inflows decreased 2 per cent to $244 billion due to a decline in Central America and the Caribbean. This decline was masked by an increase of 12 per cent in South America, where FDI inflows were a mix of natural-resource-seeking and market-seeking activity.

FDI is on the rise in structurally weak economies. FDI inflows to *least developed countries* (LDCs) hit a record high, an increase led by developing-country TNCs, especially from India. A modest increase in FDI flows to *landlocked developing countries* (LLDCs) occurred, thanks to rising flows to African and Latin American LLDCs and several economies in Central Asia. FDI flows into *small island developing State*s (SIDS) continued to recover for the second consecutive year, driven by investments in natural-resource-rich countries.

FDI flows to developed economies plummeted. In developed countries, FDI inflows fell drastically, by 32 per cent, to $561 billion – a level last seen almost 10 years ago. The majority of developed countries saw

significant drops of FDI inflows, in particular the European Union, which alone accounted for two thirds of the global FDI decline.

Transition economies saw a relatively small decline. A slump in cross-border mergers and acquisitions (M&As) sales caused inward FDI flows to *transition economies* to fall by 9 per cent to $87 billion; $51 billion of this went to the Russian Federation, but a large part of it was "round-tripping".

Investment policy trends

National investment policymaking is increasingly geared towards new development strategies. Most governments are keen to attract and facilitate foreign investment as a means for productive capacity-building and sustainable development. At the same time, numerous countries are reinforcing the regulatory environment for foreign investment, making more use of industrial policies in strategic sectors, tightening screening and monitoring procedures, and closely scrutinizing cross-border M&As. There is an ongoing risk that some of these measures are undertaken for protectionist purposes.

International investment policymaking is in transition. By the end of 2012, the regime of international investment agreements (IIAs) consisted of 3,196 treaties. Today, countries increasingly favour a regional over a bilateral approach to IIA rule making and take into account sustainable development elements. More than 1,300 of today's 2,857 bilateral investment treaties (BITs) will have reached their "anytime termination phase" by the end of 2013, opening a window of opportunity to address inconsistencies and overlaps in the multi-faceted and multi-layered IIA regime, and to strengthen its development dimension.

UNCTAD proposes five broad paths for reforming international investment arbitration. This responds to the debate about the pros and cons of the investment arbitration regime, spurred by an increasing number of cases and persistent concerns about the regime's systemic deficiencies. The five options for reform are: promoting alternative dispute resolution, modifying the existing ISDS system through individual IIAs, limiting investors' access to ISDS, introducing an appeals facility and creating a standing international investment court. Collective efforts at the multilateral level can help develop a consensus on the preferred course of action.

Global value chains: investment and trade for development

Today's global economy is characterized by global value chains (GVCs), in which intermediate goods and services are traded in fragmented and internationally dispersed production processes. GVCs are typically coordinated by TNCs, with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers. TNC-coordinated GVCs account for some 80 per cent of global trade.

GVCs lead to a significant amount of double counting in trade – about 28 per cent or $5 trillion of the $19 trillion in global gross exports in 2010 – because intermediates are counted several times in world exports, but should be counted only once as "value added in trade". Patterns of value added trade in GVCs determine the distribution of actual economic gains from trade between individual economies and are shaped to a significant extent by the investment decisions of TNCs. Countries with a greater presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs and to generate relatively more domestic value added from trade.

The development contribution of GVCs can be significant. In developing countries, value added trade contributes nearly 30 per cent to countries' GDP on average, as compared with 18 per cent in developed countries. And there is a positive correlation between participation in GVCs and growth rates of GDP per capita. GVCs have a direct economic impact on value added, jobs and income. They can also be an important avenue for developing countries to build productive capacity, including through technology dissemination and skill building, thus opening up opportunities for longer-term industrial upgrading.

However, participation in GVCs also involves risks. The GDP contribution of GVCs can be limited if countries capture only a small share of the value added created in the chain. Also, technology dissemination, skill building and upgrading are not automatic. Developing countries face the risk of remaining locked into relatively low value added activities. In addition, environmental impacts and social effects, including on working conditions, occupational safety and health, and job security, can be negative. The potential "footlooseness" of GVC activities and increased vulnerability to external shocks pose further risks.

Countries need to make a strategic choice to promote or not to promote participation in GVCs. They need to carefully weigh the pros and cons of GVC participation and the costs and benefits of proactive policies to promote GVCs or GVC-led development strategies, in line with their specific situation and factor endowments. Some countries may decide not to promote it; others may not have a choice. In reality, most are already involved in GVCs to a degree. Promoting GVC participation implies targeting specific GVC segments; i.e. GVC promotion can be selective. Moreover, GVC participation is only one aspect of a country's overall development strategy.

Policy matters to make GVCs work for development. If countries decide to actively promote GVC participation, policymakers should first determine where their countries' trade profiles and industrial capabilities stand and then evaluate realistic GVC development paths for strategic positioning. Gaining access to GVCs and realizing upgrading opportunities requires a structured approach that includes embedding GVCs in industrial development policies (e.g. targeting GVC tasks and activities); enabling GVC growth by creating a conducive environment for trade and investment and by putting in place infrastructural prerequisites; and building productive capacities in local firms and skills in the local workforce. To mitigate the risks involved in GVC participation, these efforts should take place within a strong environmental, social and governance framework, with strengthened regulation and enforcement and capacity-building support to local firms for compliance.

UNCTAD further proposes three specific initiatives:

- *Synergistic trade and investment policies and institutions.* Trade and investment policies often work in silos. In the context of GVCs they can have unintended and counterproductive reciprocal effects. To avoid this, policymakers – where necessary, with the help of international organizations – should carefully review those policy instruments that simultaneously affect investment and trade in GVCs; i.e. trade measures affecting investment and investment measures affecting trade. Furthermore, at the institutional level, the trade and investment links in GVCs call for closer coordination and collaboration between trade and investment promotion agencies.
- *"Regional industrial development compacts".* The relevance of regional value chains underscores the importance of regional cooperation. Regional industrial development compacts could encompass integrated regional trade and investment agreements focusing on liberalization and facilitation, and establishing joint trade and investment promotion mechanisms and institutions. They could also aim to create cross-border industrial clusters through joint financing for GVC-enabling infrastructure and joint productive capacity-building. Establishing such compacts requires working in partnership between governments in the region, between governments and international organizations, and between the public and private sectors.
- *Sustainable export processing zones (EPZs).* Sustainability is becoming an important factor for attracting GVC activities. EPZs have become significant GVC hubs by offering benefits to TNCs and suppliers in GVCs. They could also offer – in addition to or in lieu of some existing benefits – expanded support services for corporate social responsibility (CSR) efforts to become catalysts for CSR implementation. Policymakers could consider setting up relevant services, including technical assistance for certification and reporting, support on occupational safety and health issues, and recycling or alternative energy facilities, transforming EPZs into centres of excellence for sustainable business. International organizations can help through the establishment of benchmarks, exchanges of best practices and capacity-building programmes.

OVERVIEW

GLOBAL INVESTMENT TRENDS

FDI recovery unravels in 2012

Global foreign direct investment (FDI) fell by 18 per cent to $1.35 trillion in 2012. This sharp decline was in stark contrast to other key economic indicators such as GDP, international trade and employment, which all registered positive growth at the global level. Economic fragility and policy uncertainty in a number of major economies gave rise to caution among investors. Furthermore, many transnational corporations (TNCs) reprofiled their investments overseas, including through restructuring of assets, divestment and relocation. The road to FDI recovery is thus proving bumpy and may take longer than expected.

UNCTAD forecasts FDI in 2013 to remain close to the 2012 level, with an upper range of $1.45 trillion – a level comparable to the pre-crisis average of 2005–2007 (figure 1). As macroeconomic conditions improve and investors regain confidence in the medium term, TNCs may convert their record levels of cash holdings into new investments. FDI flows may then reach the level of $1.6 trillion in 2014 and $1.8 trillion in 2015. However, significant risks to this growth scenario remain. Factors such as structural weaknesses in the global financial system, the possible deterioration of the macroeconomic environment, and significant policy uncertainty in areas crucial for investor confidence might lead to a further decline in FDI flows.

Developing economies surpass developed economies as recipients of FDI

FDI flows to developing economies proved to be much more resilient than flows to developed countries, recording their second highest level – even though they declined slightly (by 4 per cent) to $703 billion in 2012 (table 1). They accounted for a record 52 per cent of global FDI inflows, exceeding flows to developed economies for the first time ever, by $142 billion. The global rankings of the largest recipients of FDI also reflect changing patterns of investment flows: 9 of the 20 largest recipients were developing countries (figure 2). Among regions, flows to developing Asia and Latin America remained at historically high levels, but their growth momentum weakened. Africa saw a year-on-year increase in FDI inflows in 2012 (table 1).

Figure 1. Global FDI flows, 2004–2012, and projections, 2013–2015
(Billions of dollars)

Table 1. FDI flows by region, 2010–2012
(Billions of dollars and per cent)

Region	FDI inflows			FDI outflows		
	2010	2011	2012	2010	2011	2012
World	**1 409**	**1 652**	**1 351**	**1 505**	**1 678**	**1 391**
Developed economies	696	820	561	1 030	1 183	909
Developing economies	637	735	703	413	422	426
Africa	44	48	50	9	5	14
Asia	401	436	407	284	311	308
East and South-East Asia	313	343	326	254	271	275
South Asia	29	44	34	16	13	9
West Asia	59	49	47	13	26	24
Latin America and the Caribbean	190	249	244	119	105	103
Oceania	3	2	2	1	1	1
Transition economies	75	96	87	62	73	55
Structurally weak, vulnerable and small economies	**45**	**56**	**60**	**12**	**10**	**10**
Least developed countries	19	21	26	3.0	3.0	5.0
Landlocked developing countries	27	34	35	9.3	5.5	3.1
Small island developing States	4.7	5.6	6.2	0.3	1.8	1.8
Memorandum: percentage share in world FDI flows						
Developed economies	49.4	49.7	41.5	68.4	70.5	65.4
Developing economies	45.2	44.5	52.0	27.5	25.2	30.6
Africa	3.1	2.9	3.7	0.6	0.3	1.0
Asia	28.4	26.4	30.1	18.9	18.5	22.2
East and South-East Asia	22.2	20.8	24.1	16.9	16.2	19.8
South Asia	2.0	2.7	2.5	1.1	0.8	0.7
West Asia	4.2	3.0	3.5	0.9	1.6	1.7
Latin America and the Caribbean	13.5	15.1	18.1	7.9	6.3	7.4
Oceania	0.2	0.1	0.2	0.0	0.1	0.0
Transition economies	5.3	5.8	6.5	4.1	4.3	4.0
Structurally weak, vulnerable and small economies	**3.2**	**3.4**	**4.4**	**0.8**	**0.6**	**0.7**
Least developed countries	1.3	1.3	1.9	0.2	0.2	0.4
Landlocked developing countries	1.9	2.1	2.6	0.6	0.3	0.2
Small island developing States	0.3	0.3	0.5	0.0	0.1	0.1

Developing economies' outflows reached $426 billion, a record 31 per cent of the world total. Despite the global downturn, TNCs from developing countries continued their expansion abroad. Asian countries remained the largest source of FDI, accounting for three quarters of the developing-country total. FDI outflows from Africa tripled while flows from developing Asia and from Latin America and the Caribbean remained at the 2011 level.

The BRICS countries (Brazil, the Russian Federation, India, China and South Africa) continued to be the leading sources of FDI among emerging investor countries. Flows from these five economies rose from $7 billion in 2000 to $145 billion in 2012, accounting for 10 per cent of the world total. Their TNCs are becoming increasingly active, including in Africa. In the ranks of top investors, China moved up from the sixth to the third largest investor in 2012, after the United States and Japan (figure 3).

FDI flows to and from developed countries plummet

FDI inflows to developed economies declined by 32 per cent to $561 billion – a level last seen almost 10 years ago. Both Europe and North America, as groups, saw their inflows fall, as did Australia and New Zealand. The European Union alone accounted for almost two thirds of the global FDI decline. However, inflows to Japan turned positive after two successive years of net divestments.

Outflows from developed economies, which had led the recovery of FDI over 2010–2011, fell by 23 per cent to $909 billion – close to the trough of 2009. Both Europe and North America saw large declines in their outflows, although Japan bucked the trend, keeping its position as the second largest investor country in the world.

Figure 2. Top 20 host economies, 2012
(Billions of dollars)

Internationalization of SOEs and SWFs maintains pace

The number of State-owned TNCs increased from 650 in 2010 to 845 in 2012. Their FDI flows amounted to $145 billion, reaching almost 11 per cent of global FDI. The majority of the State-owned enterprises (SOEs) that acquired foreign assets in 2012 were from developing countries; many of those acquisitions were motivated by the pursuit of strategic assets (e.g. technology, intellectual property, brand names) and natural resources.

FDI by sovereign wealth funds (SWFs) in 2012 was only $20 billion, though it doubled from the year before. Cumulative FDI by SWFs is estimated at $127 billion, most of it in finance, real estate, construction and utilities. In terms of geographical distribution, more than 70 per cent of SWFs' FDI in 2012 was targeted at developed economies. The combined assets of the 73 recognized SWFs around the world were valued at an estimated $5.3 trillion in 2012 – a huge reservoir to tap for development financing.

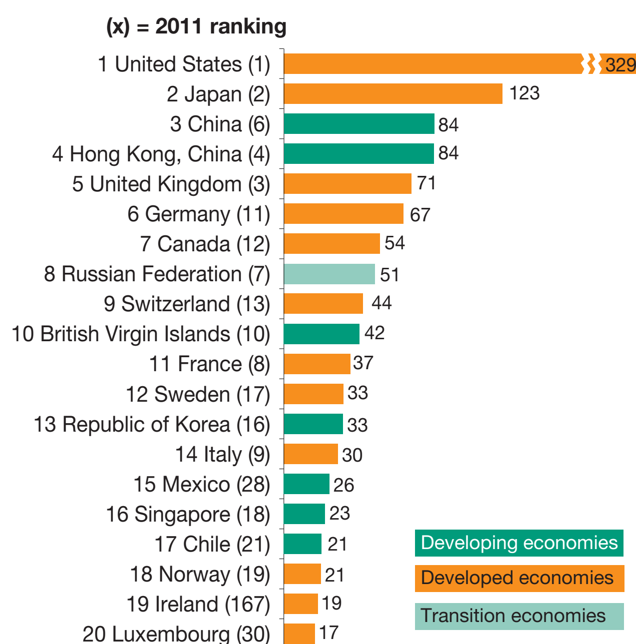
Growing offshore finance FDI raises concerns about tax evasion

Offshore finance mechanisms in FDI include mainly (i) offshore financial centres (OFCs) or tax havens and (ii) special purpose entities (SPEs). SPEs are foreign affiliates that are established for a specific purpose or that have a specific legal structure; they tend to be established in countries that provide specific tax benefits for SPEs. Both OFCs and SPEs are used to channel funds to and from third countries.

Investment in OFCs remains at historically high levels. Flows to OFCs amounted to almost $80 billion in 2012, down $10 billion from 2011, but well above the $15 billion average of the pre-2007 period. OFCs account for an increasing share of global FDI flows, at about 6 per cent.

SPEs play an even larger role relative to FDI flows and stocks in a number of important investor countries, acting as a channel for more than $600 billion of investment flows. Over the past decade, in most economies

Figure 3. Top 20 investor economies, 2012
(Billions of dollars)



that host SPEs, these entities have gained importance in investment flows. In addition, the number of countries offering favourable tax treatment to SPEs is on the increase.

Tax avoidance and transparency in international financial transactions are issues of global concern that require a multilateral approach. To date, international efforts on these issues have focused mostly on OFCs, but SPEs are a far larger phenomenon. Moreover, FDI flows to OFCs remain at high levels. Addressing the growing concerns about tax evasion requires refocusing international efforts. A first step could be establishing a closed list of "benign" uses of SPEs and OFCs. This would help focus any future measures on combating the malign aspects of tax avoidance and lack of transparency.

International production growing at a steady pace

In 2012, the international production of TNCs continued to expand at a steady rate because FDI flows, even at lower levels, add to the existing FDI stock. FDI stocks rose by 9 per cent in 2012, to $23 trillion. Foreign affiliates of TNCs generated sales worth $26 trillion (of which $7.5 trillion were for exports), increasing by 7.4 per cent from 2011 (table 2). They contributed value added worth $6.6 trillion, up 5.5 per cent, which compares well with global GDP growth of 2.3 per cent. Their employment numbered 72 million, up 5.7 per cent from 2011.

The growth of international production by the top 100 TNCs, which are mostly from developed economies, stagnated in 2012. However, the 100 largest TNCs domiciled in developing and transition economies increased their foreign assets by 20 per cent, continuing the expansion of their international production networks.

Reinvested earnings: a source of financing for long-term investment

Global FDI income increased sharply in 2011, for the second consecutive year, to $1.5 trillion, on a stock of $21 trillion, after declining in both 2008 and 2009 during the depths of the global financial crisis. FDI

Table 2. Selected indicators of FDI and international production, 1990–2012

Item	Value at current prices (Billions of dollars)				
	1990	2005–2007 pre-crisis average	2010	2011	2012
FDI inflows	207	1 491	1 409	1 652	1 351
FDI outflows	241	1 534	1 505	1 678	1 391
FDI inward stock	2 078	14 706	20 380	20 873	22 813
FDI outward stock	2 091	15 895	21 130	21 442	23 593
Income on inward FDI	75	1 076	1 377	1 500	1 507
Rate of return on inward FDI (per cent)	4	7	6.8	7.2	6.6
Income on outward FDI	122	1 148	1 387	1 548	1 461
Rate of return on outward FDI (per cent)	6	7	6.6	7.2	6.2
Cross-border M&As	99	703	344	555	308
Sales of foreign affiliates	5 102	19 579	22 574	24 198	25 980
Value added (product) of foreign affiliates	1 018	4 124	5 735	6 260	6 607
Total assets of foreign affiliates	4 599	43 836	78 631	83 043	86 574
Exports of foreign affiliates	1 498	5 003	6 320	7 436	7 479
Employment by foreign affiliates (thousands)	21 458	51 795	63 043	67 852	71 695
Memorandum:					
GDP	22 206	50 319	63 468	70 221	71 707
Gross fixed capital formation	5 109	11 208	13 940	15 770	16 278
Royalties and licence fee receipts	27	161	215	240	235
Exports of goods and services	4 382	15 008	18 956	22 303	22 432

income increased for each of the three major groups of economies – developed, developing and transition – with the largest increases taking place in developing and transition economies. The rates of return on FDI are 7 per cent globally, and higher in both developing (8 per cent) and transition economies (13 per cent) than in developed countries (5 per cent). Of total FDI income, about $500 billion was retained in host countries, while $1 trillion was repatriated to home or other countries (representing on average 3.4 per cent of the current account payments). The share of FDI income retained is highest in developing countries; at about 40 per cent it represents an important source of FDI financing. However, not all of this is turned into capital expenditure; the challenge for host governments is how to channel retained earnings into productive investment.

REGIONAL TRENDS IN FDI

Africa: a bright spot for FDI

FDI inflows to Africa rose for the second year running, up 5 per cent to $50 billion, making it one of the few regions that registered year-on-year growth in 2012. FDI outflows from Africa almost tripled in 2012, to $14 billion. TNCs from the South are increasingly active in Africa, building on a trend in recent years of a higher share of FDI flows to the region coming from emerging markets. In terms of FDI stock, Malaysia, South Africa, China and India (in that order) are the largest developing-country investors in Africa.

FDI inflows in 2012 were driven partly by investments in the extractive sector in countries such as the Democratic Republic of the Congo, Mauritania, Mozambique and Uganda. At the same time, there was an increase in FDI in consumer-oriented manufacturing and services, reflecting demographic changes.

Between 2008 and 2012, the share of such industries in the value of greenfield investment projects grew from 7 per cent to 23 per cent of the total.

FDI in and from developing Asia loses growth momentum

FDI flows to developing Asia decreased by 7 per cent to $407 billion in 2012. This decline was reflected across all subregions but was most severe in South Asia, where FDI inflows fell by 24 per cent. China and Hong Kong (China) were the second and third largest FDI recipients worldwide, and Singapore, India and Indonesia were also among the top 20. Driven by continued intraregional restructuring, lower-income countries such as Cambodia, Myanmar, the Philippines and Viet Nam were attractive FDI locations for labour-intensive manufacturing. In West Asia, FDI suffered from a fourth consecutive year of decline. State-owned firms in the Gulf region are taking over delayed projects that were originally planned as joint ventures with foreign firms.

Total outward FDI from the region remained stable at $308 billion, accounting for 22 per cent of global flows (a share similar to that of the European Union). The moderate increase in East and South-East Asia was offset by a 29 per cent decrease in outflows from South Asia. Outflows from China continued to grow, reaching $84 billion in 2012 (a record level), while those from Malaysia and Thailand also increased. In West Asia, Turkey has emerged as a significant investor, with its outward investment growing by 73 per cent in 2012 to a record $4 billion.

FDI growth in South America offset by a decline in Central America and the Caribbean

FDI to Latin America and the Caribbean in 2012 was $244 billion, maintaining the high level reached in 2011. Significant growth in FDI to South America ($144 billion) was offset by a decline in Central America and the Caribbean ($99 billion). The main factors that preserved South America's attractiveness to FDI are its wealth in oil, gas and metal minerals and its rapidly expanding middle class. Flows of FDI into natural resources are significant in some South American countries. FDI in manufacturing (e.g. automotive) is increasing in Brazil, driven by new industrial policy measures. Nearshoring to Mexico is on the rise.

Outward FDI from Latin America and the Caribbean decreased moderately in 2012 to $103 billion. Over half of these outflows originate from OFCs. Cross-border acquisitions by Latin American TNCs jumped 74 per cent to $33 billion, half of which was invested in other developing countries.

FDI flows to and from transition economies fall

Inward FDI flows in transition economies fell by 9 per cent in 2012 to $87 billion. In South-East Europe, FDI flows almost halved, mainly due to a decline in investments from traditional European Union investors suffering economic woes at home. In the Commonwealth of Independent States, including the Russian Federation, FDI flows fell by 7 per cent, but foreign investors continue to be attracted by the region's growing consumer markets and vast natural resources. A large part of FDI in the Russian Federation is due to "round tripping".

Outward FDI flows from transition economies declined by 24 per cent in 2012 to $55 billion. The Russian Federation continued to dominate outward FDI from the region, accounting for 92 per cent of the total. Although TNCs based in natural-resource economies continued their expansion abroad, the largest acquisitions in 2012 were in the financial industry.

A steep fall in FDI in 2012 reverses the recent recovery in developed economies

The sharp decline in inflows reversed the FDI recovery during 2010–2011. Inflows fell in 23 of 38 developed economies in 2012. The 32 per cent nosedive was due to a 41 per cent decline in the European Union and a 26 per cent decline in the United States. Inflows to Australia and New Zealand fell by 13 per cent and 33 per cent, respectively. In contrast, inflows to Japan turned positive after two successive years of net divestment. Also, the United Kingdom saw inflows increase. The overall decline was due to weaker growth prospects and policy uncertainty, especially in Europe, and the cooling off of investment in extractive industries. In addition, intracompany transactions – e.g. intracompany loans, which by their nature tend to fluctuate more – had the effect of reducing flows in 2012. While FDI flows are volatile, the level of capital expenditures is relatively stable.

Outflows from developed countries declined by 23 per cent, with the European Union down 40 per cent and the United States down 17 per cent. This was largely due to divestments and the continued "wait and see" attitude of developed-country TNCs. FDI flows from Japan, however, grew by 14 per cent.

FDI flows to the structurally weak and vulnerable economies rise further in 2012

FDI flows to structurally weak, vulnerable and small economies rose further by 8 per cent to $60 billion in 2012, with particularly rapid growth in FDI to LDCs and small island developing States (SIDS). The share of the group as a whole rose to 4.4 per cent of global FDI.

FDI inflows to *least developed countries* (*LDCs*) grew robustly by 20 per cent and hit a record high of $26 billion, led by strong gains in Cambodia, the Democratic Republic of the Congo, Liberia, Mauritania, Mozambique and Uganda. The concentration of inflows to a few resource-rich LDCs remained high. Financial services continued to attract the largest number of greenfield projects. With greenfield investments from developed countries shrinking almost by half, nearly 60 per cent of greenfield investment in LDCs was from developing economies, led by India.

FDI to *landlocked developing countries* (LLDCs) reached $35 billion, a new high. The "Silk Road" economies of Central Asia attracted about 54 per cent of LLDC FDI inflows. Developing economies became the largest investors in LLDCs, with particular interest by TNCs from West Asia and the Republic of Korea; the latter was the largest single investor in LLDCs last year.

FDI flows into *small island developing States* (SIDS) continued to recover for the second consecutive year, increasing by 10 per cent to $6.2 billion, with two natural-resources-rich countries – Papua New Guinea, and Trinidad and Tobago – explaining much of the rise.

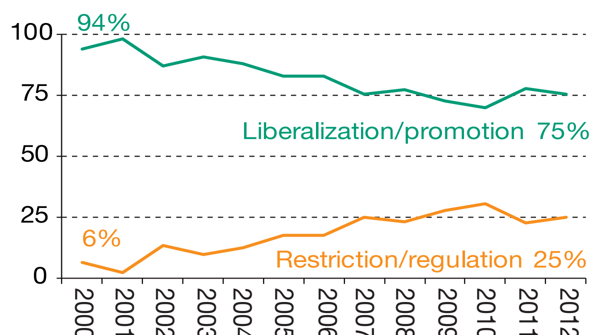
INVESTMENT POLICY TRENDS

Many new investment policies have an industry-specific angle

At least 53 countries and economies around the globe adopted 86 policy measures affecting foreign investment in 2012. The bulk of these measures (75 per cent) related to investment liberalization, facilitation and promotion, targeted to numerous industries, especially in the service sector. Privatization policies were an important component of this move. Other policy measures include the establishment of special economic zones (SEZs).

At the same time, the share of FDI-related regulations and restrictions increased to 25 per cent, confirming a longer-term trend after a temporary reverse development in 2011 (figure 4). Governments made more use of industrial policies, adjusted previous investment liberalization efforts, tightened screening and monitoring procedures, and closely scrutinized cross-border M&As. Restrictive investment policies were applied particularly to strategic industries, such as extractive industries. In general, governments became more selective about the degree of FDI involvement in different industries of their economies.

Figure 4. Changes in national investment policies, 2000–2012
(Per cent)



Screening mechanisms significantly affect cross-border M&As

One important example of how governments have recently become more selective in their admission procedures concerns cross-border M&As. This report analysed 211 of the largest cross-border M&As withdrawn between 2008 and 2012, those with a transaction value of $500 million or more. In most cases M&A plans were aborted for business reasons, but a significant number were also withdrawn because of regulatory concerns, such as competition issues, economic benefit tests and national security screening, or political opposition. These deals had an approximate total gross value of $265 billion. Their share among all withdrawn cross-border M&As stood at about 22 per cent in 2012, with a peak of over 30 per cent in 2010. The main target industry from which M&As were withdrawn for regulatory concerns or political opposition was the extractive industry.

Risk of investment protectionism persists

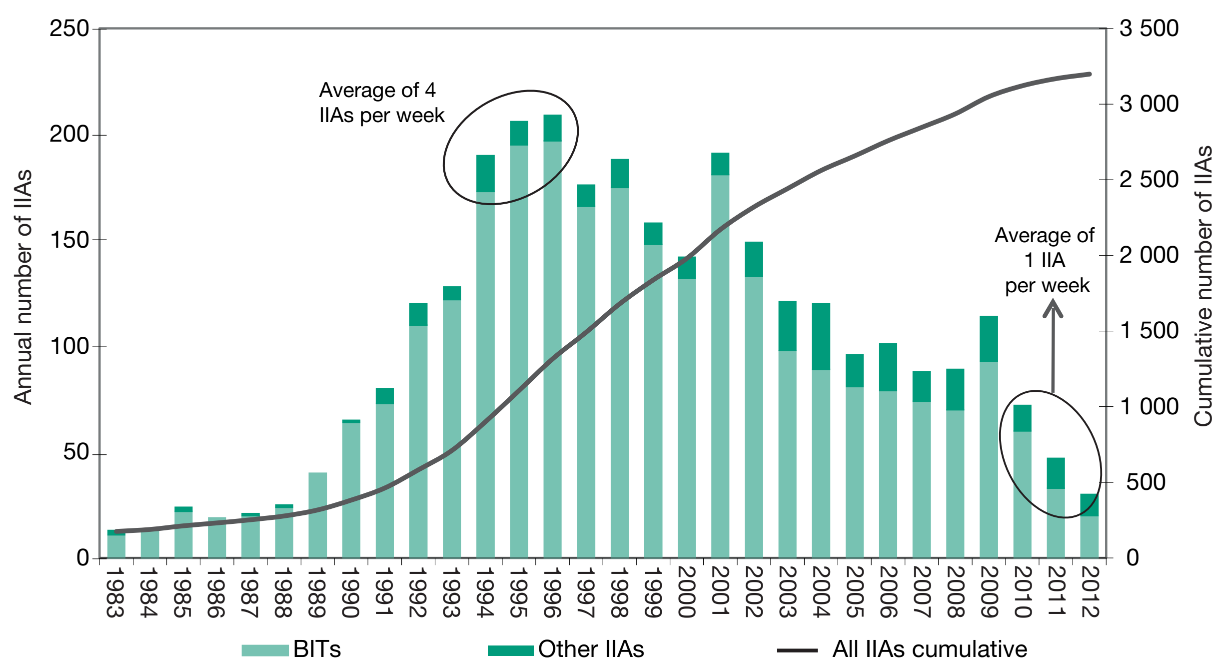
As countries make more use of industrial policies, tighten screening and monitoring procedures, closely scrutinize cross-border M&As and become more restrictive with regard to the degree of FDI involvement in strategic industries, the risk grows that some of these measures are taken for protectionist purposes. With the emergence and rapid expansion of global and regional value chains, protectionist policies can backfire on all actors, domestic and foreign.

In the absence of a commonly recognized definition of “investment protectionism”, it is difficult to clearly identify among investment regulations or restrictions those measures that are of a protectionist nature. Efforts should be undertaken at the international level to clarify this term, with a view to establishing a set of criteria for identifying protectionist measures against foreign investment. At the national level, technical assistance by international organizations can help promote quality regulation rather than overregulation. It would also be helpful to consider extending the G-20’s commitment to refrain from protectionism – and perhaps also expanding the coverage of monitoring to the world.

The number of newly signed BITs continues to decline

By the end of 2012, the IIA regime consisted of 3,196 agreements, which included 2,857 BITs and 339 “other IIAs”, such as integration or cooperation agreements with an investment dimension (figure 5). The year saw the conclusion of 30 IIAs (20 BITs and 10 “other IIAs”). The 20 BITs signed in 2012 represent the lowest annual number of concluded treaties in a quarter century.

Figure 5. Trends in IIAs, 1983–2012



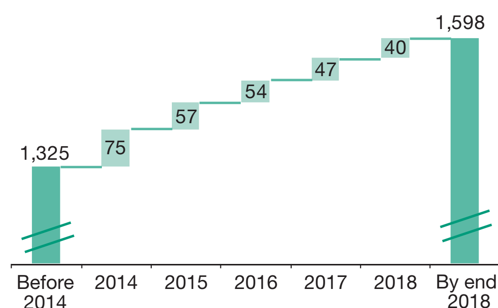
Rise of regionalism brings challenges and opportunities

Investment regionalism is gaining ground: 8 of the 10 "other IIAs" concluded in 2012 were regional ones. Furthermore, this year, at least 110 countries are involved in 22 regional negotiations. Regionalism can provide an opportunity for rationalization. If parties to nine such negotiations (i.e. those where BITs-type provisions are on the agenda) opted to replace their respective BITs with an investment chapter in the regional agreement, this would consolidate today's global BIT network by more than 270 BITs, or close to 10 per cent.

New IIAs tend to include sustainable–development–friendly provisions

IIAs concluded in 2012 show an increased inclination to include sustainable-development-oriented features, including references to the protection of health and safety, labour rights and the environment. These sustainable development features are supplemented by treaty elements that more broadly aim to preserve regulatory space for public policies in general or to minimize exposure to investment litigation in particular. Many of these provisions correspond to policy options featured in UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD).

Figure 6. Cumulative number of BITs that can be terminated or renegotiated



Opportunities for improving the IIA regime

Countries have several avenues for improving the IIA regime, depending on the depth of change they wish to achieve. These include the contracting States' right to clarify the meaning of treaty provisions (e.g. through authoritative interpretations), the revision of IIAs (e.g.

through amendments), the replacement of older IIAs (e.g. through renegotiation), or the termination of IIAs (either unilaterally or by mutual consent). Treaty expiration can support several of the above options. By the end of 2013, more than 1,300 BITs will be at the stage where they could be terminated or renegotiated at any time, creating a window of opportunity to address inconsistencies and overlaps in the multi-faceted and multi-layered IIA regime, and to strengthen its development dimension (figure 6). In taking such actions, countries need to weigh the pros and cons in the context of their investment climate and their overall development strategies.

Investor–State arbitration: highest number of new cases ever

In 2012, 58 new known investor–State dispute settlement (ISDS) cases were initiated. This brings the total number of known cases to 514 and the total number of countries that have responded to one or more ISDS cases to 95. The 58 cases constitute the highest number of known ISDS claims ever filed in one year and confirm foreign investors' increased inclination to resort to investor–State arbitration. In light of the increasing number of ISDS cases and persistent concerns about the ISDS system's deficiencies, the debate about the pros and cons of the ISDS mechanism has gained momentum, especially in those countries and regions where ISDS is on the agenda of IIA negotiations.

Investor–State arbitration: sketching paths towards reform

The functioning of ISDS has revealed systemic deficiencies. Concerns relate to legitimacy, transparency, lack of consistency and erroneous decisions, the system for arbitrator appointment and financial stakes. As a response, UNCTAD has identified five broad paths for reform: promoting alternative dispute resolution, modifying the existing ISDS system through individual IIAs, limiting investors' access to ISDS, introducing an appeals facility and creating a standing international investment court. IIA stakeholders are prompted to assess the current system, weigh the available options and embark on concrete steps for reform. Collective efforts at the multilateral level can help develop a consensus about the preferred course of reform and ways to put it into action.

GLOBAL VALUE CHAINS AND DEVELOPMENT

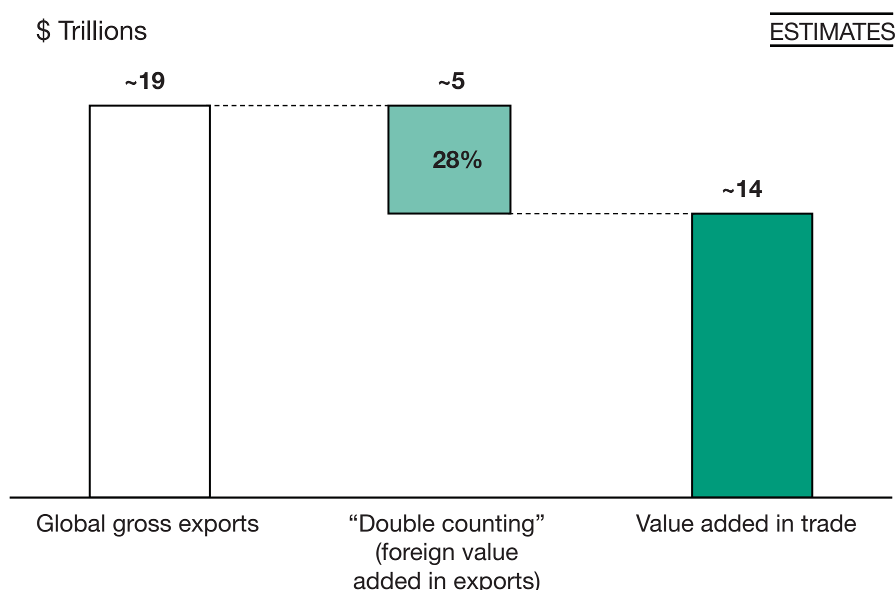
Trade is increasingly driven by global value chains

About 60 per cent of global trade, which today amounts to more than $20 trillion, consists of trade in intermediate goods and services that are incorporated at various stages in the production process of goods and services for final consumption. The fragmentation of production processes and the international dispersion of tasks and activities within them have led to the emergence of borderless production systems. These can be sequential chains or complex networks, their scope can be global or regional, and they are commonly referred to as global value chains (GVCs).

GVCs lead to a significant amount of double counting in trade, as intermediates are counted several times in world exports but should be counted only once as "value added in trade". Today, some 28 per cent of gross exports consist of value added that is first imported by countries only to be incorporated in products or services that are then exported again. Some $5 trillion of the $19 trillion in global gross exports (in 2010 figures) is double counted (figure 7). Patterns of value added trade in GVCs determine the distribution of actual economic gains from trade to individual economies.

The spread of GVCs is greater in some industries where activities can be more easily separated, such as electronics, automotive or garments, but GVCs increasingly involve activities across all sectors, including services. While the share of services in gross exports worldwide is only about 20 per cent, almost half (46

Figure 7. Value added in global exports, 2010



per cent) of value added in exports is contributed by services-sector activities, as most manufacturing exports require services for their production.

The majority of developing countries are increasingly participating in GVCs. The developing-country share in global value added trade increased from 20 per cent in 1990 to 30 per cent in 2000 to over 40 per cent today. However, many poorer developing countries are still struggling to gain access to GVCs beyond natural resource exports.

Regional value chain links are often more important than global ones, especially in North America, Europe, and East and South-East Asia. In the transition economies, Latin America and Africa, regional value chains are relatively less developed.

GVCs are typically coordinated by TNCs

GVCs are typically coordinated by TNCs, with cross-border trade of inputs and outputs taking place within their networks of affiliates, contractual partners and arm's-length suppliers. TNC-coordinated GVCs account for some 80 per cent of global trade. Patterns of value added trade in GVCs are shaped to a significant extent by the investment decisions of TNCs. Countries with a higher presence of FDI relative to the size of their economies tend to have a higher level of participation in GVCs and to generate relatively more domestic value added from trade (figure 8).

TNCs coordinate GVCs through complex webs of supplier relationships and various governance modes, from direct ownership of foreign affiliates to contractual relationships (in non-equity modes of international production, or NEMs), to arm's-length dealings. These governance modes and the resulting power structures in GVCs have a significant bearing on the distribution of economic gains from trade in GVCs and on their long-term development implications.

TNC decisions on where to invest and with whom to partner are driven by GVC locational determinants that depend on the GVC segment, task or activity. Locational determinants for GVC segments are often different, and fewer, than those for vertically integrated industries – i.e. the determinants for electronics assembly activities are fewer than those for investment in the electronics industry as a whole. For many GVC segments, there are relatively few “make or break” locational determinants that act as preconditions for countries’ access to GVCs.

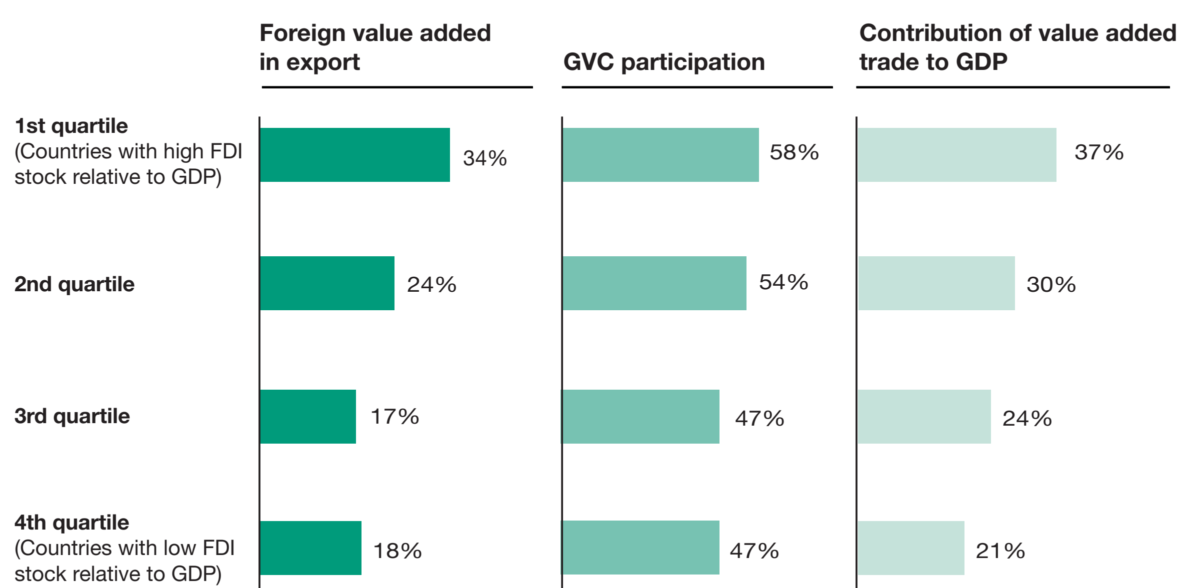
GVCs can make an important contribution to development, but GVC participation is not without risks

GVCs spread value added and employment to more locations, rather than hoarding them only in those locations that are capable of carrying out the most complex tasks. As such, they can accelerate the “catch-up” of developing countries’ GDP and income levels and lead to greater convergence between economies. At the global level, that is the essential development contribution of GVCs.

At the country level, domestic value added created from GVC trade can be very significant relative to the size of local economies. In developing countries, value added trade contributes nearly 30 per cent to countries’ GDP on average, as compared with 18 per cent for developed countries. There is a positive correlation between participation in GVCs and GDP per capita growth rates. Economies with the fastest growing GVC participation have GDP per capita growth rates some 2 percentage points above the average. Furthermore, GVC participation tends to lead to job creation in developing countries and to higher employment growth, even if GVC participation depends on imported contents in exports.

But the experience of individual economies is more heterogeneous. The value added contribution of GVCs can be relatively small where imported contents of exports are high and where GVC participation is limited to lower-value parts of the chain. Also, a large part of GVC value added in developing economies is generated by affiliates of TNCs, which can lead to relatively low “value capture”, e.g. as a result of transfer pricing or income repatriation. However, even where exports are driven by TNCs, the value added contribution of local firms in GVCs is often very significant. And reinvestment of earnings by foreign affiliates is, on average, almost as significant as repatriation.

Figure 8. Key value added trade indicators, by quartile of inward FDI stock relative to GDP, 2010



As to employment gains, pressures on costs from global buyers often mean that GVC-related employment can be insecure and involve poor working conditions, with occupational safety and health a particular concern. Also, stability of employment in GVCs can be low as oscillations in demand are reinforced along value chains and GVC operations of TNCs can be footloose. However, GVCs can serve as a mechanism to transfer international best practices in social and environmental issues, e.g. through the use of CSR standards, although implementation of standards below the first tier of the supply chain remains a challenge.

Longer-term, GVCs can be an important avenue for developing countries to build productive capacity, including through technology dissemination and skill building, opening up opportunities for industrial upgrading. However, the potential long-term development benefits of GVCs are not automatic. GVC participation can cause a degree of dependency on a narrow technology base and on access to TNC-coordinated value chains for limited value added activities.

At the firm level, the opportunities for local firms to increase productivity and upgrade to higher value added activities in GVCs depend on the nature of the GVCs in which they operate, the governance and power relationships in the chain, their absorptive capacities, and the business and institutional environment in the economy. At the country level, successful GVC upgrading paths involve not only growing participation in GVCs but also higher domestic value added creation. At the same time, it involves gradual expansion of participation in GVCs of increasing technological sophistication, moving from resource-based exports to exports of manufactures and services of gradually increasing degrees of complexity.

Countries need to make a strategic choice whether to promote or not to promote GVC participation

Countries need to carefully weigh the pros and cons of GVC participation, and the costs and benefits of proactive policies to promote GVCs or GVC-led development strategies, in line with their specific situation and factor endowments. Some countries may decide not to promote GVC participation. Others may not have a choice: for the majority of smaller developing economies with limited resource endowments there is often little alternative to development strategies that incorporate a degree of participation in GVCs. The question for those countries is not so much *whether* to participate in GVCs, but *how*. In reality, most are already involved in GVCs one way or another. Promoting GVC participation requires targeting specific GVC segments, i.e. GVC promotion can be selective. Moreover, GVC participation is one aspect of a country's overall development strategy.

Policies matter to make GVCs work for development

If countries decide to actively promote GVC participation, policymakers should first determine where their countries' trade profiles and industrial capabilities stand and evaluate realistic GVC development paths for strategic positioning.

Gaining access to GVCs, benefiting from GVC participation and realizing upgrading opportunities in GVCs requires a structured approach that includes (i) embedding GVCs in overall development strategies and industrial development policies, (ii) enabling GVC growth by creating and maintaining a conducive investment and trade environment, and by providing supportive infrastructure and (iii) building productive capacities in local firms. Mitigating the risks involved in GVC participation calls for (iv) a strong environmental, social and governance framework. And aligning trade and investment policies implies the identification of (v) synergies between the two policy areas and in relevant institutions (table 3).

Embedding GVCs in development strategy. Industrial development policies focused on final goods and services are less effective in a global economy characterized by GVCs:

Table 3. Building a policy framework for GVCs and development

Key elements	Principal policy actions
Embedding GVCs in development strategy	• Incorporating GVCs in industrial development policies • Setting policy objectives along GVC development paths
Enabling participation in GVCs	• Creating and maintaining a conducive environment for trade and investment • Putting in place the infrastructural prerequisites for GVC participation
Building domestic productive capacity	• Supporting enterprise development and enhancing the bargaining power of local firms • Strengthening skills of the workforce
Providing a strong environmental, social and governance framework	• Minimizing risks associated with GVC participation through regulation, and public and private standards • Supporting local enterprise in complying with international standards
Synergizing trade and investment policies and institutions	• Ensuring coherence between trade and investment policies • Synergizing trade and investment promotion and facilitation • Creating "Regional Industrial Development Compacts"

- GVC-related development strategies require more targeted policies focusing on fine-sliced activities in GVCs. They also increase the need for policies dealing with the risk of the middle-income trap, as the fragmentation of industries increases the risk that a country will enter an industry only at its low-value and low-skill level.
- GVCs require a new approach to trade policies in industrial development strategies, because protective trade policies can backfire if imports are crucial for export competitiveness. Trade policies should also be seen in light of the increased importance of regional production networks as GVC-based industrialization relies on stronger ties with the supply base in neighbouring developing economies.
- The need to upgrade in GVCs and move into higher value added activities strengthens the rationale for building partnerships with lead firms for industrial development. At the same time, GVCs call for a regulatory framework to ensure joint economic and social and environmental upgrading to achieve sustainable development gains.
- Finally, GVCs require a more dynamic view of industrial development. Development strategy and industrial development policies should focus on determinants that can be acquired or improved in the short term and selectively invest in creating others for medium- and long-term investment attractiveness, building competitive advantages along GVCs, including through partnerships with business.

For policymakers, a starting point for the incorporation of GVCs in development strategy is an understanding of where their countries and their industrial structures stand in relation to GVCs. That should underpin an evaluation of realistic GVC development paths, exploiting both GVC participation and upgrading opportunities. UNCTAD's GVC Policy Development Tool can help policymakers do this.

Enabling participation in GVCs. Enabling the participation of local firms in GVCs implies creating and maintaining a conducive environment for investment and trade, and putting in place the infrastructural prerequisites for GVC participation. A conducive environment for trade and investment refers to the overall policy environment for business, including trade and investment policies, but also tax, competition policy, labour market regulation, intellectual property, access to land and a range of other policy areas (see UNCTAD's Investment Policy Framework for Sustainable Development, IPFSD, which addresses relevant trade and other policy areas). Trade and investment facilitation is particularly important for GVCs in which goods now cross borders multiple times and where there is a need to build up productive capacity for exports.

Providing reliable physical and "soft" infrastructure (notably logistics and telecommunications) is crucial for attracting GVC activities. Developing good communication and transport links can also contribute to the "stickiness" of GVC operations. As value chains are often regional in nature, international partnerships for infrastructure development can be particularly beneficial.

Building domestic productive capacity. A number of policy areas are important for proactive enterprise development policies in support of GVC participation and upgrading: First, enterprise clustering may enhance overall productivity and performance. Second, linkages development between domestic and foreign firms and inter-institution linkages can provide local SMEs with the necessary externalities to cope with the dual challenges of knowledge creation and internationalization, needed for successful participation in GVCs. Third, domestic capacity-building calls for science and technology support and an effective intellectual property rights framework. Fourth, a range of business development and support services can facilitate capacity-building of SMEs so they can comply with technical standards and increase their understanding of investment and trade rules. Fifth, there is a case for entrepreneurship development policy, including managerial and entrepreneurial training and venture capital support. Sixth, access to finance for SMEs helps to direct development efforts at the upstream end of value chains where they most directly benefit local firms.

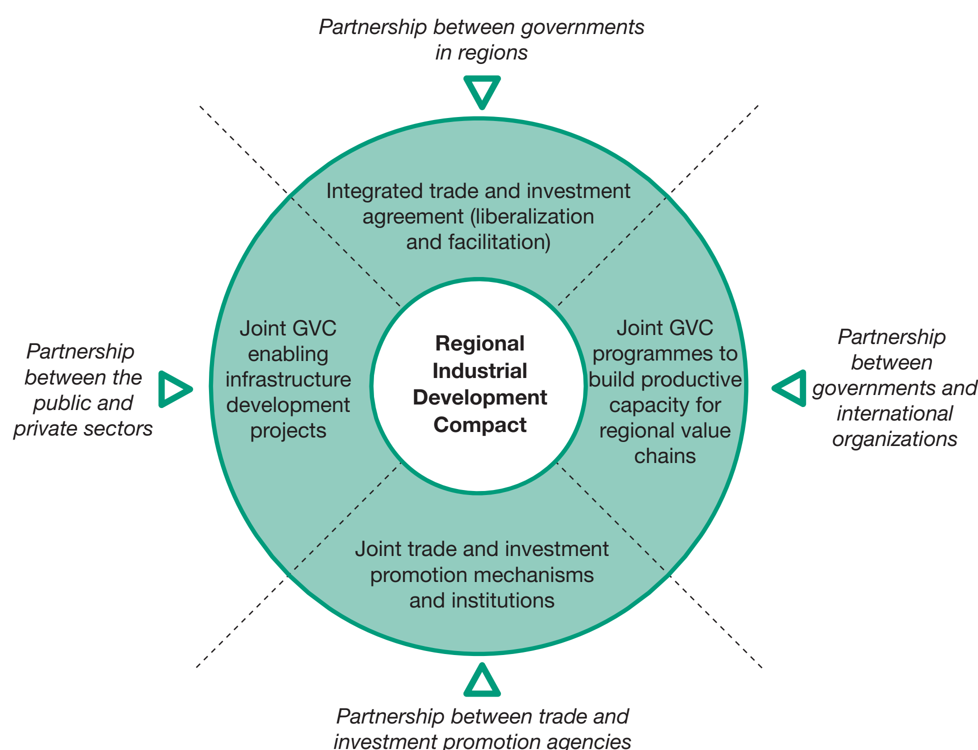
Furthermore, an effective skills development strategy is key to engagement and upgrading in GVCs, and to assist SMEs in meeting the demands of their clients with regard to compliance with certain CSR standards. It can also facilitate any adjustment processes and help displaced workers find new jobs.

Policymakers should also consider options to strengthen the bargaining power of domestic producers vis-à-vis their foreign GVC partners, to help them obtain a fair distribution of rents and risks and to facilitate gaining access to higher value added activities in GVCs (*WIR 11*).

Providing a strong environmental, social and governance framework. A strong environmental, social and governance framework and policies are essential to maximizing the sustainable development impact of GVC activities and minimizing risks. Host countries have to ensure that GVC partners observe international core labour standards. Equally important are the establishment and enforcement of occupational safety, health and environmental standards in GVC production sites, as well as capacity-building for compliance. Buyers of GVC products and their home countries can make an important contribution to safer production by working with suppliers to boost their capacity to comply with host country regulations and international standards, and avoiding suppliers that disrespect such rules.

Suppliers are increasingly under pressure to adapt to CSR policies in order to ensure their continuing role in GVCs. EPZs are an important hub in GVCs and present an opportunity for policymakers to address CSR issues on a manageable scale. Policymakers could consider adopting improved CSR policies, support services and infrastructure in EPZs (e.g. technical assistance for certification and reporting, support on occupational safety and health issues, recycling or alternative energy facilities), transforming them into centres of excellence for sustainable business and making them catalysts for the implementation of CSR. Governments or zone authorities could opt to offer such benefits in addition to or instead of some of the

Figure 9. Regional Industrial Development Compacts for regional value chains



existing benefits offered to firms in EPZs. Benefits for firms could include cost sharing, harmonization of practices, reduced site inspections and others. International organizations can help through the establishment of benchmarks, facilitation of exchanges of best practices, and capacity-building programmes.

A host of other concerns and corporate governance issues should be addressed to minimize risks associated with GVCs. These include transfer pricing, where GVCs have the duplicate effect of increasing the scope for transfer price manipulation and making it harder to combat, to the detriment of raising fiscal revenues for development. In addition, to safeguard industrial development processes, governments should seek to foster resilient supply chains that are prepared for and can withstand shocks, and recover quickly from disruption.

Synergizing trade and investment policies and institutions. As investment and trade are inextricably linked in GVCs, it is crucial to ensure coherence between investment and trade policies. Avoiding inconsistent or even self-defeating approaches requires paying close attention to those policy instruments that may simultaneously affect investment and trade in GVCs, i.e. (i) trade measures affecting investment and (ii) investment measures affecting trade.

At the institutional level, the intense trade and investment links in GVCs call for closer coordination between domestic trade and investment promotion agencies, as well as better targeting of specific segments of GVCs in line with host countries' dynamic locational advantages. A number of objective criteria, based on

a country's GVC participation and positioning, can help determine the most appropriate institutional set-up for trade and investment promotion.

Synergies should be sought also through integrated treatment of international investment and trade agreements. Regional trade and investment agreements are particularly relevant from a value chain perspective, as regional liberalization efforts are shaping regional value chains and the distribution of value added.

In fact, the relevance of regional value chains shows the potential impact of evolving regional trade and investment agreements towards *"Regional Industrial Development Compacts"*. Such Compacts could focus on liberalization and facilitation of trade and investment and establish joint investment promotion mechanisms and institutions. They could extend to other policy areas important for enabling GVC development, such as the harmonization of regulatory standards and consolidation of private standards on environmental, social and governance issues. And they could aim to create cross-border industrial clusters through joint investments in GVC-enabling infrastructure and productive capacity building. Establishing such compacts implies working in partnership – between governments in the region to harmonize trade and investment regulations and jointly promotion trade and investment, between governments and international organizations for technical assistance and capacity-building, and between the public and private sectors for investment in regional value chain infrastructure and productive capacity (figure 9).

Geneva, June 2013

Supachai Panitchpakdi
Secretary-General of the UNCTAD

GLOBAL INVESTMENT TRENDS

CHAPTER I

A. GLOBAL TRENDS: THE FDI RECOVERY FALTERS

1.Current trends

The post-crisis FDI recovery that started in 2010 and 2011 has currently stalled, with global FDI flows falling to below the pre-crisis level. The FDI recovery will now take longer than expected.

Global foreign direct investment (FDI) inflows fell by 18 per cent in 2012, down from a revised $1.65 trillion in 2011 to $1.35 trillion. The strong decline in FDI flows is in stark contrast to other macroeconomic variables, including GDP, trade and employment growth, which all remained in positive territory in 2012 (table I.1).

FDI flows in 2013 are expected to remain close to the 2012 level, with an upper range of $1.45 trillion. As macroeconomic conditions improve and investors regain confidence in the medium term, transnational corporations (TNCs) may convert their record levels of cash holdings into new investments. FDI flows may then reach the level of $1.6 trillion in 2014 and $1.8 trillion in 2015. Nevertheless, significant risks to this scenario persist, including structural weaknesses in the global financial system, weaker growth in the European Union (EU) and significant policy uncertainty in areas crucial for investor confidence.

Table I.1. Growth rates of global GDP, GFCF, trade, employment and FDI, 2008–2014
(Per cent)

Variable	2008	2009	2010	2011	2012	2013[a]	2014[a]
GDP	1.4	-2.1	4.0	2.8	2.3	2.3	3.1
Trade	3.0	-10.3	12.5	5.9	2.6	3.6	5.3
GFCF	2.3	-5.6	5.6	4.8	3.7	5.0	5.7
Employment	1.1	0.5	1.3	1.5	1.3	1.3	1.3
FDI	-9.3	-33.0	15.8	17.3	-18.2	3.6	17.1
Memorandum:							
FDI value (in $ trillions)	1.82	1.22	1.41	1.65	1.35	1.40	1.6

Source: UNCTAD based on United Nations for GDP, IMF for GFCF and Trade, and ILO for employment.
[a] Projections.
Note: GFCF = Gross fixed capital formation.

a. *FDI by geographical distribution*

(i) FDI inflows

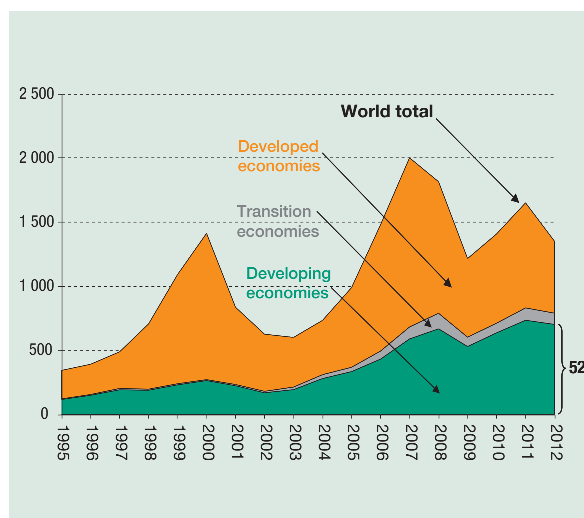
In 2012, for the first time ever, developing economies absorbed more FDI than developed countries, with nine developing economies ranked among the 20 largest recipients in the world.

FDI flows to developing economies remained relatively resilient in 2012, reaching more than $700 billion, the second highest level ever recorded. In contrast, FDI flows to developed countries shrank dramatically to $561 billion, almost one third of their peak value in 2007. Consequently, developing economies absorbed an unprecedented $142 billion more FDI than developed countries. They accounted for a record share of 52 per cent of FDI inflows in 2012 (figure I.1). The global rankings of the largest recipients of FDI also reflect changing patterns of investment flows. For example, four developing economies now rank among the five largest recipients in the world; and among the top 20 recipients, nine are developing economies (figure I.2).

Among *developing regions*, FDI inflows to developing Asia fell by 6.7 per cent as a result of decreases across most subregions and major economies, including China, Hong Kong (China), India, the Republic of Korea, Saudi Arabia and Turkey. However, 2012 inflows to Asia still attained the second highest level recorded, accounting for 58 per cent of FDI flows to developing countries. FDI inflows to the Association of Southeast Asian Nations (ASEAN) went up by 2 per cent as most countries in this group saw their FDI rise. FDI flows to West Asia declined for the fourth consecutive year: with continuing political uncertainty in the region and subdued economic prospects globally, foreign investors were still wary of making further commitments in the region.

FDI to Latin America and the Caribbean maintained the high levels it reached in 2011, decreasing only slightly, by 2.2 per cent in 2012. The high levels

Figure I.1. FDI inflows, global and by group of economies, 1995–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

Figure I.2. Top 20 host economies, 2012
(Billions of dollars)

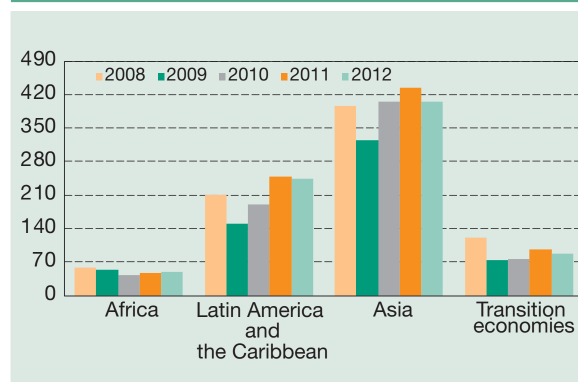
Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

of FDI flows to South America were driven mainly by the region's economic buoyancy, attracting a significant number of market-seeking investments, and by the persistent strength of commodity prices. This continued to encourage investments in the extractive industries, particularly in Chile, Peru and Colombia. FDI to Brazil slowed but remained robust, elevating the country to the world's fourth leading investment destination (see figure I.2). FDI flows to Central America decreased, mainly as a result of a decline in flows to Mexico.

Africa was the only region that saw FDI flows rise in 2012 (figure I.3). Flows to North Africa reversed their downward trend, and Egypt saw a rebound in investment from European investors. FDI inflows to sub-Saharan Africa were driven partly by investments in the extractive sector in countries such as the Democratic Republic of the Congo, Mauritania, Mozambique and Uganda. Angola – an important holder of FDI stock in Africa – continued to post divestments in 2012.

In 2012, the transition economies of South-East Europe and the Commonwealth of Independent States (CIS) saw a decline in FDI inflows, driven in large part by the plummeting value of cross-border mergers and acquisitions (M&As). In South-East Europe, FDI flows almost halved as a result of reduced investment from EU countries, the main investors in the subregion. In the CIS, FDI flows fell only slightly as foreign investors continue to be attracted by these countries' fast-growing consumer markets and natural resources. The Russian Federation saw FDI flows decline slightly, while those to Kazakhstan and Ukraine rose modestly.

Figure I.3. FDI inflows, by region, 2008–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

FDI flows declined dramatically to *developed countries* in 2012, falling sharply both in Europe and in the United States. In Europe, Belgium and Germany saw sharp declines in FDI inflows. In Belgium – which, with a drop of more than $100 billion, accounted for much of the fall – FDI flows are often volatile or inflated by the transactions of special purpose entities (SPEs). Germany posted a large decline of FDI from $49 billion in 2011 to $6.6 billion in 2012, owing to large divestments. Taken together, FDI flows to the Southern European countries affected by sovereign debt problems (Greece, Italy, Portugal and Spain) more than halved from 2011. The decline of inflows to the United States is largely explained by the fall in cross-border M&A sales. Despite that fall, the country remained the largest recipient of FDI flows in the world. A few developed countries bucked the trend and saw FDI inflows increase – namely Canada, Ireland, Japan and the United Kingdom – although none of these increases were significant in historic terms. Of note, however, Japan saw positive inflows after two years of net divestments. The return of greater stability and confidence in the Irish economy has revived the activity of TNCs in the country since the crisis.

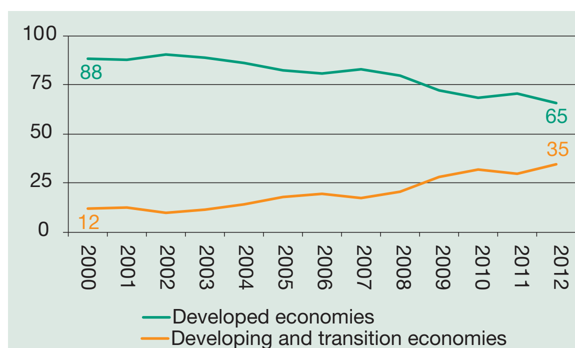
(ii) FDI outflows

Investors from developing economies remained bullish in 2012. In contrast, developed-country TNCs continued their wait-and-see approach or heavily divested their FDI assets.

Global FDI outflows fell by 17 per cent to $1.4 trillion, down from $1.7 trillion in 2011. Developed economies, in particular those in the EU, saw their FDI outflows fall close to the trough of 2009, in part because of uncertainty about the euro. In contrast, investors from developing countries continued their expansion abroad. Together, the share of developing and transition economies in global outflows reached 35 per cent (figure I.4). Among developing and transition economies, the BRICS countries (Brazil, the Russian Federation, India, China and South Africa) continue to be important outward investors (box I.1).

In contrast to the sharp decline of FDI flows from developed countries, FDI flows from *developing economies* rose slightly in 2012, amounting to $426 billion. As a result, their share in global outflows rose to a record 31 per cent. Among developing regions, FDI outflows from Africa nearly tripled, flows from Asia remained unchanged from their 2011 level, and those from Latin America and the Caribbean declined slightly (figure I.5). Asian countries remained the largest source of FDI in developing world, accounting for almost three quarters of the group's total.

Figure I.4. Share of major economic groups in FDI outflows, 2000–2012
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

The rise in outward FDI flows from Africa in 2012 – to $14 billion – was mainly due to large flows from South Africa in mining, the wholesale sector and health-care products. In 2012, FDI outflows from developing Asia remained close to the record level of 2011, reaching $308 billion. China has been one of the main drivers of outflows from Asia. Flows from the Republic of Korea, Malaysia, Saudi Arabia, Thailand and Turkey rose in 2012. In contrast, companies from Hong Kong (China), India and Singapore saw their investments abroad fall from 2011 levels. Outward FDI from Latin America and the Caribbean declined by 2 per cent in 2012, to some $100 billion. Outflows from Brazil remained restrained by high levels of repayment of intercompany loans by Brazilian affiliates abroad to their parent companies in Brazil. In contrast, Mexico and Chile saw strong increases in their FDI outflows.

Outward FDI flows from *transition economies* declined in 2012, owing to a fall in FDI outflows by Russian investors. Although natural-resource-based TNCs supported by high commodity prices

Box I.1. Rising BRICS FDI, globally and in Africa

The BRICS countries (Brazil, the Russian Federation, India, China and South Africa) have emerged as not only major recipients of FDI but also important outward investors. Their outward FDI rose from $7 billion in 2000 to $145 billion in 2012, or 10 per cent of world flows (up from only 1 per cent in 2000).

Overseas investment by BRICS countries is mainly in search of markets in developed countries or in the context of regional value chains. Over 40 per cent of their outward FDI stock is in developed countries, of which 34 per cent is in the EU (box table I.1.1). Some 43 per cent of outward FDI stock is in neighbouring economies of the BRICS – in Latin America and the Caribbean; transition economies; South Asia; South-East Asia and Africa.

Box table I.1.1. Outward FDI stock from BRICS, by destination region, 2011
(Millions of dollars)

Partner region/economy	Value	Share
World	1 130 238	100
Developed economies	470 625	42
European Union	385 746	34
United States	31 729	3
Japan	1 769	0
Developing economies	557 055	49
Africa	49 165	4
Latin America and the Caribbean	175 410	16
Asia	331 677	29
Transition economies	31 891	3
Memorandum:		
BRICS	28 599	3

Source: UNCTAD FDI-TNC-GVC Information System and data from the IMF, CDIS (Coordinated Direct Investment Survey).
Note: Data for Brazil are based on information from the partner countries.

BRICS countries are becoming significant investors in Africa. Although Africa receives only 4 per cent of BRICS FDI outflows, BRICS countries have joined the ranks of top investing countries in Africa. In 2010, the share of BRICS in FDI inward stock in Africa reached 14 per cent and their share in inflows reached 25 per cent. Their share in the total value of greenfield projects in Africa rose from one fifth in 2003 to almost one quarter in 2012. Most BRICS FDI projects in Africa are in manufacturing and services. Only 26 per cent of the value of projects and 10 per cent of the number of projects are in the primary sector.

Brazilian FDI to Africa has been on the rise in recent years, with public financial institutions playing an important role in bringing the country's investors closer to Africa. Among these, the Brazilian Development Bank (BNDES) deserves special mention as its incentives and disbursements to sub-Saharan Africa have increased strongly over the past decade. It has played a key role in the expansion of Brazilian TNCs into the new African ethanol industry, in countries such as Angola, Ghana and Mozambique.

Chinese FDI stock in Africa stood at $16 billion at the end of 2011. South Africa is the leading recipient of Chinese FDI in the continent, followed by the Sudan, Nigeria, Zambia and Algeria. China has joined the ranks of top investing countries in some least developed countries (LDCs), such as the Sudan and Zambia. In addition to resource-seeking FDI, the rapid industrial upgrading currently taking place in China provides opportunities for these countries to attract FDI in manufacturing.

With $18 billion, *South Africa* was the fifth largest holder of FDI stock in Africa in 2011 and the second largest developing country investor globally after Malaysia. The majority of this outward stock can be attributed to reinvested earnings in the private non-banking sector. The largest share of the country's outward FDI stock in Africa is in Mauritius. One fourth of this stock is also concentrated in Nigeria and in two of South Africa's neighbours, Mozambique and Zimbabwe.

/...

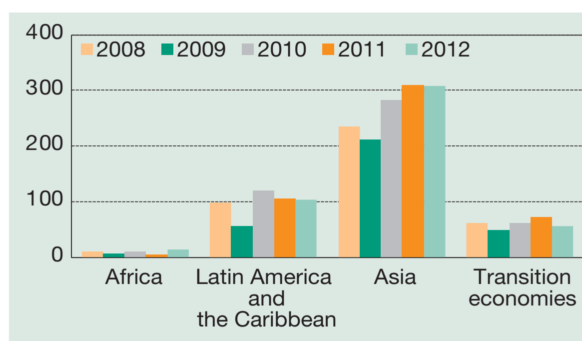
Box I.1. Rising BRICS FDI, globally and in Africa (concluded)

Indian FDI in Africa has traditionally been concentrated in Mauritius, originally because of ethnic links that led to FDI in the garment industry, but more recently because of the country's offshore financial facilities and favourable tax conditions. As a result, the final destinations of recent investments have often been elsewhere. However, Indian TNCs have recently begun investing in other countries in the region, such as Côte d'Ivoire, Ethiopia, Senegal and the Sudan.

The expansion of *Russian* TNCs in Africa is fairly recent but has been rapid, reaching $1 billion in 2011. The arrival of Russian TNCs has been motivated by a desire to enhance raw-material supplies and to expand into new segments of strategic commodities, as well as a desire to access local markets.

Source: UNCTAD.

Figure I.5. FDI outflows, by region, 2008–2012
(Billions of dollars)



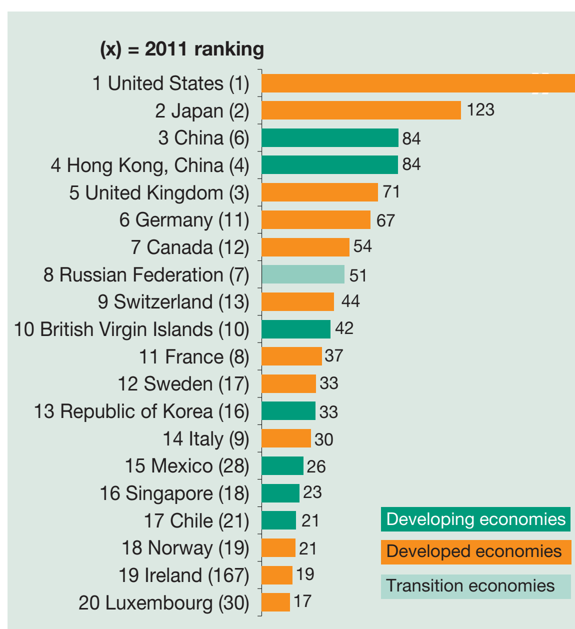
Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

continued their expansion abroad, the largest acquisitions in 2012 took place in the financial industry.

The global ranking of the largest FDI investors shows the continuing rise of developing and transition economies (figure I.6). Two developing countries now rank among the five largest foreign investors in the world, and for the first time ever, China was the world's third largest investor, after the United States and Japan.

Outward FDI from *developed countries* fell by more than $274 billion in 2012, which accounted for almost the entire decline in global outflows. Belgium, the United States and the Netherlands saw the largest declines. FDI dropped in 22 of 38 developed economies, including most of the major source countries. The continuing Eurozone crisis appears to have deterred United States investors from investing in Europe, their main target region. European TNCs,

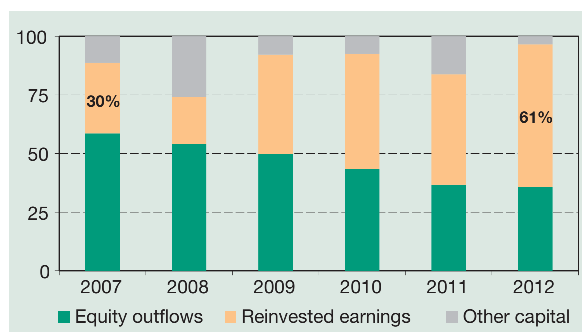
Figure I.6. Top 20 investor economies, 2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

mainly in the financial industry, heavily divested their assets abroad. In contrast, Japan kept up the momentum of the previous year to become the second largest source of FDI worldwide. A growing part of outward FDI from developed countries is made up of reinvested earnings, now a record 61 per cent of the total (figure I.7). While this reflects a growing tendency of developed-country TNCs to finance overseas expansion from foreign earnings, it also reflects the tendency of developed-country TNCs to hold large cash reserves in their foreign affiliates in the form of retained earnings.

Figure I.7. FDI outflows by components for 37 selected developed countries,[a] 2007–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

[a] Countries included are Australia, Austria, Belgium, Bermuda, Bulgaria, Canada, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.

Note: Data for reinvested earnings may be underestimated as they are reported together with equity in some countries.

b. FDI by mode and sector/industry

The deterioration of the global crisis hit FDI in all three sectors. Services displayed higher resilience and gained share at the expense of both the primary and manufacturing sectors.

In 2012 the deterioration of the global economic situation – in particular the deepening of the crisis in the Eurozone and the slowing of growth in the emerging economies – clearly depressed investors' drive to launch cross-border investment initiatives. Generally speaking, the weakening of global demand and the resulting competitive pressure pushed most operators to turn their focus to the solidity of their balance sheet and the preservation of shareholders' returns rather than on investments and growth. This trend involved both greenfield and M&A projects.

In the absence of published FDI data by sector for 2012, this section relies on data on cross-border M&As and on announced greenfield FDI investments[1] (see web annex tables for FDI by sector and industry in 2011). The estimated capital expenditure of announced greenfield projects fell by 33 per cent compared with 2011, reaching $600 billion, the lowest level in the past 10 years (figure I.8). The contraction was even more pronounced in developing economies (-38 per cent), raising additional concerns about the development impact of the downturn.

The value of cross-border M&As declined by 45 per cent, back to levels similar to those of 2009 and 2010 (figure I.8), after the financial crisis had knocked down M&A activity in developed economies.

Compared with the decline in the value of FDI projects, the decline in the number of projects was more moderate (-15 per cent for greenfield projects and -11 per cent for M&A deals). The discrepancy is explained by a significant reduction in the size of projects; specifically, the average investment value decreased by 21 per cent for greenfield projects and 38 per cent for cross-border M&As.

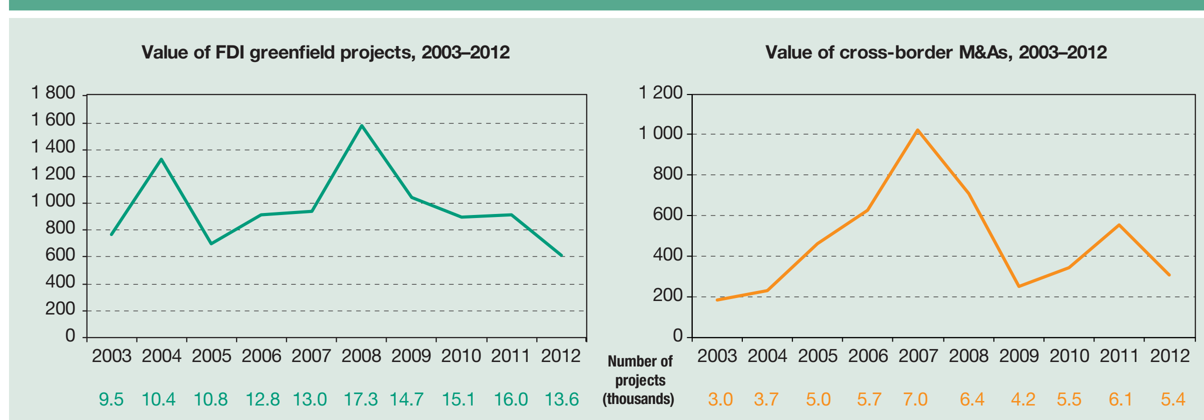
All three sectors were heavily hit by the downturn, although with different intensities (figure I.9).

The *primary sector* was the most heavily hit in relative terms, in both greenfield projects and cross-border M&As. The decline was driven by the downturn in the mining, quarrying and petroleum industry, which represents the bulk of the overall FDI activity in the sector. The contraction was particularly dramatic in developing countries, where the announced value of greenfield projects fell to one fourth of the 2011 value. Similarly, FDI inflows to developing economies generated by cross-border M&A activities plunged from some $25 billion in 2011 to a slightly negative value, revealing a predominant divestment trend by foreign investors in the sector.

Manufacturing was the sector with the largest decrease in FDI project value in absolute terms, originating mainly from a decline in the value of greenfield projects across all three groups of economies – developed, developing and transition economies. The retreat in greenfield project activity is confirmed by a significant decline in the number of such projects, down by 21 per cent globally. By contrast, the decline in the value of cross-border M&As was driven primarily by a decrease in the average deal value, as weak business sentiment – particularly in some developed economies – prevented companies from engaging in large projects.

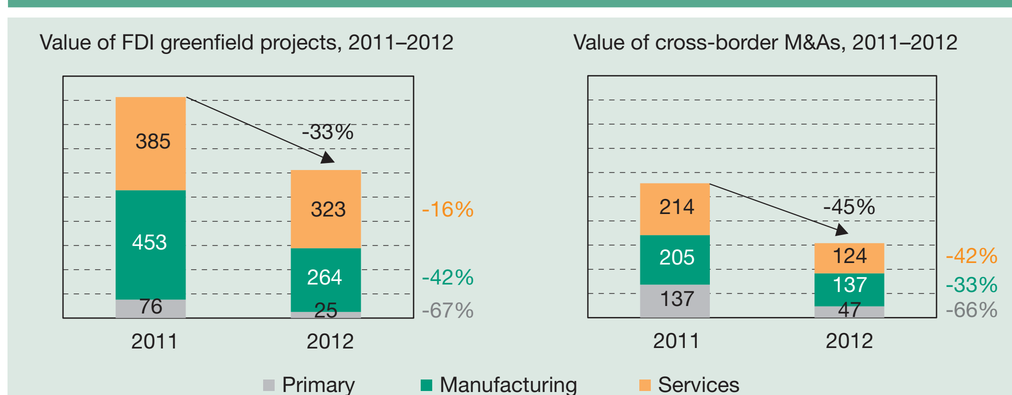
Services turned out to be the sector least affected, despite sharing the overall fall with the primary and

Figure I.8. Historic trend of FDI projects, 2003–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

Figure I.9. FDI projects by sector, 2011–2012
(Billions of dollars)

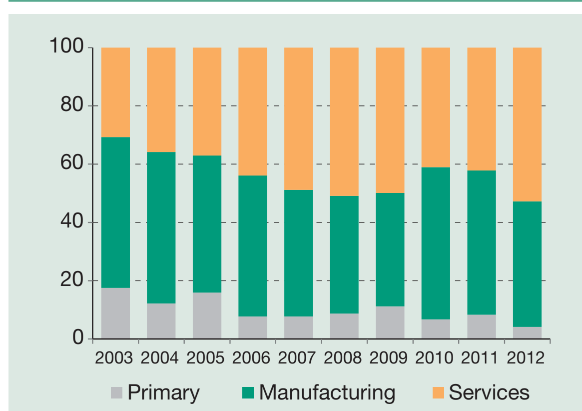


Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

manufacturing sectors. In particular, the relatively limited decrease in the number of greenfield projects (-8 per cent), especially to developing countries (-4 per cent), offers reassurance about the fundamental resilience of highly strategic services industries such as business services, trade, finance and transport. These industries have represented a key FDI growth engine in recent years and also contributed to the creation of a stronger entrepreneurial environment. On the negative side, a significant decrease in the average value of greenfield FDI projects (-16 per cent in developing countries) lowered the level of capital flows considerably. Similar dynamics held for M&A initiatives, where the fall in value was due primarily to the lower propensity of investors to enter high-value deals rather than to a decline in the volume of activity.

The different sectoral performances changed the composition of the value of FDI projects with some remarkable effects, especially for greenfield projects (see figure I.10). In fact, as the global crisis in some key developed countries worsened and spread from the "financial" to the "real" sphere, the manufacturing sector lost ground to the services sector. The long-term trend leading

Figure I.10. Distribution of the value of greenfield investment projects, by sector, 2003–2012
(Per cent)



Source: UNCTAD based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).

to the dominance of services activity in FDI was reinforced, though its amount declined. Also, growing marginalization trend of the primary sector seems to have picked up, with the sector's share in announced greenfield projects declining to some 4 per cent, corresponding to half of its 2011 share and less than one fourth of its 2003 share.

Although the impact of the crisis was widespread, across the spectrum of productive activities, clear differences became apparent in how individual industries were affected (figure I.11).

Mining, quarrying and petroleum, representing by far the bulk of the primary sector, was heavily hit by falling commodity prices and declining demand. Manufacturing industries that are closely linked upstream to extractive activity were exposed to similar adverse industrial dynamics, resulting in a comparably poor FDI performance. In fact, the three industries in which FDI declined most in 2012 were *mining, quarrying and petroleum* and two manufacturing industries (*metals and metal products* and *coke, petroleum products and nuclear fuel*) that process extractive material. Together, the three industries accounted for almost 50 per cent of the overall decrease in the value of announced greenfield projects (corresponding to some $130 billion).

The FDI contraction was particularly dramatic in developing economies, where the already unstable market environment was further complicated by the changes of the investment climate in some countries rich in natural resources.

On the M&A side, the FDI picture confirms a pessimistic investment outlook for the extractive

Figure I.11. Ten industries with the largest declines in greenfield FDI projects in 2012
(Billions of dollars and per cent)

	Loss in value, 2012 vs 2011		Loss in number of projects, 2012 vs 2011	
	$ billion	Per cent	Number	Per cent
Mining, quarrying and petroleum	51	-67%	76	-46%
Coke, petroleum products and nuclear fuel	46	-69%	71	-49%
Metals and metal products	33	-53%	135	-27%
Electricity, gas and water	26	-28%	116	-30%
Transport, storage and communications	26	-35%	26	-3%
Chemicals and chemical products excl. pharmaceuticals	21	-39%	175	-28%
Motor vehicles and other transport equipment	21	-25%	251	-22%
Electrical and electronic equipment	19	-41%	251	-22%
Business services	15	-21%	94	-3%
Rubber and plastic products	12	-48%	154	-32%
All	302	-33%	2 381	-15%

Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).

industry, characterized by a prevalence of divestments in developing economies as highlighted by the negative value of M&A flows. Specific examples include the divestments of Anglo American PLC of part of its activities in copper ore mining in Chile, for $2.9 billion, and in other metal ores in South Africa and Zimbabwe, for a total of $0.7 billion. Another example is the sale by BG Group PLC of a majority stake in the Companhia de Gas de São Paulo in Brazil, valued at $1.7 billion.

Other manufacturing industries responded differently to the downturn. Consumer industries, such as *motor vehicles and other transport equipment* and *electrical and electronic equipment*, were among those most affected. Because of their highly cyclical nature, they are more affected by weak global demand than are other manufacturing industries. Two factors contributed to depressed demand: the crisis in the Eurozone and the deceleration of growth in emerging market economies, in particular China and India. As weak demand squeezed industry margins, companies increasingly resorted to investment cuts in an attempt to mop up large overcapacity, restore financial strength and save cash. However, some less cyclical manufacturing activities, such as *food, beverages and tobacco* and *pharmaceuticals*, managed to limit FDI losses.

Industries in the services sector were more resilient than other industries. For example, *business services* and *transport, storage and communication* managed to preserve their volume of projects despite significant reductions in announced investment value owing to the smaller sizes of individual projects. This shows that international companies were still actively seeking opportunities to expand their service activities, especially into developing countries, though with less aggressive investment operations than in 2011. The decrease in *electricity, gas and water* was confined almost entirely to developed economies, where it reflects the declining demand caused by the current crisis. On a positive note, for the first time since the onset of the crisis in 2008 the *construction* industry registered an increase in both the value and the number of FDI projects, raising hopes for a more structural recovery.

c. FDI by selected types of investors

This section focuses on international investment by some important new types of investors. It makes a distinction between State-controlled entities (SCEs), including sovereign wealth funds (SWFs), and State-owned enterprises (SOEs), on the one hand, and private equity funds, on the other. From a development perspective, this distinction is important as the primary motivation for SCEs' international investment decisions may be criteria other than financial return, such as strategic industrial development objectives. In practice this distinction may be less important because governments increasingly favour the use of holding companies as a form of ownership, but may have limited involvement in the running of a firm or affiliate. Moreover, investors of all types are increasingly intertwined as the process of globalization becomes more complex and geographically widespread: for example, SWFs are investors in private equity funds.

(i) Sovereign wealth funds (SWFs)

FDI by sovereign wealth funds in 2012 remained small at $20 billion, though it doubled from the year before.

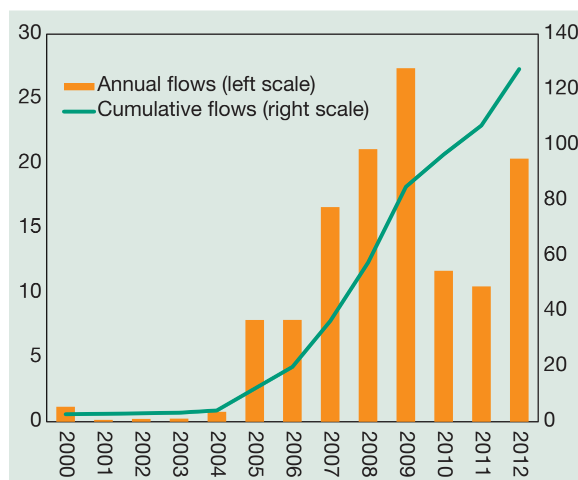
In 2012, SWFs were estimated to have $5.3 trillion worth of assets under management,[2] 80 per cent of which were in the hands of developing economies. In 2012, there were 73 recognized SWFs globally, 60 per cent of which were established in the past decade; and another 21 countries are considering establishing their own SWFs (Santiso, 2012). UNCTAD has highlighted the role that these funds could play in supporting sustainable development outcomes and, in particular, the further potential for their deployment as development-enhancing FDI in developing countries (e.g. UNCTAD, 2011, 2012).

SWF FDI flows doubled in 2012, from $10 billion to over $20 billion, bucking the global trend (figure I.12). Cumulative FDI by SWFs, at $127 billion, nonetheless remains somewhat small as a proportion of total SWF assets under management. However, UNCTAD figures for FDI by SWFs capture only investments in which SWFs are the sole and immediate investors. The data do not include

investments by other entities established by SWFs or those made jointly with other investors. It is likely that total SWF FDI is in fact higher than the figure above suggests.

During the period 2003–2012, cross-border M&As accounted for 89 per cent of SWF FDI, reflecting their position as strategic investment funds, in contrast to the bulk of global FDI, which is invested through greenfield projects. Strategically, the majority of SWF investment through FDI targets the services sector (70 per cent), and in particular finance, real estate, construction and utilities. Finance remains the most popular industry for SWF investment, attracting over $21 billion in cumulative flows over the period 2003–2012 (figure I.13). Following the large jump in investment by SWFs in the utilities industries in 2011 (electricity, gas and water), the trend continued in 2012, with cumulative flows increasing by 26 per cent. A similar story can be seen in real estate, where cumulative flows leapt by 44 per cent between 2011 and 2012. Despite attracting lower levels of FDI in absolute terms, the transport, storage and communications industries experienced a 81 per cent jump in flows from 2011 to 2012, from $6 billion to $11 billion. These trends

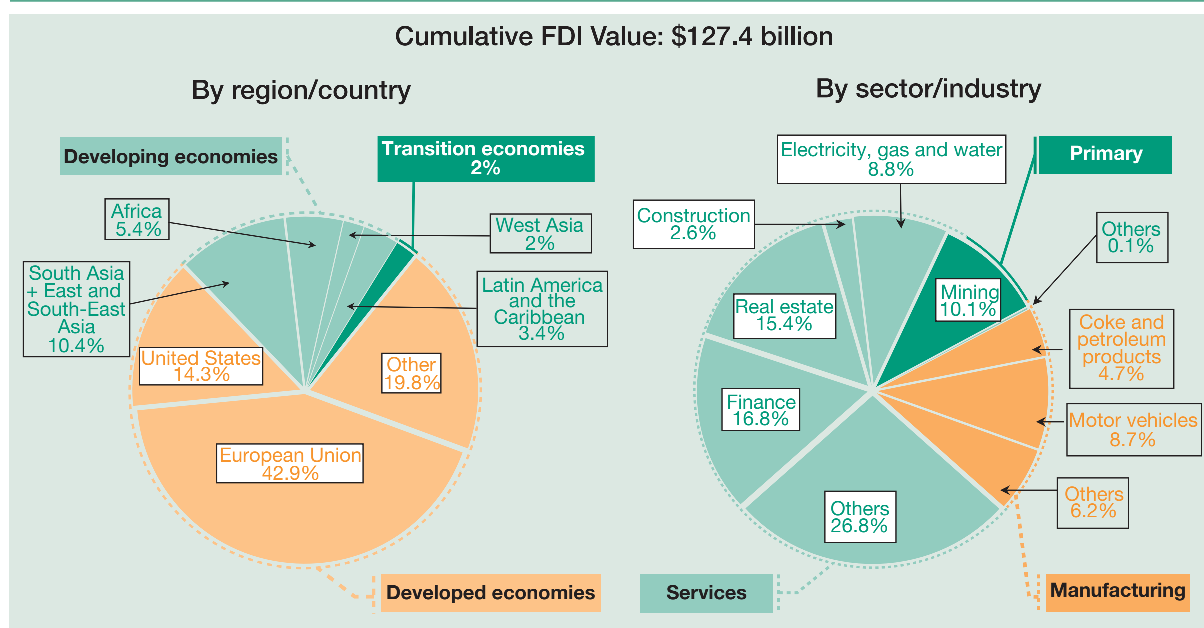
Figure I.12. Annual and cumulative value of FDI by SWFs, 2000–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

Note: Data include value of flows for both cross-border M&As and greenfield FDI projects and only investments by SWFs which are the sole and immediate investors. Data do not include investments made by entities established by SWFs or those made jointly with other investors. In 2003–2012, cross-border M&As accounted for 89 per cent of total.

Figure I.13. FDI by SWFs, cumulative value, by region and by sector/industry, 2012
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

in non-finance sectors may reflect the changing priorities of SWFs in terms of their investment strategies.

With regard to geographical distribution, the majority of SWF FDI is in developed economies, which received more than 70 per cent of inflows in 2012. Of this figure, Europe accounts for nearly two thirds, but the United States experienced a noticeable jump (39 per cent) in inward SWF FDI. Although cumulative SWF FDI to developing and transition countries increased from 2011 to 2012, the share of these countries in global SWF FDI actually fell, from 25 per cent to 23 per cent. This share has been in constant decline since its high of over 30 per cent in 2008, which may suggest changing SWF investment strategies, in terms of the geographical orientation of their FDI.

In the face of the multitude of complex and unpredictable challenges confronting all countries, long-term financial planning and investment (including overseas) provide countries with a necessary form of self-insurance. Some of the strategic concerns that a government may seek to address through a SWF include correcting currency fluctuation and maintaining macroeconomic stability (as in the case of Brazil's SWF); addressing long-term population changes such as aging; hedging against the existential threat of climate change (one of the reasons that the Government of the Maldives established its SWF); and intergenerational equity and preserving current revenues for future generations (e.g. Norway).

Distinct objectives, motives and approaches of individual SWFs may also have a bearing on their investment decisions in terms of sector, asset class and geographical scope, and different SWFs deploy different investment strategies accordingly. Looking ahead, the increase in the number of countries seeking to establish SWFs means that SWF investments, including FDI, are almost certain to increase in the near future. Although several developed countries, including Italy and France, have established SWFs in the past few years, the main home countries of sovereign investment are likely to remain in emerging markets in the global South. However, it is still not clear how SWF investment potential will be realized as it will probably vary by country and fund.

(ii) State-owned enterprises (SOEs)

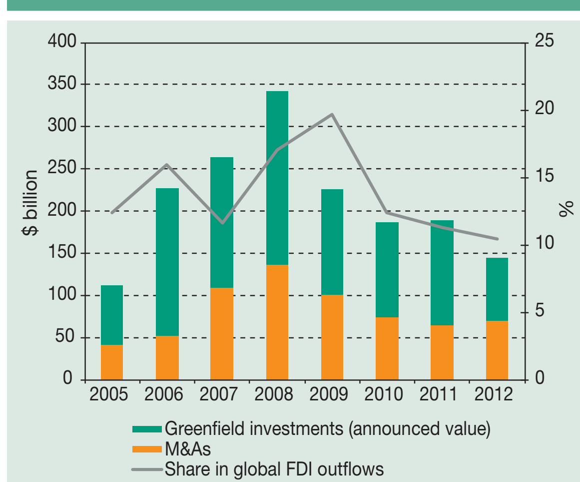
State-owned enterprises slowly continued their international expansion, with the value of their cross-border M&As increasing by 8 per cent in 2012, mostly led by developing country firms in pursuit of strategic assets.

The trend towards liberalization and privatization in the past 30 years has been accompanied by the rising importance of the State in foreign ownership. This is true for SWFs and also for SOEs, which are increasingly internationalizing and becoming leading players in international investment. Although the number of SOEs has been shrinking, their market power has been increasing, in part due to their consolidation into national champions across a range of strategic industries.[3] There are now 18 SOEs among the world's top 100 TNCs. The Chinese State is the largest shareholder in that country's 150 biggest firms, and State companies make up 80 per cent of the stock market value; in the Russian Federation, they account for 62 per cent and in Brazil, 38 per cent. With this increasing market power and financial strength, many SOEs are expanding abroad; indeed, their share of acquisitions in total FDI flows is much greater than the share of SOEs in the total number of TNCs (UNCTAD, 2011).

State-owned TNCs (SO-TNCs) remained important international investors. Their number increased from 659 in 2010 to 845 in 2012, and they account for one tenth of global FDI outflows (figure I.14). Overall, however, FDI by SO-TNCs fell by 23 per cent, from $189 billion to $145 billion.

Looking at FDI projects (including cross-border M&A purchases and greenfield investments), SO-TNCs – unlike SWFs – have historically preferred greenfield investment as their dominant mode of entry. Since 2009, however, the value of greenfield projects has been declining significantly relative to the value of M&As. In 2012, greenfield investment appeared to collapse by a further 40 per cent to $75 billion, or roughly half of all SO-TNC investment. This is in direct contrast to global greenfield investment, which still represents two thirds of all FDI flows despite falling to its lowest level ever in 2012. This trend can be accounted for primarily by SOEs based in developed countries, whose new investments have been seriously affected by the financial crisis.

Figure I.14. Value of FDI projects[a] by SO-TNCs[b] and share in total FDI outflows, 2005–2012
(Billions of dollars and per cent)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database for M&As and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com) for greenfield projects.

[a] Includes both greenfield investments and cross-border M&As. The value of the former dataset refers to estimated amounts of capital investment of the project.

[b] Data cover only SO-TNCs where the state has a 50 per cent or more share.

The absolute value of M&As by SO-TNCs increased by 8 per cent from 2011 to 2012, mirroring the overall rise in M&A activity by TNCs from developing countries, where the majority of global SO-TNC M&As originate. This perhaps also reveals the strategic nature of SOE investments abroad, which seek to acquire technology, intellectual property or brand names, as well as natural resources.

SOEs continue to internationalize, as the number of SO-TNCs has increased significantly in the past two years, to 845 in 2012.[4] Their composition is changing. The relative share of developing and transition country SO-TNCs in the total number of SOEs investing abroad also rose, from 53 per cent of all major SOE international investors in 2010 to over 60 per cent in 2012. Notable home countries include Malaysia, India and the Russian Federation, where the number of SOEs investing abroad has more than doubled since 2010.

The distribution of SO-TNC investment by sector and industry has not changed much in the past two years: the vast majority of SOEs investing abroad (about 70 per cent of firms) are in the services sector – in particular, financial services, transportation and communications, and utilities (electricity, gas and water). In 2012, the international investment strategies of developed and developing country SO-TNCS continued to reflect the sectors in which their principal SOEs are involved: the most active SO-TNCs from developed countries tend to be utilities; in developing economies, they are more likely to be involved in extractive industries.

(iii) Private equity funds

Private equity firms engaged in a growing number of M&A deals, though their net FDI fell by 34 per cent.

Although private equity is considered separately in this section, institutional investors, like government-owned pension funds and SWFs, also participate in private equity funds, which makes public-private distinctions less clear cut.

Following the crash in private equity investment after the global economic crisis, there was a small recovery in flows from 2009 to 2011. This recovery appears to have come to an end in 2012, with net private equity FDI falling by 34 per cent, from $77 billion to $51 billion (table I.2). At the same time, divestment of foreign affiliates by private equity funds increased, illustrated by the growing ratio of net to gross deals, which is the largest on record for which data are available (table I.2). However, while the value of deals fell, the net number of deals involving private equity and hedge funds stood at its second highest level (and the gross number at an all-time high), increasing by 22 per cent from 2011. The period of the mega-deal appears over, but the proliferation in the number of deals last year demonstrates that private equity is still viable, despite being constrained by a less favourable credit environment since the global crisis.

Debt-driven private equity deals – leveraged buy-outs (LBOs) – which peaked just before the economic crisis in 2007 will continue to face refinancing problems in 2014. The favourable credit conditions that characterized pre-crisis debt markets helped fuel the increase in private equity, and in particular highly leveraged acquisitions; post-crisis, credit conditions have become less favourable, partly explaining the fall in the value of LBOs.

A look at the sectoral distribution of cross-border M&As by private equity firms shows a preference for

investment in the services sector, with finance and other services accounting for 74 per cent of all private equity investment (figure I.15). Since 2011, mining, quarrying and petroleum has slightly increased its share in the distribution of private equity investment, although food, beverages and tobacco has shrunk to its lowest share at less than 1 per cent of total private equity investment, from almost 10 per cent in 2011.

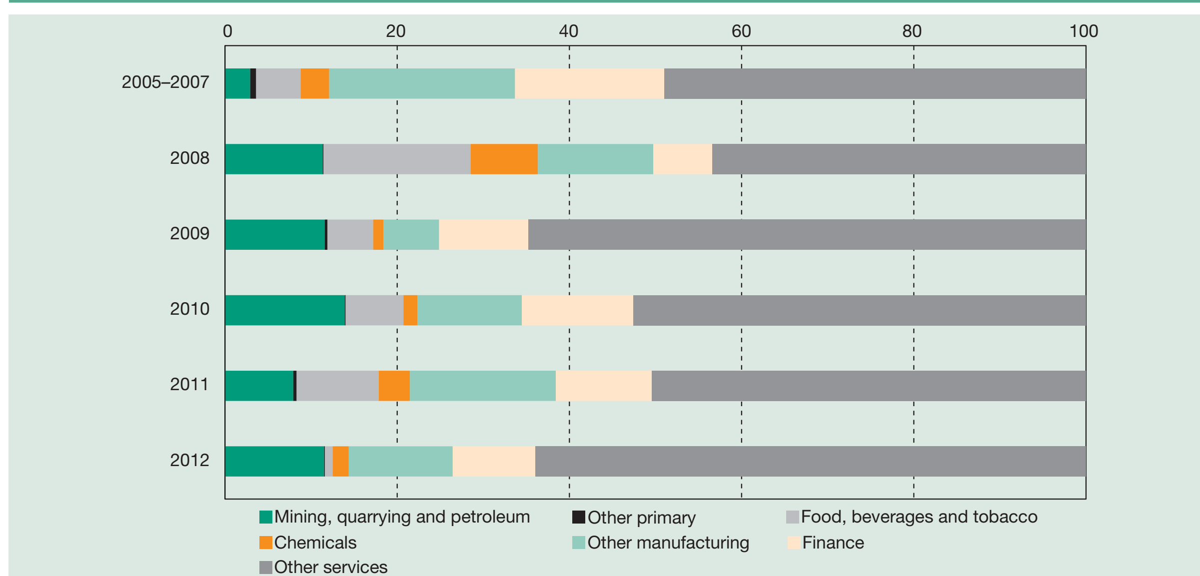
Table I.2. Cross-border M&As by private equity firms, 1996–2012
(Number of deals and value)

	Gross M&As				Net M&As			
	Number of deals		Value		Number of deals		Value	
Year	Number	Share in total (%)	$ billion	Share in total (%)	Number	Share in total (%)	$ billion	Share in total (%)
1996	932	16	42	16	464	13	19	14
1997	925	14	54	15	443	11	18	10
1998	1 089	14	79	11	528	11	38	9
1999	1 285	14	89	10	538	10	40	6
2000	1 340	13	92	7	525	8	45	5
2001	1 248	15	88	12	373	9	42	10
2002	1 248	19	85	18	413	13	28	11
2003	1 488	22	109	27	592	20	53	29
2004	1 622	22	157	28	622	17	76	33
2005	1 737	20	221	24	795	16	121	26
2006	1 698	18	271	24	786	14	128	20
2007	1 918	18	555	33	1 066	15	288	28
2008	1 785	18	322	25	1 080	17	204	29
2009	1 993	25	107	19	1 065	25	58	23
2010	2 103	22	131	18	1 147	21	65	19
2011	2 020	19	153	14	902	15	77	14
2012	2 229	23	182	22	1 104	20	51	16

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

Note: Value on a net basis takes into account divestments by private equity funds. Thus it is calculated as follows: Purchases of companies abroad by private equity funds (-) Sales of foreign affiliates owned by private equity funds. The table includes M&As by hedge and other funds (but not sovereign wealth funds). Private equity firms and hedge funds refer to acquirers as "investors not elsewhere classified". This classification is based on the Thomson Finance database on M&As.

Figure I.15. Cross-border M&As by private equity firms, by sector and main industry, 2005–2012
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

Note: Not adjusted to exclude FDI by SWFs.

d. FDI and offshore finance

Rising FDI in offshore financial centres (or tax havens) and special purpose entities challenges efforts to increase transparency in international financial transactions and reduce tax avoidance. This global issue requires a multilateral approach.

Since the beginning of 2008, driven in large part by increased pressure on public finances as a result of the financial crisis, the international community has renewed and strengthened efforts to reduce tax avoidance and increase transparency in international financial flows. For example, improving tax transparency and promoting information exchange have been key features of deliberations at G-20 summits since their inception. Significant pressure has been put on tax havens by the international community, on individuals and firms by governments, and on multinationals by activist groups to limit their facilitation or use of tax avoidance schemes.

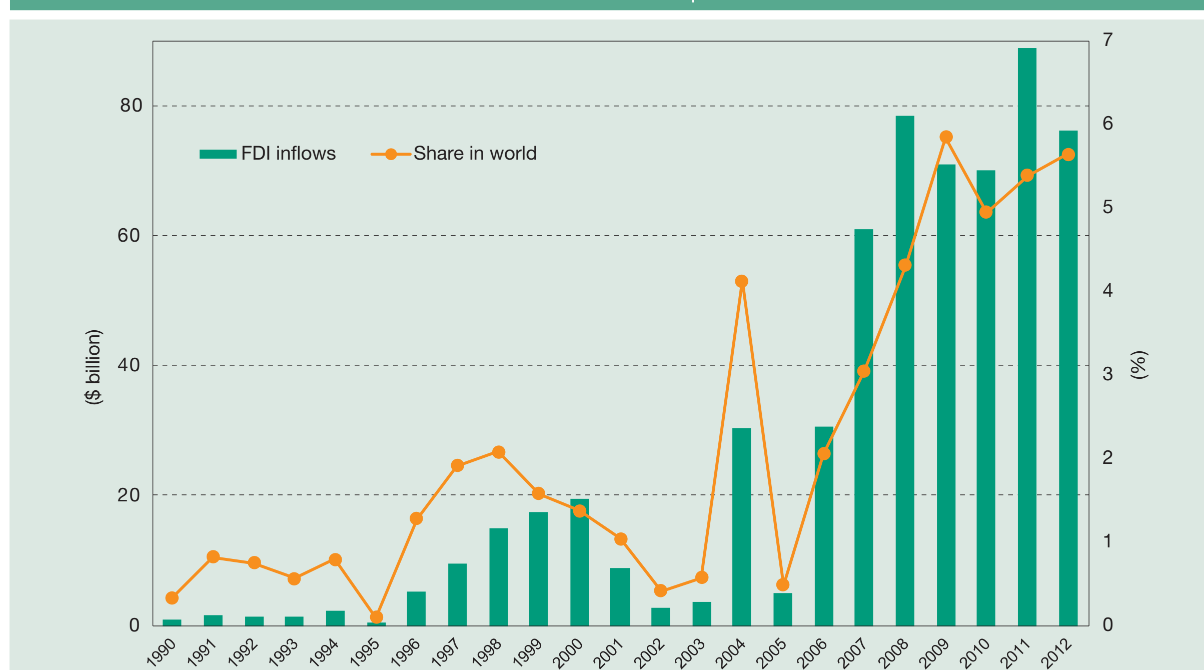
Offshore finance in FDI flows and stocks: macro trends

Offshore finance mechanisms in FDI include mainly (i) offshore financial centres (OFCs) or tax havens[5] *and (ii) special purpose entities (SPEs).* SPEs are foreign affiliates that are established for a specific purpose (e.g. administration, management of foreign exchange risk, facilitation of financing of investment) or a specific structure (e.g. holding companies). They tend to be established in low-tax countries or in countries that provide specific tax benefits for SPEs. They may not conduct any economic activity of their own and have few employees and few non-financial assets. Both OFCs and SPEs are used to channel funds to and from third countries.

Investments to OFCs remain at historically high levels. In 2012 FDI flows to OFCs were almost $80 billion, despite a contraction of about $10 billion (-14 per cent) compared with 2011 (figure I.16).[6] Flows to OFCs have boomed since 2007, following the start of the financial crisis. The average annual FDI inflows to OFCs in the period 2007–2012 were $75 billion, well above the $15 billion average of the pre-2007 period (2000–2006). Tax haven economies now account for a non-negligible and increasing share of global FDI flows, at about 6 per cent.

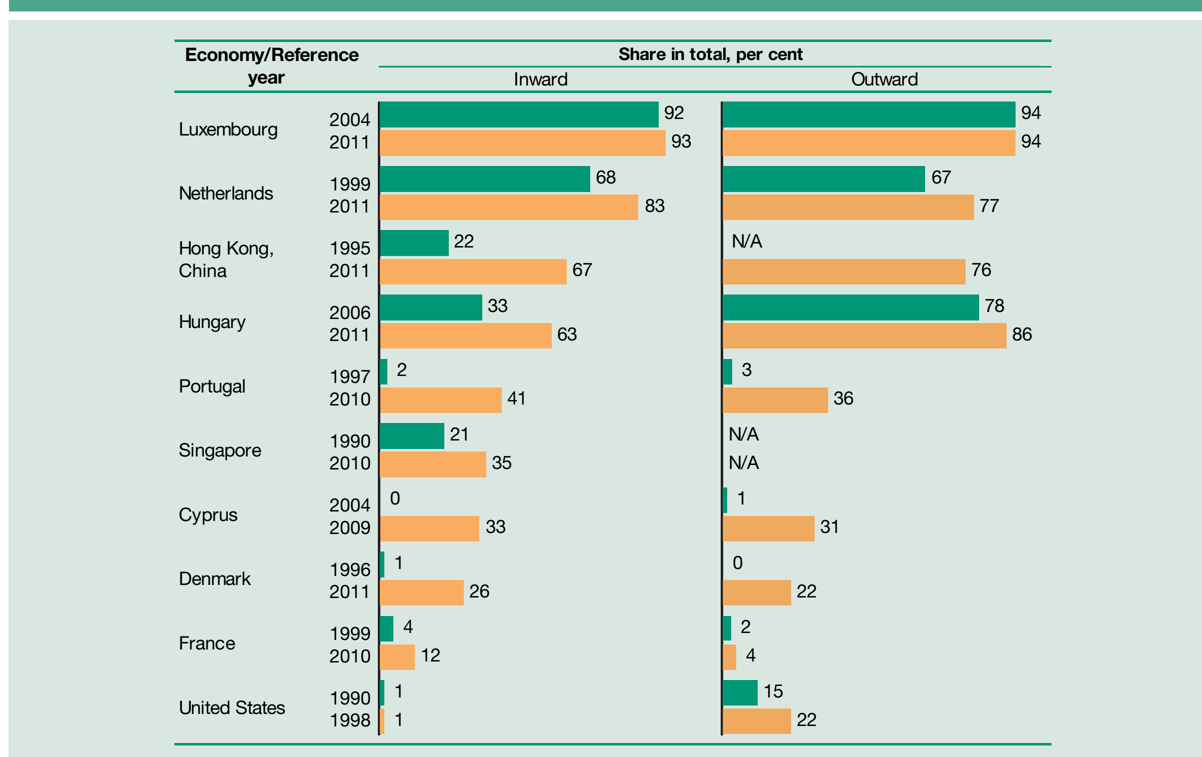
FDI flows to OFCs do not stay there but are redirected. A significant part of inflows consists

Figure I.16. Value and share of OFCs in global FDI flows, 1990–2012
(Billions of dollars and per cent)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

Figure I.17. FDI stock in financial holding companies, selected economies



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).
Note: Data for Hong Kong (China) in 2011 refer to investment holdings, real estate and various business activities.

of "round–tripping" FDI to the original source countries. For example, the top three destinations of FDI flows from the Russian Federation – Cyprus, the Netherlands and the British Virgin Islands – coincide with the top three investors in the Russian Federation (see also the discussion in chapter II.A.6). Such flows are more akin to domestic investments disguised as FDI. The bulk of inflows in OFCs consists of FDI in transit that is redirected to other countries.

Financial flows through SPEs in Luxembourg, the Netherlands and Hungary are not counted in UNCTAD's FDI data. However, *relative to FDI flows and stocks, SPEs are playing a large and increasing role in a number of important investor countries* (figure I.17). These entities play a role similar to that of OFCs in that they channel financial flows for investment and redirect them to third countries. Luxembourg and the Netherlands are typical examples of countries that provide favourable tax treatment to SPEs. Over the past decade, in most economies that host SPEs, these entities have gained importance relative to FDI flows and stocks. This phenomenon is also increasingly involving countries where SPEs had historically played a marginal role, such as Portugal and Denmark. There are no data measuring the extent to which investment in SPEs is directed to activities in the host economy versus activities in other countries, but anecdotal evidence indicates that most is reinvested in third countries. For example, Austrian SPEs, which account for one third of inward FDI stock, are used mostly for investments in Central and Eastern Europe.

The decision to locate investments in economies that host SPEs is driven by the tax treatment of SPEs and also by double-taxation treaties. For example, Mauritius, which has concluded a double-taxation treaty with India, has attracted foreign firms – especially those owned by non-resident Indians – that establish holding firms in Mauritius to invest in India. As a conduit for SPE FDI, Mauritius has become one of the largest FDI sources for India.

Although tax considerations are the main driver for the use of OFCs and SPEs, there are other motivations, e.g.:

- They can be used for tax-neutral solutions, for example, for joint venture partners from countries with different tax regimes.
- They can be used for legal neutrality for shareholders dispersed across different jurisdictions.
- They can help firms from countries with weak institutions to set up an international business more easily and to gain access to international capital markets and legal systems.

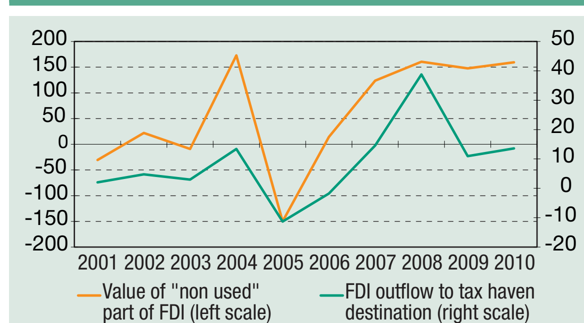
International efforts to reduce tax avoidance and increase transparency, and their effects

Concrete efforts to combat tax avoidance in international financial transactions, mostly promoted by the OECD, have generally focused on OFCs. However, FDI flows to OFCs do not appear to be decreasing, mainly for two reasons:

- *A key driver of funds flowing to OFCs is the level of overseas cash holdings by TNCs* that need to be "parked". In fact, FDI flows into OFCs mirror the estimated levels of retained earnings by TNCs as shown, e.g. by the parallel effect of the 2005 United States Homeland Investment Act both on retained earnings by United States TNCs and on FDI flows to OFCs (figure I.18). Efforts since 2008 to reduce flows to OFCs have coincided with record increases in retained earnings and cash holdings by TNCs.
- *Any effect of initiatives to reduce flows to OFCs from some countries (OECD members) is being offset by the increasing weight of new FDI players in overall global outflows.* FDI flows from the United States to OFCs, for example, decreased by two thirds from $39 billion to $11 billion in 2009, and FDI outflows to OFCs from Japan declined from $23 billion to $13 billion in the same year, but these reductions were compensated by increased flows from emerging outward investors.

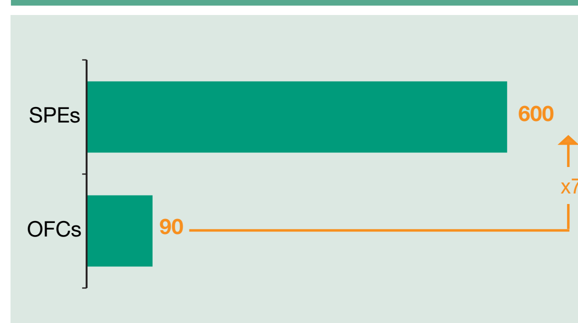
But OFCs are only a small part of the problem. Although most international efforts to combat tax evasion have focused on OFCs, flows through SPEs are far more important. Three countries alone – namely Hungary, Luxembourg and the Netherlands – reported more than $600 billion in investment flows to SPEs for 2011 compared with $90 billion of flows to OFCs (figure I.19) (As mentioned above, UNCTAD does not include flows to SPEs in these countries in global FDI flows statistics.) Any change in the use of SPEs, thus, would dwarf variations in OFC flows. And although this section covers only FDI flows and stocks (and not operational data), it is likely that transfer pricing schemes through lower tax jurisdictions not listed as OFCs and without the use of SPEs account for even more tax avoidance.

Figure I.18. Investments in OFCs and retained earnings by United States TNCs, 2001–2010
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics). See also *WIR11*, box.1.2.

Figure I.19. Estimated investment flows to SPEs and OFCs, 2011
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

Note: Include only flows to SPEs based in Hungary, Luxembourg and the Netherlands.

The way forward: policy considerations

Possible policy responses are complex, but a number of observations can be made:

- *Tackling OFCs alone is clearly not enough,* and is not addressing the main problem.
- *Engaging emerging new outward FDI players is a must.* An assessment of the role of new outward investors should take into account that their use of OFCs is often not only for tax avoidance but for other potential benefits they cannot obtain in their home economies (e.g. easy company set-up, trade policy advantages, international investment agreements). Also, their relative use of sophisticated alternative tax avoidance mechanisms and SPEs is lower.
- *Tax avoidance and transparency in international financial transactions are global issues that require an intensified multilateral approach.*
- Ultimately, *moves to combat tax avoidance through OFCs and SPEs must go hand in hand with a discussion of corporate tax rate differentials between countries, the application of extraterritorial tax regimes, and the utility of triggering tax liabilities upon repatriation of earnings*. Without parallel action on those fronts, efforts to reduce tax avoidance through OFCs and SPEs remain akin to swimming against the tide. Such a discussion could also include transfer pricing mechanisms beyond OFCs and SPEs, including radical solutions to distribute tax revenues fairly across the operations of TNCs based on real value added produced (e.g. based on a formula including sales, assets and employees, in a unitary approach).
- Policymakers could have a useful discussion on *a list of "acceptable" or "benign" non-tax drivers of use of OFCs (and SPEs).* That would help focus any future measures on combating the malign aspects of tax avoidance and lack of transparency.
- Finally, investment flows to and from OFCs and SPEs requires attention from policymakers, and monitoring such investment flows is important. International organizations recommend that the data-compiling countries collect detailed information on transactions by SPEs and make it available separately from traditional FDI data. However, *data remain scarce and the visibility of sources and destinations of FDI funds is marginal.* Further research will be helpful in improving transparency on the issue.

2. Global FDI prospects in 2013–2015

a. General FDI prospects

Global FDI flows in 2013 are expected to remain at the 2012 level. As investors regain confidence, flows will rise in 2014–2015. However, significant risks remain.

FDI flows in 2013 are expected to remain close to the 2012 level, with an upper range of $1.45 trillion. As investors regain confidence in the medium term, flows are expected to reach levels of $1.6 trillion in 2014 and $1.8 trillion in 2015 (figure I.20). This scenario is based on various leading indicators, as well as the results of UNCTAD's World Investment Prospects Survey 2013–2015 (WIPS), an econometric model of forecasting FDI inflows (*WIR11*), and data for the first four months of 2013 for cross-border M&As and greenfield investment values.

Responses to this year's WIPS (box I.2) support this scenario. According to this year's WIPS one half of all respondents remain neutral about the global investment outlook for 2013. However, their expectations for 2014 and 2015 improve sharply (figure I.21). When asked about their intended FDI expenditures, half of the respondents forecast an increase over 2012 levels in each of the next three years. Among the factors positively affecting FDI over the next three years, the two mentioned most were the state of the economy in the BRICS and the United States.

Similarly, the econometric model shows that FDI flows in 2013 are projected to remain almost at the same level or increase slightly at best, reaching their pre-crisis level. Several international organizations and research institutes forecast slightly higher FDI in 2013. For example, the IMF's current *World Economic Outlook* estimated a moderate increase in net FDI inflows in emerging economies to $477 billion in 2013 from $446 billion in 2012 (IMF, 2013). Estimates of net FDI inflows from the Institute of

Figure I.20. Global FDI flows, 2004–2012, and projections, 2013–2015
(Billions of dollars)

Source: UNCTAD FDI/TNC database (http://www.unctad.org/fdistatistics).

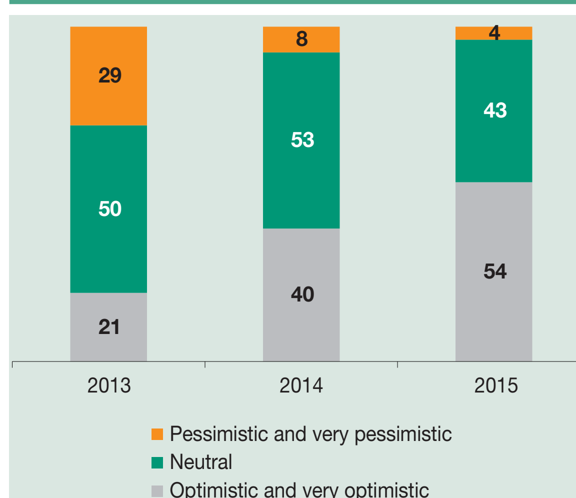
International Finance for 30 emerging economies are $517 billion in 2013 compared with $499 billion in 2012 (IIF, 2013).

Firm-level factors also support the UNCTAD forecast. Annual TNC profits in 2012 were lower than in 2011 but remained at high levels (figure I.22). There is an indication that in the first quarter of 2013, the level of cash holdings of the largest TNCs has been lower than that in the same period last year, as companies are using part of their available cash to acquire companies abroad. Data on greenfield investment and cross-border M&As in the first few months of 2013 have not indicated an upward trend. This may be translated into higher levels of investment in the near future.

However, significant risks to this growth scenario remain. Factors such as structural weaknesses in the global financial system, the possible deterioration of the macroeconomic environment, and significant policy uncertainty in areas crucial for investor confidence might lead to a further decline in FDI flows.

When asked about the principal factors affecting FDI flows in the medium term, TNCs in the survey put the state of the EU economy at the top of their worries, followed closely by political factors, such as the adoption of austerity policies, the rise of trade protectionism, and sovereign debt concerns.

Figure I.21. TNCs' perception of the global investment climate, 2013–2015
(Percentage of respondents)



Source: UNCTAD survey.
Note: Based on 159 company responses.

Box I.2. World Investment Prospects Survey, 2013–2015: methodology and results

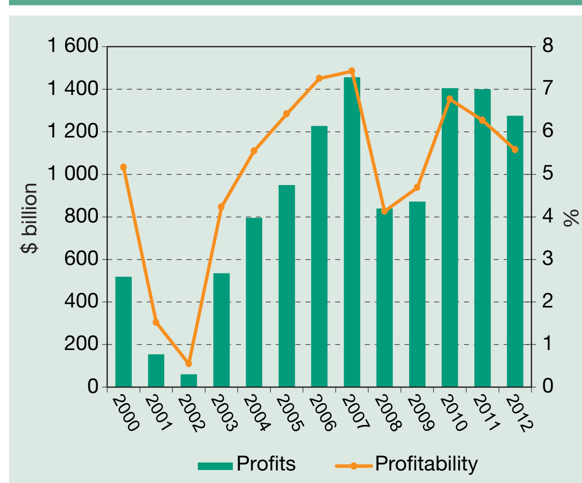
The aim of the WIPS is to provide insights into the medium-term prospects for FDI flows. This year's survey was directed to executives among the largest 5,000 non-financial TNCs and professionals working in 245 national and sub-national investment promotion agencies (IPAs). Questions for TNC executives were designed to capture their views on the global investment climate, their companies' expected changes in FDI expenditures and internationalization levels, and the importance their companies give to various regions and countries. IPAs were asked about their views on the global investment climate and which investor countries and industries were most promising in terms of inward FDI.

This year's survey results are based on 159 and 64 validated responses by TNCs and by IPAs, respectively, collected by e-mail and through a dedicated website between February and April 2013. TNCs in developed economies accounted for 79 per cent of responses, while TNCs from developing and transition countries represented 21 per cent of responses. In terms of sectoral distribution, 66 per cent of respondent TNCs were classified as operating in the manufacturing sector, 27 per cent in the services sector, and 7 per cent in the primary sector. For IPAs, 69 per cent of respondents were located in developing or transition economies and 31 per cent were located in developed economies.

Source: UNCTAD.

A number of countries have also implemented a significant number of policies that regulate or restrict investment, bringing the share of such measures to a recent high, although investment liberalization and promotion remained the dominant feature of national investment policies (chapter III).

Figure I.22. Profitability and profit levels of TNCs, 2000–2012
(Billions of dollars and per cent)



Source: UNCTAD, based on data from Thomson ONE.
Note: The number of TNCs covered in this calculation is 3,039. Profitability is calculated as the ratio of net income to total sales.

b. FDI prospects by sector/industry

FDI expenditures are set to increase, but short-term concerns about the global investment climate are common across industries. Certain manufacturing industries face gloomy short-term prospects.

Reflecting the general trend shown by the WIPS survey, TNCs across all major sectors are cautious about the international investment climate in 2013 but more optimistic in the medium term. Short-term FDI plans vary across sectors and industries, with respondents from some manufacturing industries such as leather, stone, clay and glass products and metals, as well as from transportation services and metal mining indicating falling investments in the short term. In contrast, more than half of the TNCs active in the remaining manufacturing industries and in the trade and other services industries already foresee an increase in their FDI budgets in 2013. By 2015, almost half of TNCs in all sectors expect to see an increase in their FDI expenditures, in line with their rising optimism for the global investment environment.

On the host country side, the view from investment promotion agencies (IPAs) for inward FDI differs by region (figure I.23). IPAs in developed economies anticipate good prospects for FDI in business services, such as computer programming and consultancy. African IPAs expect further investments in the agriculture sector, while Latin American

IPAs emphasize the extractive industry, tourism and services. Asian IPAs refer to prospects in a wider range of industries for inward FDI, including agriculture, oil and gas, food products, construction and transport. Transition economy IPAs have high expectations for the machinery and textiles industries, most probably positioning themselves as major suppliers to Western European TNCs.

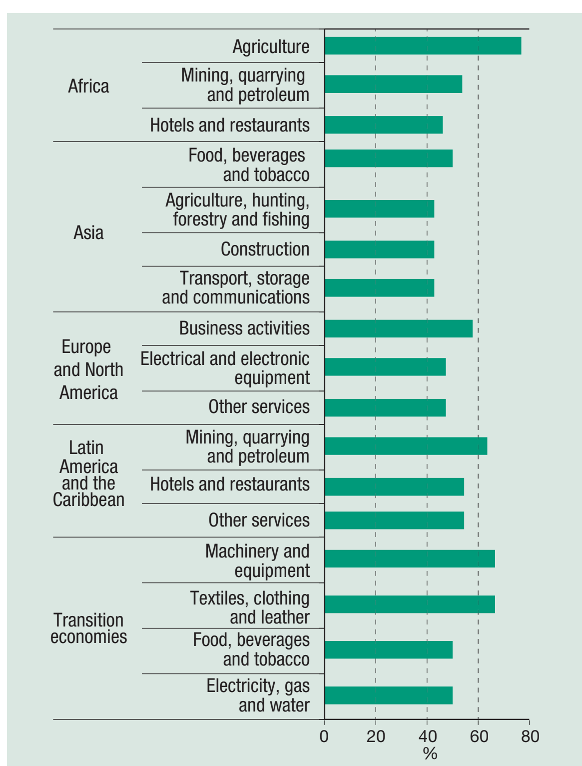
c. FDI prospects by home region

FDI expenditures are set to expand from both developed and developing home countries.

Despite uncertainties for 2013, more than half (57 per cent) of respondents from developing countries and about 40 per cent of those from developed countries forecast an increase in their FDI expenditures over 2012 levels. Differences across the two groups of countries exist, however, when comparing medium-term prospects. In particular, less than 4 per cent of developed-country TNCs expect their FDI budgets to decline in 2015, compared with almost 12 per cent of TNCs from developing countries. A possible trend in the medium term therefore could be a shift back towards developed-country TNCs as main outward investors.

Perhaps anticipating such a prospect, IPAs largely see developed-country TNCs as the most promising sources of FDI in the medium term (figure I.24), although developing economies are becoming more important as investors. Indeed, this year, 60 per cent of IPA respondents ranked China as the most promising source of FDI, thanks largely to the rapid increase of its outward FDI in recent years. The United States, Germany, the United Kingdom, Japan and France ranked as the most promising

Figure I.23. IPAs' selection of most promising industries for attracting FDI in their own country, 2013–2015
(Percentage of IPA respondents)



Source: UNCTAD.
Note: Based on 64 IPA responses. Aggregated by region of responding IPA.

Figure I.24. IPAs' selection of most promising investor economies for FDI in 2013–2015
(Percentage of IPA respondents selecting economy as top source of FDI)

Source: UNCTAD.
Note: Based on 64 IPA responses.

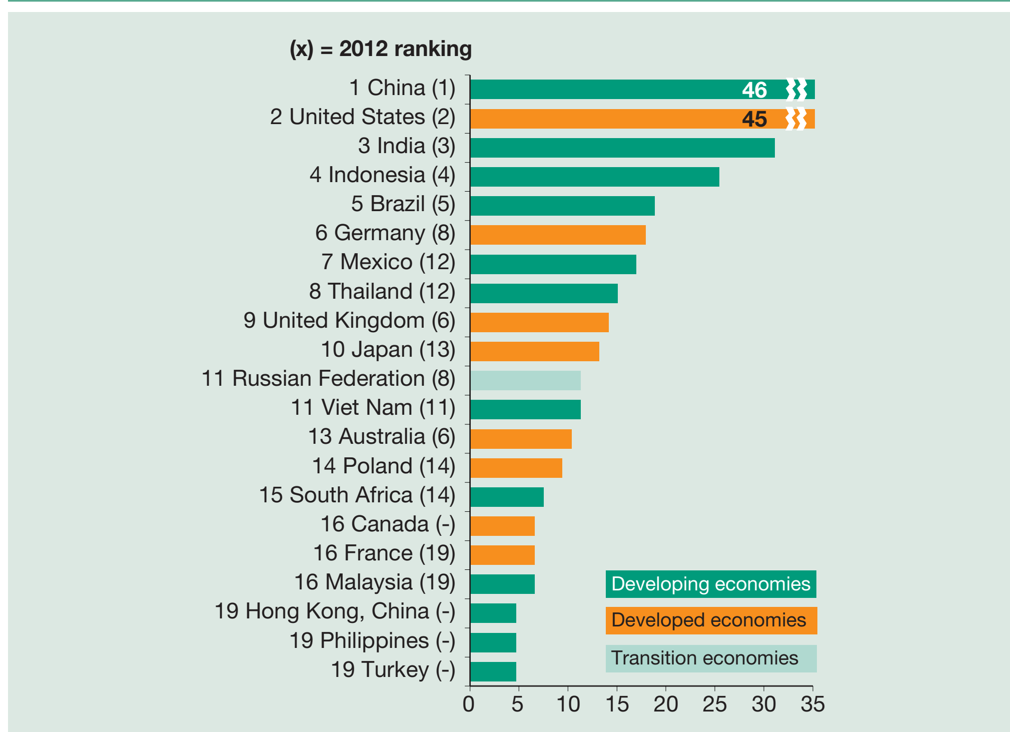
developed-economy investors, underscoring their continuing role in global FDI flows. India, the Republic of Korea, the Russian Federation, the United Arab Emirates and Turkey (for the first time) are also seen as major developing country sources of FDI, while Brazil fell out of the ranking, most likely because of last year's slower outflow activity.

d. FDI prospects by host region

Developing economies will continue to experience strong FDI inflows in the medium term.

For the medium term, IPAs – regardless of location – exhibited rising optimism in terms of FDI inflows, although those in developing and transition economies were most optimistic. This optimism is not unwarranted. TNCs that respond to the survey have increasingly ranked developing host regions as highly important. The ranking of the top five host economies is the same as last year, with China leading the list and cited by 46 per cent of all respondents, followed closely by the United States, cited by 45 per cent. Developing countries make up four of the top five host economies (figure I.25). Six of the top 10 prospective host countries also come from the developing world, with Mexico and Thailand appearing for the first time. Among developed countries, Japan jumped three positions largely because of reconstruction efforts after the 2011 tsunami, and recent expansionary monetary policies have together increased the country's attractiveness for foreign investment in the medium term. At the same time, Australia, the Russian Federation and the United Kingdom slipped down the rankings from last year's survey, while Germany gained two positions.

Figure I.25. TNCs' top prospective host economies for 2013–2015
(Percentage of respondents selecting economy as a top destination)



Source: UNCTAD survey.
Note: Based on 159 company responses.

B. INTERNATIONAL PRODUCTION

1. Overall trends

TNCs' internationalization process grew at a slower pace in 2012, with foreign affiliates' value added and exports rising only moderately.

International production continues to expand, with all indicators of foreign affiliate activity increasing, although at a slower rate than in earlier years (table I.3). Sales rose 7.4 per cent over 2011, continuing their recovery from the lows during the crisis. Employment of foreign affiliates rose by 5.7 per cent, reaching 72 million, while exports of foreign affiliates remained relatively stable in 2012 registering only a small increase of 0.6 per cent. Likewise, value added and assets of foreign affiliates, increased slowly – by 5.5 and 4.3 per cent, respectively, over the previous year. This state of affairs reflects weak economic conditions around the world (section A.1.d). Sluggish economic growth in developed countries affected both developing and transition economies in 2012, through a sharp deceleration in demand from key advanced economies and the end of investment booms in some major emerging market economies.

Global trends in international production are reflected in the internationalization levels of the world's largest TNCs. Data for the top 100 TNCs, mostly from developed economies, show that their internationalization in 2012 slowed. Foreign sales of the largest 100 TNCs in the world declined 2.1 per cent in 2012, while their domestic sales – largely in developed economies – remained stable (table I.4). Likewise, foreign employment and foreign assets stagnated, while their domestic employment and assets increased by 6.8 and 5 per cent, respectively. These data reflect both a change in strategy by the top 100 TNCs that seems to focus more on domestic production and a change in the composition of the top 100 in 2012.

In 2012, some long-established companies significantly reduced their assets (both total and foreign), slipping out of the global top 100 TNC list (e.g. Bayer AG, Nokia OYJ and ThyssenKrupp AG). This enabled some more active corporations from developing and transition economies (e.g. Hon Hai Precision Industries, Vimpelcom Ltd, and América Móvil SAB) to enter the global ranking for the first time.

In fact, data on internationalization indicators for the largest 100 TNCs headquartered in developing and transition economies reveal a strong internationalization effort with steep increases in foreign assets and sales. The foreign assets of TNCs from these economies rose 19.7 per cent in 2011, a rate faster than that of the largest 100 TNCs and almost double the remarkable 11 per cent increase in domestic assets (see table I.4). In 2011, their foreign sales increased by more than a third with respect to the previous year, easily surpassing the growth in domestic sales. The only area where this trend did not hold was in employment, where the growth of domestic jobs slightly outpaced that of foreign jobs in 2011. This trend suggests that while TNCs from developing countries and transition economies are quickly internationalizing their operations, the core of their production process is still based at home.

The importance of the largest TNCs in the universe of TNCs is declining slowly. Their share of all TNCs' foreign assets in 2011 was down to 9.3 per cent, compared with 12 per cent a decade earlier, though their share of foreign affiliates' employment increased marginally from 13.7 per cent in 2001 to 14.4 per cent in 2011. The largest 100 TNCs' share in foreign global sales increased sharply, however, from 13 per cent to 21 per cent over the same time period. The decrease in foreign assets coupled with the increase in foreign sales largely reflects the importance of non-equity modes; i.e. a rising share of foreign production is controlled through contracts rather than direct ownership.

By contrast, the largest 100 TNCs from developing and transition countries are strengthening their position within the TNC universe. Their share in global production is rising: the foreign assets share rose from 0.8 to 1.6 per cent between 2001 and 2011, that of foreign sales went up from 0.9 to 5.9 per cent, and that of foreign employment increased from 1 to 8 per cent during the same period.

Some differences also emerge when comparing M&A deals (figure I.26). The majority of M&A deals by the 100 largest TNCs were conducted in developed economies (just over 300 cross-border

M&A purchases in developed countries against fewer than 100 in developing and transition economies in 2012), while the majority of M&A purchases by developing and transition economies took place in other developing and transition economies (nearly 120 in 2012 against 70 in developed economies). Data suggest that the 100 largest TNCs conduct both vertical and horizontal investments[7] (with variation by year). The 100 largest TNCs from developing and transition economies engage significantly more in vertical investment, both in developed countries (more than 20 vertical purchases against fewer than 10 in 2012) and in developing and transition economies.

Both the largest TNCs and the TNCs from developing and transition economies implement the largest number of greenfield projects in developing and transition economies. In these host economies, TNCs from developing and transition economies tend to establish proportionately more new affiliates than the largest TNCs. By contrast, nearly half of greenfield ventures in developed countries take place through expansion, and the largest TNCs engage more in co-location than the 100 TNCs from developing and transition economies (figure I.27).

Table I.3. Selected indicators of FDI and international production, 1990–2012

	Value at current prices (Billions of dollars)				
Item	1990	2005–2007 pre-crisis average	2010	2011	2012
FDI inflows	207	1 491	1 409	1 652	1 351
FDI outflows	241	1 534	1 505	1 678	1 391
FDI inward stock	2 078	14 706	20 380	20 873	22 813
FDI outward stock	2 091	15 895	21 130	21 442	23 593
Income on inward FDI[a]	75	1 076	1 377	1 500	1 507
Rate of return on inward FDI[b] (per cent)	4	7	6.8	7.2	6.6
Income on outward FDI[a]	122	1 148	1 387	1 548	1 461
Rate of return on outward FDI[b] (per cent)	6	7	6.6	7.2	6.2
Cross-border M&As	99	703	344	555	308
Sales of foreign affiliates	5 102	19 579	22 574	24 198[c]	25 980[c]
Value added (product) of foreign affiliates	1 018	4 124	5 735	6 260[c]	6 607[c]
Total assets of foreign affiliates	4 599	43 836	78 631	83 043[c]	86 574[c]
Exports of foreign affiliates	1 498	5 003	6 320	7 436[d]	7 479[d]
Employment by foreign affiliates (thousands)	21 458	51 795	63 043	67 852[c]	71 695[c]
Memorandum:					
GDP	22 206	50 319	63 468	70 221[e]	71 707[e]
Gross fixed capital formation	5 109	11 208	13 940	15 770	16 278
Royalties and licence fee receipts	27	161	215	240	235
Exports of goods and services	4 382	15 008	18 956	22 303[e]	22 432[e]

Source: UNCTAD.

[a] Based on data from 168 countries for income on inward FDI and 136 countries for income on outward FDI in 2012, in both cases representing more than 90 per cent of global inward and outward stocks.
[b] Calculated only for countries with both FDI income and stock data.
[c] Data for 2011 and 2012 are estimated based on a fixed effects panel regression of each variable against outward stock and a lagged dependent variable for the period 1980–2010.
[d] Data for 1995–1997 are based on a linear regression of exports of foreign affiliates against inward FDI stock for the period 1982–1994. For 1998–2012, the share of exports of foreign affiliates in world export in 1998 (33.3 per cent) was applied to obtain values.
[e] Data from IMF, World Economic Outlook, April 2013.

Note: Not included in this table are the value of worldwide sales by foreign affiliates associated with their parent firms through non-equity relationships and of the sales of the parent firms themselves. Worldwide sales, gross product, total assets, exports and employment of foreign affiliates are estimated by extrapolating the worldwide data of foreign affiliates of TNCs from Australia, Austria, Belgium, Canada, Cyprus, the Czech Republic, Finland, France, Germany, Greece, Hungary, Israel, Italy, Japan, Latvia, Lithuania, Luxembourg, Norway, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, the United Kingdom and the United States for sales; those from Cyprus, the Czech Republic, France, Israel, Japan, Portugal, Romania, Slovenia, Sweden, and the United States for value added (product); those from Austria, Germany, Japan and the United States for assets; and those from Australia, Austria, Belgium, Canada, Cyprus, the Czech Republic, Finland, France, Germany, Greece, Hungary, Italy, Japan, Latvia, Lithuania, Luxembourg, Macao (China), Norway, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States for employment, on the basis of the shares of those countries in worldwide outward FDI stock.

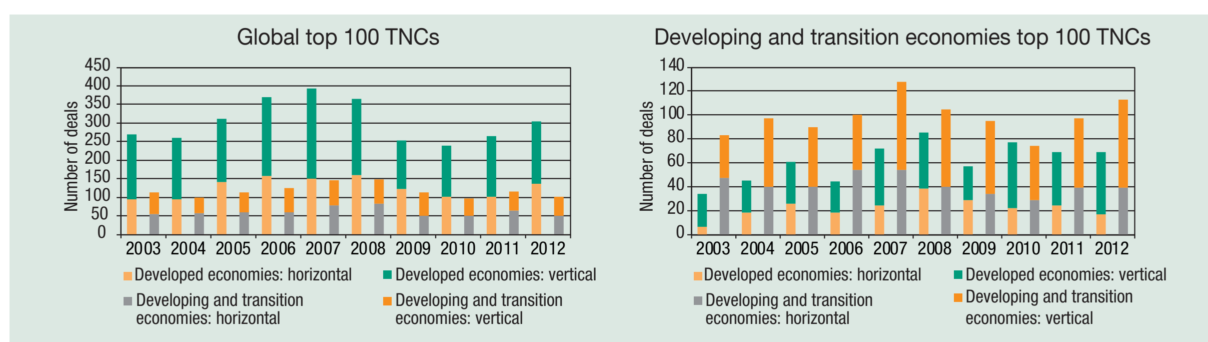
Table I.4. Internationalization statistics of 100 largest non-financial TNCs, worldwide and from developing and transition economies, 2010–2012

Variable	100 largest TNCs worldwide					100 largest TNCs from developing and transition economies		
	2010	2011[a]	2010–2011 % Change	2012[b]	2011–2012 % Change	2010	2011	% Change
Assets (billions of dollars)								
Foreign	7 285	7 634	4.8	7 698	0.8	1 104	1 321	19.7
Domestic	4 654	4 897	5.2	5 143	5.0	3 207	3 561	11.0
Total	11 939	12 531	5.0	12 842	2.5	4 311	4 882	13.2
Foreign as % of total	61	61	-0.1	60	-1.0[c]	26	27	1.5[c]
Sales (billions of dollars)								
Foreign	4 883	5 783	18.4	5 662	-2.1	1 220	1 650	35.3
Domestic	2 841	3 045	7.2	3 065	0.7	1 699	1 831	7.8
Total	7 723	8 827	14.3	8 727	-1.1	2 918	3 481	19.3
Foreign as % of total	63	66	2.3[c]	65	-0.6[c]	42	47	5.6[c]
Employment (thousands)								
Foreign	9 392	9 911	5.5	9 845	-0.7	3 561	3 979	11.7
Domestic	6 742	6 585	-2.3	7 030	6.8	5 483	6 218	13.4
Total	16 134	16 496	2.2	16 875	2.3	9 044	10 197	12.7
Foreign as % of total	58	60	1.9[c]	58	-1.7[c]	39	39	-0.3[c]

Source: UNCTAD.
[a] Revised results.
[b] Preliminary results.
[c] In percentage points.

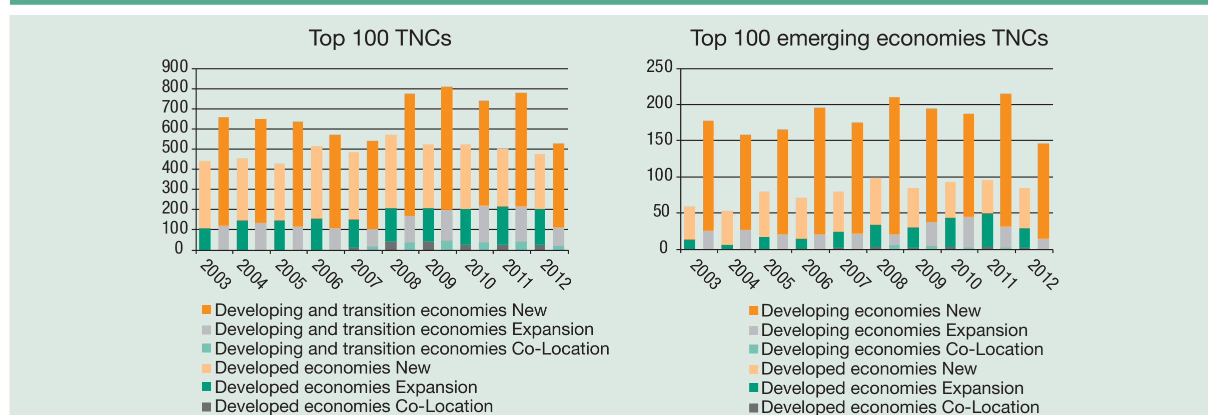
Note: From 2009 onwards, data refer to fiscal year results reported between 1 April of the base year to 31 March of the following year. Complete 2012 data for the 100 largest TNCs from developing and transition economies were not available at press time.

Figure I.26. M&A cross-border purchases in developed, developing and transition economies by largest TNCs: number of horizontal vs vertical investments, 2003–2012



Source: UNCTAD.

Figure I.27. Global top 100 TNCs greenfield projects by region and type, 2003–2012
(Number of projects)



Source: UNCTAD.

2. Repositioning: the strategic divestment, relocation and reshoring of foreign operations

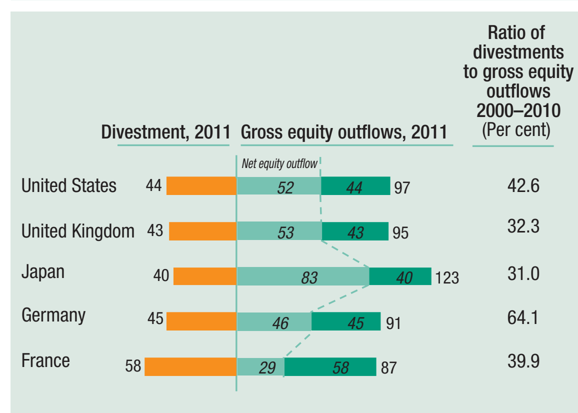
Many TNCs reprofiled their investment overseas through divestment. Reshoring and relocation of foreign affiliates are important elements of corporate divestment strategy.

A decline in global FDI outflows may result from fewer (or smaller) global investment projects and also from divestment decisions by TNCs (box I.3). In some cases, divestment from a location is part of a TNC's repositioning of operations internationally to reflect changing patterns of demand or locational competitiveness. TNCs can relocate either to a third country or to their home country (reshoring). TNCs engage in reshoring of activities when costs associated with offshoring become high or the distance between markets or activities is disadvantageous.[8]

Divestments are a constituent element of TNCs' international strategies, representing an aspect of their positioning of assets and activities in a dynamic global economy. Divestment decisions may involve the complete or partial sale of foreign affiliates by parent firms to local or third-country firms, or reduce equity investment by parent firms in their foreign affiliates, or complete closure of affiliates. Divestment can also be partly or purely financial. Where an operation in a host country is closed, this may be accompanied by the reshoring of operations or activities back to a TNC's home country and/or their relocation from one host country to another.

Although data on divestment are scarce, evidence shows that it is a significant phenomenon. France, Germany, Japan, the United Kingdom and the United States are among the few countries that report statistics on divestment as a part of their FDI dataset. For these countries, the scale of divestment is significant, ranging from one third (Japan) to two thirds of gross equity outflows (France) in 2011. For example, in the United Kingdom, gross equity outflows were $95 billion in 2011, but equity divestment from the country was $43 billion, which means that net equity outflows were only $53 billion (figure I.28). The scale of divestment varies over time, depending on factors such as the business cycle, corporate strategies and the business environment. Over the period 2000–2010, for instance, the ratio of equity divestment to gross equity outflows for France was only 39.9 per cent, far lower than the 2011 figure (67 per cent) (see figure I.28).

Figure I.28. Equity divestment in 2011 and its ratio to gross equity outflows, 2000–2010, from France, Germany, Japan, the United Kingdom and the United States
(Billions of dollars and per cent)



Source: UNCTAD, based on information from the Banque de France; Deutsche Bundesbank, Bank of Japan, United Kingdom Office of National Statistics and United States Bureau of Economic Analysis.

Repositioning decisions may arise from a major realignment of locational factors. For instance, many United States manufacturing TNCs are reconsidering the location of some international operations because four trends – rising wage costs in developing countries, a weak dollar, technological advances such as 3D printing, and falling energy costs in the economy (arising from the extensive exploitation of shale gas) – are improving the United States' manufacturing competitiveness. As a whole, however, most repositioning decisions are more modest, reflecting the ongoing evolution of the world economy, GVCs and TNC strategies.

If divestment is linked to relocation (to a third country) or reshoring (back to the home country), it is not synonymous with a decline in the number of overseas operations by a TNC. Similarly, under the best circumstances for a host economy, if another company invests in the operation that the TNC is divesting from, divestment may not result in loss of local employment or productive capacity. However, this may not be the case: full closures or

Box I.3. TNCs' strategic repositioning and divestment

TNCs adopt dynamic strategies towards the global configuration of their activities and, for this reason, divestment and new investments go hand in hand. TNCs govern a complex internal system of interlocking value added activities positioned across countries. This system evolves continuously, with expansion in one sector or territory sometimes accompanied by contraction in another. The composition and organization of value added activities by a TNC change continuously to respond to exogenous environmental, technological and social factors, as well as new endogenous strategic priorities. The key forms of strategic positioning are defined below.

Offshoring Offshoring is the process of transferring part or all of the value added activities conducted by a TNC from the home country to another. When it engages in offshoring, the TNC maintains ownership over activities conducted overseas. This differs from offshore outsourcing, which involves purchasing products or services from another firm located overseas.

Divestment Divestment is the process of reverse investment, involving capital withdrawals and reduction in the stock of assets TNCs hold abroad. Divestment can involve either full or partial withdrawals of foreign assets. It is difficult to measure globally because FDI statistics are recorded on a balance-of-payments basis. National statistics do not report the magnitude of divestment explicitly because they record only *net* flows or stocks.

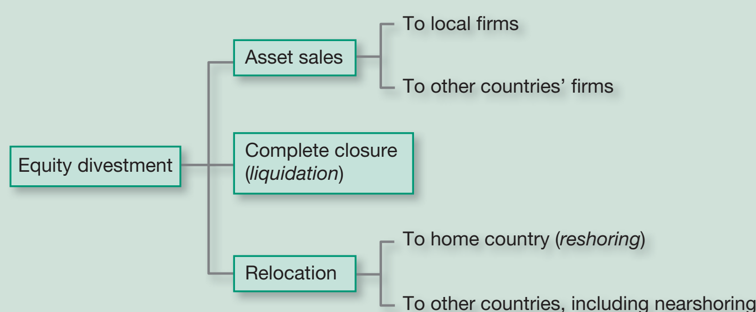
Relocation Relocation is the movement of existing assets, resources and people from one location to another. It can be linked to divestment. TNCs may decide to relocate all or part of value added activities in response to new environmental conditions or to reflect new strategies adopted by the firm. Relocation can take place within a host country, across borders to a new host country or back to the home country of the TNC.

Reshoring Reshoring is the process through which a TNC relocates all or part of value added activities conducted abroad back to the home country of the TNC.

Nearshoring Nearshoring is the process of positioning all or part of the value added activities in a country that is geographically, economically and culturally close to the country of origin of the TNC.

In terms of operational elements, equity divestment involves asset sales, liquidation and relocation (box figure I.3.1).

Box figure I.3.1. Structure of equity divestment



Source: UNCTAD.

scaling down of operations can lead to losses in employment, local incomes, tax receipts, etc. As TNCs continue to give a proportionally greater role to NEMs, as opposed to affiliates in their international production networks, divestment or reshoring may be further intensified. For instance, the impact of reshoring information technology (IT) services away from a host country partner is similar to that of divesting an affiliate, and with less cost for the TNC, which may make such decisions more likely. It is therefore incumbent on host country governments to be aware of TNCs' positioning, divestment and relocation strategies (including reshoring), both in general and in how they are likely to affect the host country.

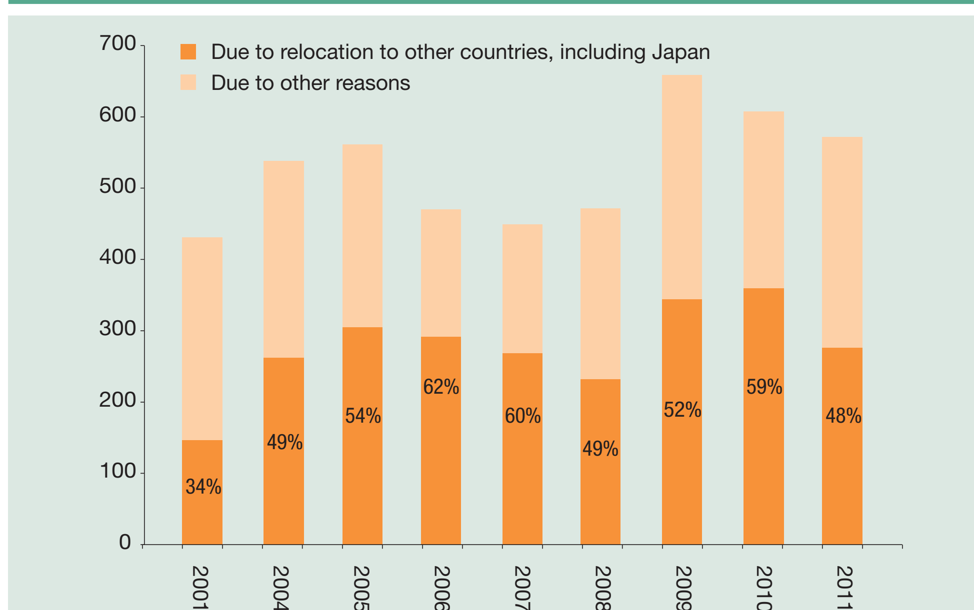
Over the period 2000–2011, divestment was more than 30 per cent of gross equity outflows for Japanese TNCs (see figure I.28). The main reason for affiliates' closures – in those cases where data are available – is their strategic decision to relocate operations to other countries, including reshoring to Japan. Indeed, relocation appears to be a significant feature of Japanese TNCs' positioning and divestment strategies. According to a survey by Japan's Ministry of Economy, Trade and Industry, in 2011 about half of divested affiliates were relocated either back to Japan or other countries (figure I.29). Another survey, by Toyo Keizai, shows that relocation to third countries is rising: in 2011–2012, one quarter of all divested firms were relocated to third countries, compared with one tenth a decade ago. These two surveys reveal that one half of relocated firms are involved in reshoring for Japanese TNCs.

A number of factors can drive divestment decisions. Some relate to changes in global or regional TNC strategies, others to evolving environments in host markets, or to the industry-specific economic environment. (For some examples explaining the recent reshoring of manufacturing operations back to the United States, see table I.5.) Apart from changes in financing operations, TNC strategies that drive divestment include:

- evolving global or regional strategies; for instance to reorganize, restructure and/or downsize with the purpose of raising efficiency through a reconfiguration of international production networks of the TNC;
- changes in market servicing decisions, for instance by moving away from direct production to the use of NEMs; or
- the poor performance of foreign affiliates (a survey of 500 Japanese foreign affiliates involved in divestment strategies in 2011 shows that 15 per cent of them were closed because of poor performance (Japan, METI, 2013)).

Divestment can also occur following changes in host country environments, for instance when significant cost savings can be gained by relocating (such as relocation from higher- to lower-cost countries), or when local operating conditions become unfavourable (including policy shifts or rising competitive pressures). Firms can decide to divest when local competitive pressures are too

Figure I.29. Number of Japanese foreign affiliates closed, 2001 and 2004–2011



Source: UNCTAD, based on data from Japan, Ministry of Economy, Trade and Industry.

high. For instance, the divestment ratio tends to be high in the United States, where foreign affiliates' profitability is low (the rate of return to FDI in 2011 was 4.8 per cent).

Finally, industry- and technology-related factors can drive divestment decisions, which result from dynamic changes occurring through the industry life cycle or industry-level consolidation (as industries mature). High-tech knowledge-based industry segments quickly reach a stage of maturity or require different types of technology. These shifts in technology may lead to divestment decisions.

There are a number of policy implications to draw from the divestment activities of TNCs. For host economies, the key questions are about the type and strategy of investment conducted by TNCs; whether divestment leads to a sale (capital divestment) or a closure (liquidation) of the foreign affiliate; and the reasons behind divestments. Companies may decide to divest because locational advantages offered by the country are no longer favourable. Host governments therefore need to consider how attractive their country is to new investment as much as to existing firms. As countries develop, it can be expected that low value added types of activities will relocate to countries that offer cheaper factors of production. Divestment of certain segments of GVCs, in this case, may reflect the development objectives of host governments. But this should go hand in hand with a shift towards higher value-added types of activities. When a divestment is driven by shrinking opportunities worldwide, often coupled with financial difficulties faced by TNCs, host governments may consider intensifying their aftercare services with a view to retaining FDI in the country.

Research on divestment is in its early stages, in part because data are insufficient. Further research and detailed data on divestment are required because it is a significant phenomenon and entails a number of implications for policymaking.

Table I.5. Selected cases of reshoring of manufacturing operations to the United States, 2010–2013

Company	Reshored from	Comments
ACE Clearwater Enterprises	Hungary, China	The company, a maker of complex formed and welded assemblies for aerospace and energy generation, reshored mainly because of quality control issues.
Altierre Digital Retail	China	The company makes digital displays and signs for retail stores. The reshoring introduced automation processes in order to make labor an insignificant part of overall production costs and demanded skilled workers.
Bison Gear & Engineering Corp.	China	The company's end products, gear motors, are used in products from ice machines to solar panels. Reshoring to make motors in-house enabled the company to respond quickly to changes in demand.
Farouk Systems	Republic of Korea, China	A manufacturer of hair and spa products had various reasons to move operations, from the climate to the international mix of residents to the accessibility of the city. The company realized it could manufacture products in the United States at costs comparable with those abroad.
General Electric Appliances	China	The company manufactures dishwashers, refrigerators and heaters. Labour savings were eaten away by an inability to carry appropriate inventory levels as well as by inconsistent delivery schedules, resulting in overall costs that were 6 per cent higher than in the United States.
LightSaver Technologies	China	The company produces emergency lights for homeowners. It found that manufacturing in the United States was 2 to 5 per cent cheaper after accounting for the time and trouble of producing overseas, although manufacturing alone was 30 per cent cheaper in China.
NCR Corporation	India, China and Hungary	The company returned part of its ATM production to a new manufacturing facility in order to be close to customers and innovate directly on-site with them. It was not seeking the lowest cost manufacturing location but reshoring realize other benefits: decreased time-to-market, improved internal collaboration and lowered current operating costs.
Neutex Advanced Energy Group	China	By reshoring, the company was able to automate LED manufacturing processes, thus cutting workforce numbers and improving quality control. In addition, language barriers were eliminated and the company gained greater control of product delivery.
Offsite Networks	China	Rapid improvements in technology made it more affordable for the company to manufacture locally. This meant that labour costs, which had driven the search for cheaper workers overseas, would be a smaller percentage of total costs. In addition, other costs in China, such as shipping, had been increasing.
Pigtronix	China	A producer of pedals that create electric guitar sound effects discovered that it could not adequately monitor quality at Chinese factories. It also faced an erosion of benefits from having capital tied up in products that spent a week in transit and then piled up in inventory.
SolarWorld	China	A builder of solar panels committed to western labour and environmental standards that were not matched by its Chinese site. Labour accounted for less than 10 per cent of total costs, and close to half of the savings on labour from using Chinese workers was lost to higher shipping costs. The other half, or more, was made up for by the higher labour productivity in the United States.

Source: UNCTAD, based on information from the Reshoring Initiative. Available at http://www.reshorenow.org/resources/library.cfm# and company websites.

C. FDI INCOME AND RATES OF RETURN

FDI income amounted to $1.5 trillion in 2011 (the latest year for which most countries have data), broadly equivalent to the amount of FDI inflows. The rate of return on FDI was 7 per cent in the same year, with higher rates in developing and transition economies than in developed countries. Reinvested earnings accounted for about one third of total inward FDI income and almost the same share of FDI flows during 2005–2011.

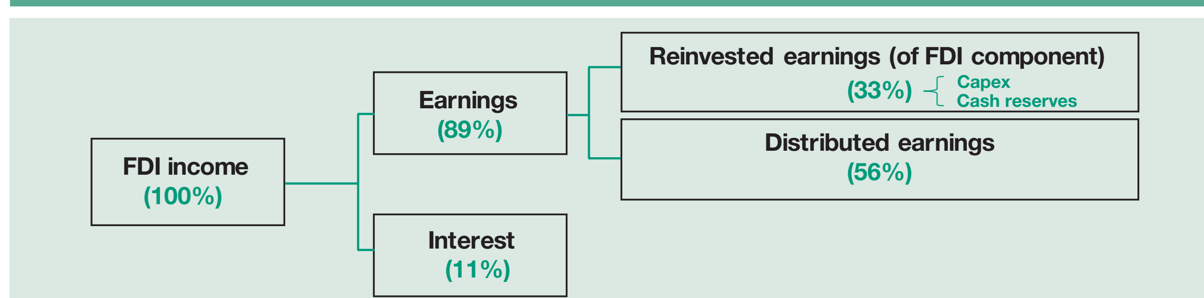
In a globalized economy, for home economies, FDI provides opportunities for TNCs to earn profits on economic activities conducted outside the TNC's home economy. For host economies, FDI income represents the return on direct investment positions that accrues to TNCs acting as direct investors. Part of this income may be used by TNCs as additional sources for their capital expenditures in host economies, and the rest is repatriated to home or other countries. In some cases, these returns from host countries constitute a significant share of the total return to TNC capital.

FDI income consists of earnings (profits) on equity investments in direct investment enterprises (or foreign affiliates) plus interest income on debt between direct investors (or parent firms) and direct investment enterprises, and between fellow enterprises. Earnings constitute a very large share of FDI income (figure I.30). Earnings can be further distinguished between reinvested earnings, which represent a component of FDI flows, and repatriated (distributed) earnings. Reinvested earnings are earnings retained within the host economy. They are composed of capital expenditures (capex) (earnings used to acquire or upgrade physical assets) and cash reserves.

Because of the growth of FDI, FDI income has become an increasingly important component of the balance of payments, contributing significantly to FDI itself, and can play an important role in the overall economy as a source of domestic income or as an income outflow. From a host country perspective, FDI income is one of several benefits that can derive from the activities of TNCs. FDI is a potential source of capital formation, employment, technology transfer and industrial upgrading; thus, short-term income deficits have to be strategically offset against long-term capacity-building. In addition, rates of return on direct investment often exceed returns on other types of investment and vary significantly among regions of the world. Variations in the level of reinvested earnings, repatriated earnings and the rate of return on FDI raise questions about the characteristics of FDI and the impact of tax and other FDI-related policies.

This section addresses some key empirical issues related to recent major trends and salient features of FDI income, mainly from the host country point of view. Subsection 1 reviews trends in FDI income by income component at both global and regional levels. Subsection 2 focuses on rates of return on FDI by region and country. Changes in rates of return during and after the financial crisis are also addressed. Subsection 3 evaluates FDI income in the context of the balance of payments. The last subsection concludes by summarizing the results and discussing some FDI policy implications.

Figure I.30. Structure of FDI income, 2005–2011



Source: UNCTAD.
Note: Figures in parenthesis show the distribution share of total inward FDI income during 2005–2011.

1. Trends in FDI income

a. General trends

Global FDI income was $1.5 trillion, almost equivalent to FDI inflows. It increased for all three groups of economies, with the largest increases in developing and transition host economies.

Global FDI income increased sharply in 2011 for the second consecutive year, after declining in both 2008 and 2009 during the depths of the global financial crisis. FDI income rose to $1.5 trillion in 2011 from $1.4 trillion in 2010, an increase of 9 per cent (figure I.31). FDI income, a component of the balance of payments, accounted for 6.4 per cent of the global current account.

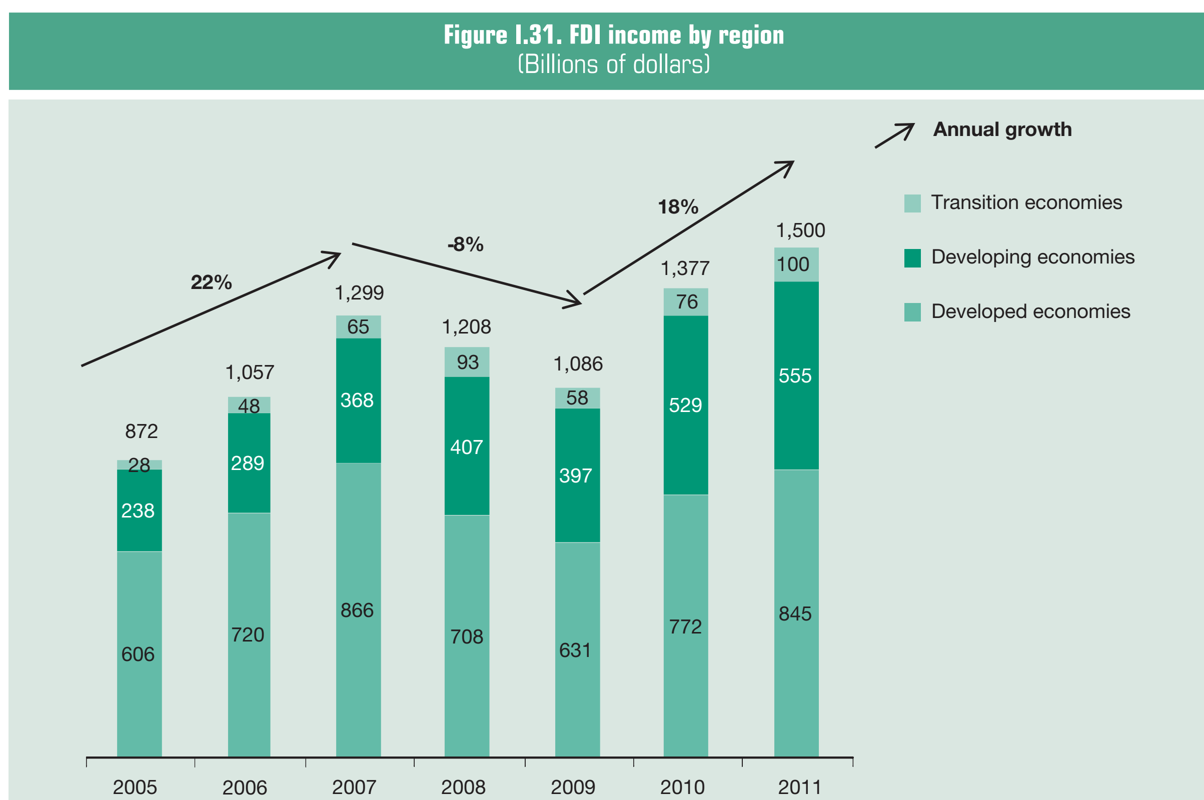
The fall in FDI income in 2008 and 2009 suggests that foreign affiliate operations were severely affected at the outset of the global downturn. This is consistent with sharp declines in the corporate profits in many economies. By 2010, however, global FDI income had surpassed the previous peak reached in 2007. For developed economies, FDI income generated by investing TNCs has not completely recovered to its pre-crisis 2007 level, primarily because of slow growth in the EU that reflects the region's continuing sovereign debt crisis. For developing economies, FDI income declined modestly in 2009 before growing strongly in 2010, especially in East and South-East Asia. For transition economies, FDI income declined sharply in 2009 but rebounded strongly in 2010 and 2011.

b. Rates of return

Globally, FDI rates of return declined to less than 6 per cent in 2009, but have recovered since then. In 2011, rates of return were highest in developing and transition economies, at 8.4 and 13 per cent, respectively.

Rates of return on FDI[9] or FDI profitability can be compared across regions, by direction of investment, and with other types of cross-border investment. For instance, for the United States, the cross-border portfolio rate of return was 2.7 per cent, while the FDI rate of return was 4.8 per cent in 2011 – the latest year for which data are almost complete. FDI rates of return can also

Figure I.31. FDI income by region
(Billions of dollars)



Source: UNCTAD based on data from the IMF Balance of Payments database.

be compared with rates of return for investment conducted by locally owned corporations in host economies (on a country-by-country basis). In the United States, the rate of return on inward FDI is lower than that of locally owned entities (for 2011, 4.8 per cent as against 7.5 per cent[10]), but this varies from country to country. There are a number of reasons why rates of return may be different between FDI and locally owned firms in a host economy. They may include firms' characteristics (such as length of operations), possession of intangible assets, transfer pricing and other tax minimization strategies, and relative risk.

In 2011, the global rate of return on FDI was 7.2 per cent, up slightly from 6.8 per cent in 2010 (table I.6). Rates of return have decreased since 2008 in developed economies. In developing and transition economies, FDI rates of return are higher than those in developed economies, and vary over time and by region. For example, while the global average rate of return on FDI for 2006–2011 was 7.0 per cent, the average inward rate for developed economies was 5.1 per cent. In contrast, the average rates for developing and transition economies were 9.2 per cent and 12.9 per cent, respectively. For instance, in Africa and transition economies, natural resources, extractive and processing industries consistently contribute to higher rates of return. At the individual country level, therefore, many such economies rank high in the list of the top economies with the highest rates of return, and all but one of the 20 economies are developing or transition economies (figure I.32).

Table I.6. Inward FDI rates of return, 2006–2011
(Per cent)

Region	2006	2007	2008	2009	2010	2011
World	**7.3**	**7.2**	**7.7**	**5.9**	**6.8**	**7.2**
Developed economies	**6.3**	**6.1**	**4.6**	**4.0**	**4.6**	**4.8**
Developing economies	**9.7**	**9.8**	**9.7**	**8.7**	**9.0**	**8.4**
Africa	10.0	13.4	15.8	10.8	8.9	9.3
Asia	9.5	9.1	8.9	8.8	9.8	8.8
East and South-East Asia	9.7	9.3	9.1	9.2	10.5	9.2
South Asia	14.2	12.9	10.6	8.6	8.5	8.8
West Asia	3.9	3.8	6.7	5.4	4.9	5.1
Latin America and the Caribbean	10.2	10.3	9.9	7.6	7.1	7.1
Transition economies	**14.5**	**12.0**	**16.5**	**10.7**	**10.8**	**13.0**

Source: UNCTAD, based on data from the IMF Balance of Payments database.

Figure I.32. Top 20 economies with highest inward FDI rates of return, 2011
(Per cent)

Source: UNCTAD, based on data from the IMF Balance of Payments database.

c. Reinvested earnings versus repatriated earnings

One third of inward FDI income is retained within host countries as reinvested earnings that are a major component of global FDI inflows.

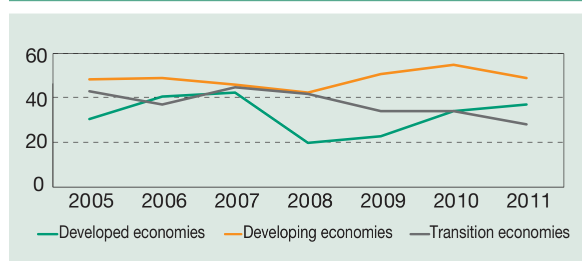
Reinvested earnings are a major component of FDI flows in the financial account of the balance of payments. It is important to note, however, that reinvested earnings can be used by TNCs either to (i) acquire or establish new foreign affiliates or to increase capital expenditures at existing affiliates, or (ii) to retain as cash holdings. In fact, TNC affiliates around the world have accumulated record levels of cash and other short-term assets from their reinvested earnings (section A).

At the global level, in 2011, $499 billion in FDI earnings were reinvested in host countries (table I.7), while $1 trillion were repatriated to home or other countries. The share of reinvested earnings in total

FDI earnings varies over time; it was one third in 2006 and 2007, 20 per cent in 2008 at the onset of the financial crisis, before returning to one third in 2011. Over the 2005–2011 period, the share of reinvested earnings in total FDI earnings averaged 32 per cent. In 2008 reinvested earnings on inward FDI for developed economies fell even more sharply than total earnings (figure I.33).

Since 2009, the share of reinvested earnings is highest in developing countries, reaching 49 per cent in 2011 (figure I.33). This share has declined slowly in transition economies since 2007, perhaps reflecting investor concerns with business prospects in some parts of the region.

Figure I.33. Share of reinvested earnings in FDI earnings, 2005–2011
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

2. Impacts of FDI income on the balance of payments of host countries

FDI income can be retained in the host economy or repatriated. Financial flows related to FDI income have an impact on the current accounts of countries.

In the balance of payments, direct investment income is a component of the broader category of primary income, which includes compensation of employees and other types of investment income. Payments of income on inward FDI reduce the current account surplus or increase the deficit, while diminishing the capital resources available to the host economy.

Reinvestment of earnings (or reinvested earnings) – one of the components of direct investment financial flows – is a major source of FDI inflows, with variation by region and over time. In 2011, at the global level, reinvested earnings accounted for 30 per cent of worldwide FDI of $1.65 trillion. Over the period 2005–2011 reinvested earnings as a share of FDI averaged 23 per cent, with a low of 14 per cent in 2008 as the global financial crisis started, and a high of 32 per cent in 2010.

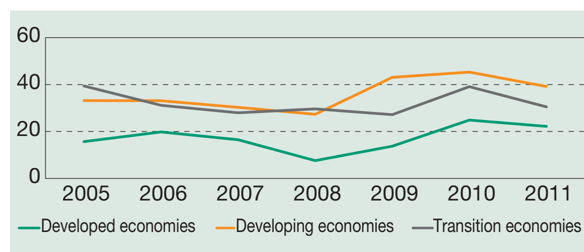
Developed economies were host to almost 50 per cent of global inward FDI flows in 2011, of which 22 per cent was financed through reinvested earnings. Reinvested earnings financed 39 per cent of inward FDI in developing countries in 2011 and 31 per cent in the case of transition economies (figure I.34). Over the period 2005–2011, the

Table I.7. Inward FDI reinvested earnings, 2005–2011
(Billions of dollars)

Region	2005	2006	2007	2008	2009	2010	2011
World	**258**	**378**	**470**	**277**	**291**	**477**	**499**
Developed economies	**161**	**253**	**312**	**109**	**112**	**219**	**260**
Developing economies	**86**	**109**	**131**	**130**	**161**	**235**	**214**
Africa	7	9	13	17	13	15	11
Asia	59	72	85	86	116	189	166
East and South-East Asia	55	65	75	74	105	175	148
South Asia	3	6	8	10	9	12	12
West Asia	1	1	1	2	2	3	5
Latin America and the Caribbean	21	28	32	27	31	30	37
Oceania	0	0	0	0	0	0	0
Transition economies	**11**	**17**	**28**	**37**	**18**	**23**	**25**

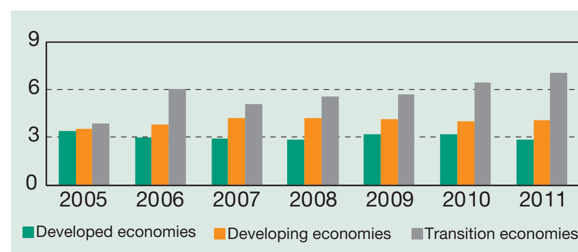
Source: UNCTAD, based on data from the IMF Balance of Payments database.

Figure I.34. Share of inward FDI flows financed through reinvested earnings, by region, 2005–2011
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

Figure I.35. Share of repatriated earnings in current account total payments, by region, 2005–2011
(Per cent)



Source: UNCTAD, based on data from the IMF Balance of Payments database.

average share of reinvested earnings in inward FDI was the highest for developing countries at 36 per cent, followed by transition economies at 32 per cent, while the share for developed economies was at a much lower 17 per cent. (Among developed economies, the share for the EU is lower than that of other countries at 12 per cent.) Differences among regions may reflect differences in rates of return on FDI, tax treatment, the financing requirements of TNCs and the range of financing sources available.

Another means through which FDI income has an impact on the current account in the balance of payments is through repatriated earnings. The share of repatriated earnings in the current account total payments is, on average, about 3.4 per cent (figure I.35). This share is lower for developed economies (repatriated earnings accounted for 2.9 per cent of total payments in 2011), than for developing and transition economies (4.0 per cent and 7.0 per cent, respectively). The share varies significantly by country. For instance, it was relatively high for Kazakhstan (24 per cent), Nigeria (18 per cent), Yemen (17 per cent) and Colombia (13 per cent). Differences result from the different sectoral composition of FDI (repatriated earnings are more common for FDI in extractive industries), differences in tax systems and TNCs' own financial decisions.

3. Policy implications

The magnitude of and trends in income generated by FDI have a number of implications for policymakers:

Policies should be developed and promoted that encourage greater use of foreign affiliates' reinvested earnings for capital expenditures and other activities that support host country economies.

- FDI income is significant, comparable to the annual flows of global FDI. FDI income represents a return on foreign investment which also generates value added in host countries, contributes to GDP, creates jobs and income for workers, and yields fiscal revenues. It is the surplus generated by foreign affiliates after payment of factor costs and taxes.
- The high rates of return on FDI that can be observed in some countries that attract FDI predominantly in extractive industries have at times raised concerns about excessive rents for foreign firms. Although rates of return fluctuate – e.g. they rise and fall with commodity prices – and must be considered case by case, a number of fiscal tools are available to policymakers to ensure that a fair share of rents on resources accrues to the domestic economy (UNCTAD, 2012). Ultimately, from an investor perspective, returns are a compensation for risk. Policymakers need to consider country, industry and project risk factors when assessing rates of return.

- High rates of return, in some cases, coincide with high shares of repatriated earnings in total FDI income. This is partly a function of the industries where this occurs: FDI projects that require high upfront investments in economies that provide relatively little opportunity for follow-up investment in the same industry will see higher shares of repatriated earnings. This has raised concerns in some countries of the potential negative long-term effects of FDI on the balance of payments. The data have shown that in most countries the magnitude of income transfers relative to total current account payment is limited, also due to the export-generating effects of FDI.
- Profits generated by foreign affiliates and repatriated earnings are a more general concern for policymakers, to the extent that they may be perceived as "income leakage" for the domestic economy. Although value added created by foreign affiliates contributes to a country's GDP, the surplus generated by foreign affiliates (after tax) is not part of the country's gross national income. A key policy objective should be to maximize the reinvestment rate in order to keep as much of the rents as possible on FDI in the domestic economy and generate further productive capacity for development.
- Finally, earnings retained in the economy do not automatically translate into capital expenditures. For host countries of FDI, the same measures that promote investment will help maximize the extent to which retained earnings are reinvested. In addition, some countries adopt targeted incentives to facilitate reinvestment.

Notes

[1] Greenfield projects data refer to announced greenfield FDI. The value of greenfield projects indicates the capital expenditure planned by the investor at the time of the announcement. Although these data provide an important indicator of investor feeling about the launch of cross-border expansion investments, they can be substantially different from the official FDI data as reported, as companies can raise capital locally, phase their investments over time and channel their investment through different countries for tax efficiency. In addition, the project may be cancelled or may not start in the year it is announced.

[2] SWF Institute Fund Rankings, updated February 2013. Accessed on 13 March 2013 at www.swfinstitute.org/fund-rankings.

[3] *The Economist,* "The state advances", 6 October 2012.

[4] UNCTAD research suggests that this number is still very small as a proportion of all SOEs (*WIR11*, p. 31).

[5] For the purpose of this report, the countries and territories falling into this group include Andorra, Anguilla, Antigua and Barbuda, Aruba, Bahrain, Barbados, Belize, the British Virgin Islands, the Cayman Islands, the Cook Islands, Dominica, Gibraltar, Grenada, the Isle of Man, Liberia, Liechtenstein, Maldives, the Marshall Islands, Monaco, Montserrat, Nauru, Netherlands Antilles, Niue, Panama, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Seychelles, Tonga, Turks and Caicos Islands, US Virgin Islands and Vanuatu. Based on OECD, "Towards Global Tax Co-operation".

[6] FDI flows to OFCs are likely to be underestimated as many OFCs do not report FDI data. For example, data on FDI inflows to the British Virgin Islands are collected from home countries that report investments there. This estimation method tends to underestimate the level of flows.

[7] An investment is horizontal if the target company operates in the same industry as the acquiring TNC and thus has the same primary SIC code at the two-digit level. A vertical investment is a purchase of a company operating in another industry.

[8] "Outsourcing and offshoring: Here, there and every where", Special report, *The Economist*, 19 January 2013.

[9] Annual rates of return are measured as annual FDI income for year divided by the average of the end-of-year FDI positions for years t and t-1. For this study, rates of return have been calculated only for those countries that reported both FDI income and positions for a given year. Rates of return by sector are not provided in this report because FDI income data by sector are not readily available for most countries.

[10] Data from United States Department of Commerce.

REGIONAL TRENDS IN FDI

CHAPTER II

INTRODUCTION

In 2012, foreign direct investment (FDI) inflows decreased in all three major economic groups – developed, developing and transition economies (table II.1), although at different paces.

In *developed countries*, FDI flows fell by 32 per cent to $561 billion — a level last seen almost ten years ago. The majority of European Union (EU) countries and the United States experienced significant drops in their FDI inflows. FDI flows to *developing economies* remained relatively resilient, declining by only 4 per cent, accounting for 52 per cent of global inflows in 2012. Flows to developing Asia and Latin America and the Caribbean lost some momentum, although they remained at historically high levels. All subregions in developing Asia – East and South-East Asia, South Asia and West Asia – saw their flows decline in 2012, compared with the previous year. Africa was the only major region to enjoy a year-on-year increase in FDI inflows in 2012. FDI flows to *transition economies* declined by 9 per cent.

FDI inflows to the structurally weak, vulnerable and small economies rose further in 2012 from a small base of $56 billion in 2011 to $60 billion, owing to the strong growth of FDI to least developed countries (LDCs) and small island developing States (SIDS) (table II.1). Their share in the world total also rose, to 4.4 per cent from 3.4 per cent in 2011.

Outward FDI from developed economies declined by $274 billion in 2012, accounting for almost all of the fall in global outward FDI. In contrast to the sharp decline of FDI flows from developed countries, FDI flows from developing economies rose by 1 per cent in 2012, amounting to $426 billion. As a result, their share in global outflows reached a record 31 per cent. FDI outflows from Africa almost tripled; flows from Asia and Latin America and the Caribbean remained almost at the 2011 level. Asian countries remained the largest source of FDI, accounting for three quarters of the developing-country group's total. Outward FDI flows from transition economies declined in 2012, owing to the fall of FDI outflows by investors from the Russian Federation – the main home country for outward FDI from the region.

Table II.1. FDI flows, by region, 2010–2012
(Billions of dollars and per cent)

Region	FDI inflows			FDI outflows		
	2010	2011	2012	2010	2011	2012
World	**1 409**	**1 652**	**1 351**	**1 505**	**1 678**	**1 391**
Developed economies	696	820	561	1 030	1 183	909
Developing economies	637	735	703	413	422	426
Africa	44	48	50	9	5	14
Asia	401	436	407	284	311	308
East and South-East Asia	313	343	326	254	271	275
South Asia	28	44	34	16	13	9
West Asia	59	49	47	13	26	24
Latin America and the Caribbean	190	249	244	119	105	103
Transition economies	75	96	87	62	73	55
Structurally weak, vulnerable and small economies [a]	45	56	60	12	10	10
LDCs	19.0	21.0	26.0	3.0	3.0	5.0
LLDCs	27.0	34.0	35.0	9.3	5.5	3.1
SIDS	4.7	5.6	6.2	0.3	1.8	1.8
Memorandum: percentage share in world FDI flows						
Developed economies	49.4	49.7	41.5	68.4	70.5	65.4
Developing economies	45.2	44.5	52.0	27.5	25.2	30.6
Africa	3.1	2.9	3.7	0.6	0.3	1.0
Asia	28.4	26.4	30.1	18.9	18.5	22.2
East and South-East Asia	22.2	20.8	24.1	16.9	16.2	19.8
South Asia	2.0	2.7	2.5	1.1	0.8	0.7
West Asia	4.2	3.0	3.5	0.9	1.6	1.7
Latin America and the Caribbean	13.5	15.1	18.1	7.9	6.3	7.4
Oceania	0.2	0.1	0.2	0.0	0.1	0.0
Transition economies	5.3	5.8	6.5	4.1	4.3	4.0
Structurally weak, vulnerable and small economies [a]	3.2	3.4	4.4	0.8	0.6	0.7
LDCs	1.3	1.3	1.9	0.2	0.2	0.4
LLDCs	1.9	2.1	2.6	0.6	0.3	0.2
SIDS	0.3	0.3	0.5	0.0	0.1	0.1

Source: UNCTAD, FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).
[a] Without double counting.

A. REGIONAL TRENDS

1. Africa

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $3.0 billion	Nigeria, Mozambique, South Africa, Democratic Republic of the Congo and Ghana	South Africa
$2.0 to $2.9 billion	Morocco, Egypt, Congo, Sudan and Equatorial Guinea	Angola and Libya
$1.0 to $1.9 billion	Tunisia, Uganda, United Republic of Tanzania, Algeria, Liberia, Mauritania and Zambia	Nigeria and Liberia
$0.5 to $0.9 billion	Ethiopia, Madagascar, Niger, Guinea, Sierra Leone, Gabon and Cameroon	..
$0.1 to $0.4 billion	Côte d'Ivoire, Zimbabwe, Mauritius, Namibia, Senegal, Chad, Mali, Botswana, Kenya, Lesotho, Togo, Rwanda, Benin, Malawi, Seychelles, Somalia and Djibouti	Democratic Republic of the Congo, Morocco, Egypt, Cameroon, Zambia and Togo
Below $0.1 billion	Swaziland, Gambia, Eritrea, Central African Republic, Cape Verde, São Tomé and Principe, Burkina Faso, Comoros, Guinea-Bissau, Burundi and Angola	Mauritius, Gabon, Sudan, Malawi, Senegal, Zimbabwe, Côte d'Ivoire, Kenya, Tunisia, Niger, Swaziland, Mali, Mauritania, Seychelles, Guinea, Ghana, Guinea-Bissau, Burkina Faso, São Tomé and Principe, Cape Verde, Namibia, Mozambique, Botswana, Lesotho, Algeria and Benin

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

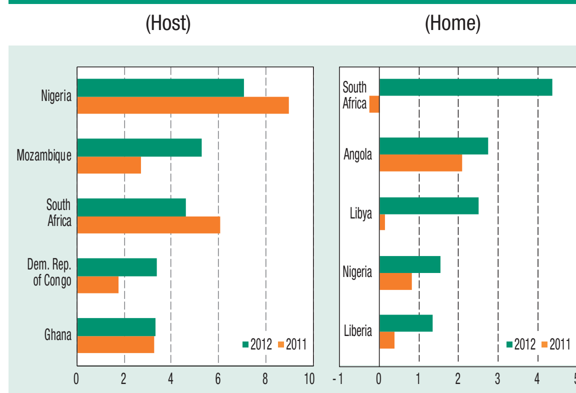


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

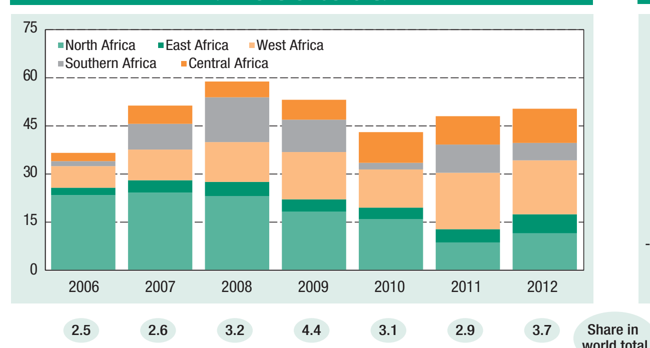
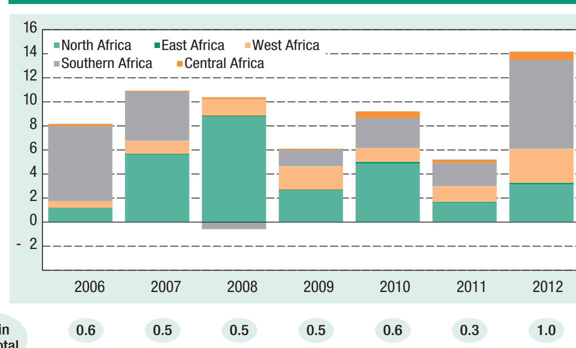


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



	2006	2007	2008	2009	2010	2011	2012
Share in world total (inflows)	2.5	2.6	3.2	4.4	3.1	2.9	3.7
Share in world total (outflows)	0.6	0.5	0.5	0.5	0.6	0.3	1.0

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales		Purchases	
	2011	2012	2011	2012
Total	**8 592**	**-1 195**	**4 378**	**611**
Primary	**2 993**	**-1 127**	**- 5**	**267**
Mining, quarrying and petroleum	2 924	-1 150	- 5	245
Manufacturing	**1 766**	**245**	**4 418**	**1 518**
Food, beverages and tobacco	870	634	15	185
Coke, petroleum products and nuclear fuel	-	-	2 099	-
Chemicals and chemical products	155	59	835	340
Metals and metal products	286	- 437	-	-
Services	**3 833**	**- 313**	**- 35**	**-1 174**
Trade	2 161	-	- 181	-
Transport, storage and communications	489	- 782	- 10	- 16
Finance	1 120	325	198	-1 702
Business services	149	114	37	379

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales		Purchases	
	2011	2012	2011	2012
World	**8 592**	**- 1 195**	**4 378**	**611**
Developed economies	**4 397**	**- 3 412**	**4 288**	**634**
European Union	2 400	- 1 619	1 986	1 261
United States	1 634	- 144	41	-
Japan	649	-	-	-
Developing economies	**4 163**	**2 049**	**90**	**- 23**
Africa	409	114	409	114
East and South-East Asia	2 986	1 843	- 94	- 386
China	2 441	1 580	- 16	-
South Asia	318	22	- 337	426
West Asia	464	73	87	100
Latin America and the Caribbean	- 14	- 3	24	- 277
Transition economies	**-**	**-**	**-**	**-**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	Africa as destination		Africa as investors	
	2011	2012	2011	2012
Total	**82 939**	**46 985**	**35 428**	**7 447**
Primary	**22 824**	**7 479**	**4 640**	**445**
Mining, quarrying and petroleum	22 824	7 479	4 640	445
Manufacturing	**31 175**	**20 863**	**23 107**	**4 013**
Food, beverages and tobacco	2 009	2 227	411	438
Coke, petroleum products and nuclear fuel	9 793	5 661	20 742	50
Metals and metal products	5 185	4 469	9	1 144
Motor vehicles and other transport equipment	3 151	2 316	-	-
Services	**28 940**	**18 643**	**7 681**	**2 979**
Electricity, gas and water	10 484	6 401	1 441	60
Transport, storage and communications	5 696	2 940	419	895
Finance	1 426	1 511	916	614
Business services	5 631	1 886	2 282	889

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	Africa as destination		Africa as investors	
	2011	2012	2011	2012
World	**82 939**	**46 985**	**35 428**	**7 447**
Developed economies	**39 181**	**17 314**	**18 983**	**1 683**
European Union	23 861	7 882	178	251
United States	6 638	4 831	18 759	1 362
Japan	1 302	726	-	39
Developing economies	**43 033**	**29 604**	**16 445**	**5 764**
Africa	10 749	3 821	10 749	3 821
East and South-East Asia	12 360	4 616	400	166
China	1 953	1 764	334	102
South Asia	11 113	9 315	980	149
West Asia	7 038	11 610	150	1 160
Latin America and the Caribbean	1 774	242	1 167	469
Transition economies	**725**	**67**	**-**	**-**

FDI inflows to Africa grew to $50 billion in 2012, a rise of 5 per cent over the previous year. The overall increase in FDI inflows translated into increased flows to North Africa, Central Africa and East Africa, whereas West Africa and Southern Africa registered declines. FDI from developing countries is increasing. There is a rising interest in FDI by private equity funds in Africa, but the level of investment is still low. FDI oriented to the African consumers is becoming more widespread in manufacturing and services but will remain relatively limited in the near term.

Africa is one of the few regions to enjoy year-on-year growth in FDI inflows since 2010. Investment in exploration and exploitation of natural resources, and high flows from China (tables C and E) both contributed to the current level of inward flows. More generally, the continent's good economic performance – GDP grew at an estimated 5 per cent in 2012 – underpinned the rise in investment, including in manufacturing and services.

Investor confidence appears to have returned to North Africa, as FDI flows rose by 35 per cent to $11.5 billion in 2012 (figure B). Much of the growth was due to a rise in investment in Egypt. Whereas the country experienced a net divestment of $0.5 billion in 2011, it attracted net investment inflows of $2.8 billion in 2012 (table A). Across the subregion, FDI flows also increased to Morocco and Tunisia, but decreased to Algeria and the Sudan.

In contrast, FDI flows to West Africa declined by 5 per cent, to $16.8 billion, to a large extent because of decreasing flows to Nigeria. Weighed down by political insecurity and the weak global economy, that country saw FDI inflows fell from $8.9 billion in 2011 to $7.0 billion in 2012 (figure A). Meanwhile, Liberia and Mauritania both experienced a surge in inward FDI flows. In Mauritania, FDI inflows doubled to $1.2 billion, which can be attributed in part to the expansion in mining operations (copper and gold) by Canada-based First Quantum Minerals and Kinross.

Central Africa attracted $10 billion of FDI in 2012, a surge of 23 per cent on the previous year. Slowing FDI inflows to the Congo were offset by an increase to the Democratic Republic of the Congo, where inward FDI flows jumped from $1.7 billion to $3.3 billion. Some of the flows went towards the expansion of the copper-cobalt Tenke Fungurume mine. Recent natural resource discoveries also contributed to the increase in FDI inflows to East Africa, from $4.6 billion in 2011 to $6.3 billion in 2012. This includes investment in recently discovered gas reserves in the United Republic of Tanzania and oil fields in Uganda (*WIR12*).

FDI flows to Southern Africa plunged from $8.7 billion in 2011 to $5.4 billion in 2012. The decline was mainly due to falling FDI flows to two recipients: Angola and South Africa. Angola registered a third successive year of net divestment, as the contraction in FDI flows widened to -$6.9 billion. The lower FDI flows to South Africa – a drop of 24 per cent to $4.6 billion in 2012 (figure A) – were due to net divestments in the last quarter of the year, which was primarily attributed to a foreign mining company offloading its stake in a South African subsidiary. The decreases in these two countries were partly offset by the near doubling of flows to Mozambique, where the appeal of huge offshore gas deposits helped to attract investor interest to the tune of $5.2 billion.

Transnational corporations (TNCs) from developing countries are increasingly active in Africa, building on a trend in recent years of a higher share of FDI flows coming from emerging markets. Malaysia, South Africa, China and India (in that order) are the largest developing-country sources of FDI in Africa. Malaysia, with an FDI stock of $19 billion in Africa in 2011 (the latest year for which data are available) has investments in all sectors across the continent, including significant FDI in agribusiness and finance. Its agribusiness investments are in both East and West Africa, while FDI in finance is concentrated in Mauritius. South Africa and China are the next largest investors, with $18 billion and $16 billion, respectively, of FDI stock in Africa; their FDI is diversified across all sectors. The bulk of India's $14 billion FDI in Africa is in Mauritius, but greenfield investment project data indicate that the country's investments in landlocked developing countries (LLDCs) in Africa are on the rise.

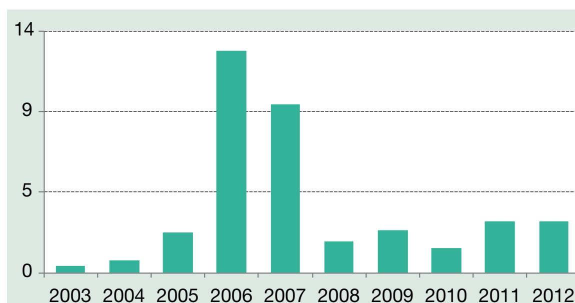
Outward FDI flows from Africa nearly tripled in 2012, from $5 billion in the previous year to an estimated $14 billion (figure C). South African companies were active in acquiring operations in mining, wholesale

and health-care industries, helping raise outflows from the country to $4.4 billion in 2012. The growth in investment from South Africa, coupled with year-on-year increases in FDI outflows from Angola, resulted in a significant expansion of overseas investment activities from the Southern Africa region. Central Africa, North Africa and West Africa also recorded significant rises in their outflows in 2012, boosted primarily by increases from the Democratic Republic of the Congo, Liberia, Libya and Nigeria (figure A).

Interest in FDI by private equity funds is rising in Africa, but levels are still low. One type of FDI source that has garnered increasing attention in recent years is private equity in Africa. But how do the high expectations surrounding private equity in Africa measure up against actual activity? Cross-border merger and acquisition (M&A) activity, the main mode of private equity investment (figure II.1) suggests that private equity has yet to take off in Africa. High points were reached in 2006 and 2007 but activity since then has levelled off, as the hiatus in FDI by private equity funds (chapter I) has also affected Africa.

Private equity investment in Africa is concentrated in a few countries. South Africa is, by far, the largest recipient of private equity on the continent,

Figure II.1. Cross-border M&As by private equity funds in Africa, 2003–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database.

accounting for more than half (53 per cent) of total investments in 2011, according to data from Preqin. Egypt, Mauritius and Morocco each had a share of 8 per cent, while Nigeria accounted for 5 per cent. The attractiveness of South Africa is also reflected in the ranking of the biggest private equity deals in Africa, with the country hosting 7 of the 10 largest FDI deals by private equity firms in the period 1996–2012 (table II.2).

The sectoral distribution of private equity in Africa is not as narrow as the geographic spread, with the

Table II.2. The 10 largest FDI deals by private equity firms in Africa, 1996–2012

Year	Value ($ million)	Acquiring company	Home economy	Acquired company	Host economy	Industry of the acquired company
2006	4 802	Shareholders[a]	South Africa	Kumba Iron Ore	South Africa	Iron ores
2007	3 502	Bain Capital LLC	United States	Edgars Consolidated Stores Ltd	South Africa	Retail stores, nec
2006	2 313	Investor group[a]	United Arab Emirates	Tunisie-Telecoms	Tunisia	Telephone communications, except radiotelephone
2007	1 438	Shareholders[a]	South Africa	Mondi Ltd	South Africa	Paper mills
2007	1 410	Abraaj Capital Ltd	United Arab Emirates	Egyptian Fertilizers Co SAE	Egypt	Nitrogenous fertilizers
2009	1 277	Paulson & Co Inc	United States	AngloGold Ashanti Ltd	South Africa	Gold ores
1997	1 261	Investor group[a]	United States	Telkom South Africa(Telkom)	South Africa	Telephone communications, except radiotelephone
2011	1 200	Investor group[a]	Kuwait	Orascom Telecom Tunisie SA	Tunisia	Telephone communications, except radiotelephone
2006	1 000	Lexshell 44 General Trading (Pty) Ltd	United Kingdom	Victoria & Alfred Waterfront (Pty)Ltd	South Africa	Land subdividers and developers, except cemeteries
2007	933	Cleansheet Investments (Proprietary) Ltd	United States	Alexander Forbes Ltd	South Africa	Insurance agents, brokers and service

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (http//www.unctad.org/fdistatistics).
[a] Acquisitions by shareholders or a goup of investors include private equity funds as a partner.

four most popular sectors being business services, information technology, industrial products and telecom, media and communications, according to fund managers. M&A data also highlight the importance of extractive industries. The mining, quarrying and petroleum sector has accounted for nearly 46 per cent of all cross-border M&As in Africa by private equity firms in the past four years. The other major sector has been non-financial services such as infrastructure and communications.[1]

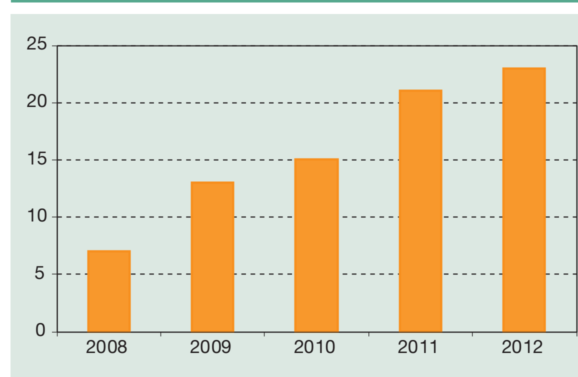
Though FDI by private equity funds is relatively diverse in terms of the industries in which these investors are active, the amount remains small and is geographically concentrated. That said, these funds are likely to become more active in FDI globally and in Africa, as the world economy recovers from its current doldrums. In anticipation, policymakers should pay it due attention, as this investment form can play a role not filled by other types of finance and bring with it benefits such as better management practices and improved corporate governance. Policymakers should similarly be conscious of possible concerns with private equity, such as issues of transparency and the span of investment horizons (*WIR12*: 12).

FDI oriented to the African consumer is becoming more widespread. Investors in Africa are becoming increasingly aware of the positive demographic outlook for the continent. First, the roughly 1 billion population is predicted to swell by a quarter in the next 10 years and more than double by 2050. Second, the urban population is also expected to increase: from 40 per cent in 2010 to 54 per cent in 2050, and with this expansion comes a rising middle class. Third, the share of the population that is 25 years or younger currently stands at about 60 per cent and is projected to remain at that level over the next few decades (UNDESA, 2011). These features, coupled with a positive economic outlook, raise the prospect of an increasingly dynamic African consumer market.

The data show some incipient signs of an investor reorientation towards the burgeoning African consumer market, as some of the most attractive sectors during the past decade have been consumer-related manufacturing and service industries, e.g. financial services; food, beverages and tobacco; and motor vehicles (tables B and D). The move towards FDI in consumer-oriented industries is also shown by greenfield investment projects data (FDI data do not provide detailed industry classification). Current levels are small and geographically concentrated. However, the share of greenfield FDI in these industries as a portion of total greenfield FDI is rising and set to reach roughly one quarter in 2012 (figure II.2).

There is a rising number of success stories of manufacturing FDI in Africa that are not directly related to extractive industries, including in the automotive sector in South Africa, the leather industry in Ethiopia, the garment business in Lesotho and pharmaceuticals across East Africa. It is noteworthy that these cases are not limited to FDI from developed countries – in many cases, foreign investors from developing countries such as Brazil, China, India and Turkey have started to make inroads into Africa's manufacturing sector. Moreover, intra-African investment, albeit comparatively small, tends to go to services and manufacturing – in the latter case, particularly to less technology- and capital-intensive targets.

Figure II.2. Share of consumer-related FDI greenfield projects in total value of FDI greenfield projects in Africa, 2008–2012[a]
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System and information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).

[a] Consumer-related FDI includes selected industries in manufacturing (food, beverages and tobacco; textiles, clothing and leather; electrical and electronic equipment; motor vehicles and other transport equipment) and services (transport, storage and communication; finance; education; health and social services; community, social and personal services activities).

In terms of geographic distribution, the largest consumer markets in Africa also count among the continent's main FDI destinations for consumer-oriented FDI in manufacturing and services, but foreign investors are not limiting themselves to consumers in these markets only. For instance, telecommunications companies such as South Africa-based MTN and India-based Bharti Airtel are both present in at least 15 African countries. The South Africa–based retailers Shoprite and Massmart (in which United States–based Walmart acquired a majority stake in 2011) have operations in 17 and 12 African markets, respectively.

The expansion of FDI flows in some consumer-oriented industries in Africa and their geographic distribution are indications that the prospect of the greater spending power of African consumers is attracting more foreign investors. Still, it is also clear that any such attraction is at an incipient stage. An important reason is that, for some time to come, investors are primarily targeting high-end consumers, who constitute a very small strata of the population. Projections of consumption growth in Africa for 2011–2016 suggest that 40 per cent of the growth will come from households that earn more than $20,000 a year – a group that represents only 1–2 per cent of all households.[2] From a policy perspective, the challenge for countries is to channel investment into poverty-alleviating sectors, producing goods and services accessible and affordable for the poor, and creating business linkages with domestic SMEs.

2. East and South-East Asia

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $50 billion	China, Hong Kong (China) and Singapore	China and Hong Kong (China)
$10 to $49 billion	Indonesia and Malaysia	Republic of Korea, Singapore, Malaysia, Taiwan Province of China and Thailand
$1.0 to $9.9 billion	Republic of Korea, Thailand, Viet Nam, Mongolia, Taiwan Province of China, Philippines, Myanmar, Cambodia and Macao (China)	Indonesia, Philippines and Viet Nam
$0.1 to $0.9 billion	Brunei Darussalam and Lao People's Democratic Republic	Macao (China)
Below $0.1 billion	Democratic People's Republic of Korea and Timor-Leste	Mongolia, Cambodia, Brunei Darussalam and Lao People's Democratic Republic

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

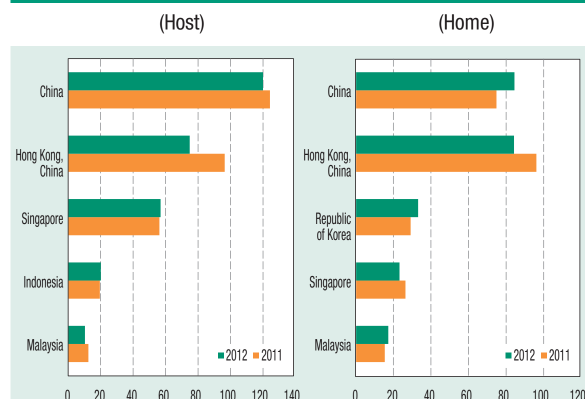


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

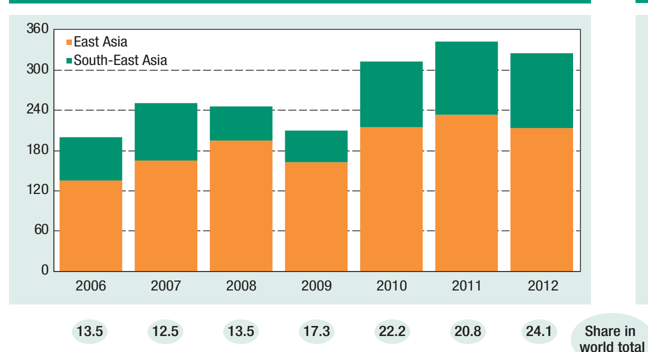
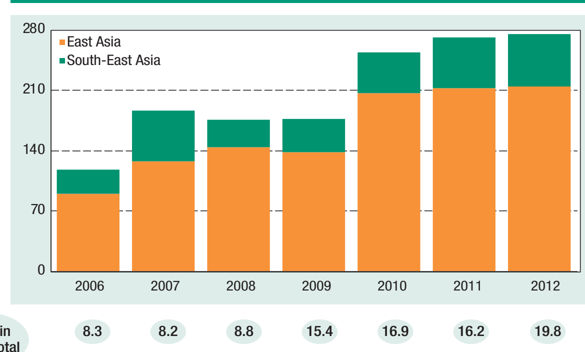


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



Share in world total

	2006	2007	2008	2009	2010	2011	2012
Inflows	13.5	12.5	13.5	17.3	22.2	20.8	24.1
Outflows	8.3	8.2	8.8	15.4	16.9	16.2	19.8

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
Total	**35 513**	**22 550**	**72 458**	**69 357**
Primary	**5 658**	**758**	**21 083**	**10 344**
Mining, quarrying and petroleum	5 224	357	21 431	11 756
Manufacturing	**11 436**	**12 873**	**11 582**	**12 859**
Food, beverages and tobacco	3 462	7 197	1 311	4 948
Metals and metal products	789	281	1 281	2 822
Machinery and equipment	533	1 830	390	1 596
Electrical and electronic equipment	3 407	717	2 306	2 477
Services	**18 419**	**8 919**	**39 793**	**46 153**
Electricity, gas and water	2 539	756	4 017	2 525
Transport, storage and communications	1 697	4 426	- 1 414	4 633
Finance	4 962	721	33 411	38 820
Business services	5 537	2 043	- 432	1 050

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
World	**35 513**	**22 550**	**72 458**	**69 357**
Developed economies	**16 708**	**5 148**	**47 518**	**50 102**
European Union	5 591	2 686	14 773	20 062
United Kingdom	2 796	- 2 958	6 192	15 091
North America	3 865	- 1 584	21 349	15 125
Canada	1 220	- 290	8 968	7 778
United States	2 645	- 1 294	12 381	7 347
Japan	6 516	3 821	738	2 969
Developing economies	**16 428**	**16 427**	**24 206**	**24 198**
Africa	- 94	- 386	2 986	1 843
South, East and South-East Asia	14 596	17 234	11 637	16 570
Latin America and the Caribbean	168	119	9 311	5 324
Transition economies	**1 531**	**-**	**734**	**- 4 944**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	East and South-East Asia as destination 2011	East and South-East Asia as destination 2012	East and South-East Asia as investors 2011	East and South-East Asia as investors 2012
Total	**206 049**	**147 608**	**115 133**	**118 476**
Primary	**4 444**	**363**	**5 158**	**3 022**
Mining, quarrying and petroleum	4 444	363	5 158	3 022
Manufacturing	**127 673**	**70 614**	**73 297**	**43 443**
Chemicals and chemical products	25 615	9 886	6 495	10 733
Metals and metal products	16 836	8 902	14 522	6 799
Electrical and electronic equipment	21 768	9 361	11 455	11 468
Motor vehicles and other transport equipment	17 578	17 716	9 022	4 797
Services	**73 932**	**76 632**	**36 678**	**72 011**
Electricity, gas and water	4 567	4 507	7 697	22 813
Construction	7 021	19 652	3 840	29 147
Transport, storage and communications	19 730	13 096	7 653	2 950
Finance	16 651	13 658	5 371	6 074

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	East and South-East Asia as destination 2011	East and South-East Asia as destination 2012	East and South-East Asia as investors 2011	East and South-East Asia as investors 2012
World	**206 049**	**147 608**	**115 133**	**118 476**
Developed economies	**133 212**	**99 091**	**16 726**	**43 863**
European Union	58 072	38 248	7 299	18 768
Germany	22 308	12 020	1 129	249
United Kingdom	11 621	8 372	1 175	15 003
United States	32 580	27 628	5 961	21 525
Australia	2 230	1 473	1 410	2 070
Japan	30 416	24 646	533	677
Developing economies	**71 605**	**47 824**	**91 844**	**69 246**
Africa	400	166	12 360	4 616
East and South-East Asia	55 390	43 666	55 390	43 666
South Asia	10 973	2 388	9 197	8 211
Transition economies	**1 232**	**694**	**6 563**	**5 368**

FDI inflows to East and South-East Asia declined by 5 per cent, while outflows from two subregions rose by 1 per cent in 2012. The subregions now account for 24 per cent of the world's total FDI inflows and 20 per cent of outflows. There has been a considerable wave of relocation in manufacturing within the subregions during the past few years, particularly for labour-intensive industries. Meanwhile, both the extractive and the infrastructure industries have received significant foreign capital, driven partly by intraregional investment.

FDI inflows to East and South-East Asia fell to $326 billion in 2012 (figure B) – the first decline since 2009 – as a result of drops in major economies such as China, Hong Kong (China), Malaysia and the Republic of Korea. The sluggish global economy, fiscal constraints in Europe, a significant shrinkage in global M&A activities and cautious sentiment in investing by TNCs were among the key reasons for the decline.

The decrease was visible in both cross-border M&As and greenfield investments (tables B–E). In 2012, M&A sales contracted by about 37 per cent to $23 billion, and the value of greenfield investments decreased by 28 per cent – the lowest level recorded in a decade. However, M&A activities undertaken by companies from within the subregions rose by 18 per cent, to $17 billion, contributed mainly by the proactive regional expansion drive of firms from China, Hong Kong (China), Malaysia and Thailand. The strong intraregional M&A activity, nevertheless, could not compensate for the slide in M&As by developed-country firms, which were less than one third the level of 2011.

East Asia experienced an 8 per cent drop in FDI inflows, to $215 billion. China continues to be the leading FDI recipient in the developing world despite a 2 per cent decline in inflows. FDI remained at a high level of $121 billion (figure A),[3] in spite of a strong downward pressure on FDI in manufacturing from rising production costs, weakening export markets and the relocation of foreign firms to lower-income countries. Hong Kong (China), the second largest recipient in East and South-East Asia, saw a 22 per cent decline in FDI inflows, to $75 billion, but the situation has been improving since the end of 2012 as strong capital inflows resumed. FDI inflows to the Republic of Korea dropped slightly, by 3 per cent, to $10 billion, as both equity investments and reinvested earnings decreased. Inflows to Taiwan Province of China turned positive, from -$2 billion in 2011 to $3 billion in 2012. Inflows to Mongolia declined but remained above $4 billion thanks to foreign investment in mining. However, FDI prospects in the sector have become uncertain as a dispute between the Government and a foreign investor looms.

In contrast to East Asia, South-East Asia saw a 2 per cent rise in FDI inflows (to $111 billion), partly because of higher flows (up 1.3 per cent to $57 billion) to Singapore, the subregion's leading FDI host country. Higher inflows to Indonesia and the Philippines also helped, as did the improved FDI levels in low-income countries such as Cambodia, Myanmar and Viet Nam. These countries are the emerging bright spots of the subregion, particularly for labour-intensive FDI and value chain activities. These low-income countries also experienced a rise in investments in the extractive sector and infrastructure, including those under contractual arrangements. Thailand continued to attract higher levels of greenfield projects, particularly in the automotive and electronic industries. Some automotive makers, especially Japanese TNCs, have been strengthening and expanding their operations in Thailand. For instance, Thailand has overtaken China to become Toyota's third largest production base.[4]

TNCs from Japan and elsewhere are increasing their FDI in this subregion because of regional integration, the prospects of the Association of Southeast Asian Nations (ASEAN) economic community and emerging opportunities in low-income countries, such as Myanmar. A number of companies from Europe and the United States have also recently established or are establishing operations in Myanmar. For instance, Hilton is opening a hotel in Yangon under a management contract. Chinese investment in infrastructure has been increasing in countries such as Indonesia and the Lao People's Democratic Republic, providing new dynamism to intraregional FDI in infrastructure in East and South-East Asia.

Prospects for FDI inflows to East and South-East Asia are likely to turn positive, as the performance of key economies in the region improves and investor confidence picks up strength.

Overall, outward FDI from East and South-East Asia rose by 1 per cent, to $275 billion (figure C), against the backdrop of a sharp decline in worldwide FDI outflows. This marks the fourth consecutive year of increasing flows from the region, with its share in global FDI outflows jumping from 9 per cent in 2008 to 20 per cent in 2012, a share similar to that of the EU.

In East Asia, FDI outflows rose by 1 per cent to $214 billion in 2012. Outflows from China continued to grow, reaching a new record of $84 billion. The country is now the world's third largest source of FDI (see chapter I). Chinese companies remained on a fast track of internationalization, investing in a wide range of industries and countries driven by diversified objectives, including market-, efficiency-, natural resources- and strategic assets-seeking motives.[5] FDI outflows from the Republic of Korea rose 14 per cent, to $33 billion, while those from Taiwan Province of China increased slightly to $13 billion. Large investments in high-end segments of the electronics industry in Mainland China were one of the main drivers of rising outward FDI from these two economies.

FDI outflows from South-East Asia increased 3 per cent to $61 billion in 2012. Outflows from Singapore, the leading source of FDI in the subregion, declined by 12 per cent to $23 billion. However, outflows from Malaysia and Thailand rose by 12 per cent and 45 per cent, amounting to $17 billion and $12 billion, respectively. The rise of these two countries as FDI sources was driven mainly by intraregional investments.

Manufacturing is relocating within the region. Rising production costs in China have led to the relocation of manufacturing activities by foreign as well as Chinese TNCs. The phenomenon has been generally contained within the region, though there are some cases of relocation to other regions as well as to home countries of foreign TNCs (see chapter I.B). On the one hand, foreign productive facilities have been relocating inland from the coastal area of China, leading to a boom in FDI inflows to the middle and western areas of the country. Accordingly, the share of FDI inflows to the inland areas in the national total rose from 12 per cent in 2008 to 17 per cent in 2012.[6] On the other hand, some foreign companies have started to relocate their production and assembly facilities to low-income countries in South-East Asia.[7] Until now, more relocation activities have been made to inland China than from China to South-East Asia, but the latter destination has gained strength as production costs in China as a whole have kept rising.[8]

The resulting relocation of productive capacities took place primarily in labour-intensive industries, such as garments and footwear. For instance, some companies from economies within the region, such as Hong Kong (China) and Taiwan Province of China, have relocated from Mainland China to Cambodia, where labour costs are about a third of those in China and productivity is rising towards the level in China. Traditionally important target countries for such relocation are Indonesia and Viet Nam in South-East Asia, as well as Bangladesh in South Asia. A number of large TNCs, including Nike (United States) and Adidas (Germany), have strengthened their contract manufacturing activities in low-cost production locations in South-East Asia. As a result, for instance, the share of Viet Nam in the footwear production of Nike rose from 25 per cent in 2005 to 41 per cent in 2012.[9]

Meanwhile, the manufacturing sector in China has been upgrading as both domestic and foreign investments take place in high-technology industries, such as advanced electronics components. For instance, Samsung has invested in a joint venture producing the latest generation of liquid crystal displays (LCDs) in Suzhou and has announced plans to build a $7 billion facility in Xi'an to produce advanced flash memory. The facility, to be operational at the end of 2013, will become Samsung's second largest memory chip production base – and the company's largest-ever overseas investment. In addition, a greater number of foreign-invested research and development (R&D) centres – which have doubled over the past five years, to about 1,800 at the end of 2012 – demonstrates that FDI has helped China enter into more advanced activities along the value chain.

Extractive industries attract more attention from foreign investors. Over the past few years, foreign participation in extractive industries (including both oil and gas, and metal mining) has helped boost FDI in

certain countries, including Mongolia and Myanmar (table II.3). In some instances, foreign participation in mining has resulted in political controversies, at both national and international levels, which have had significant implications for international investors.

Since Mongolia opened its door to foreign participation in metal mining, the country has seen significant FDI inflows targeting its mining assets, which include coal, copper, gold and uranium. In 2009, the Oyu Tolgoi mine, one of the world's largest untapped deposits of copper and gold, was granted to a joint venture between the Mongolian Government and Turquoise Hill Resources (previously known as Ivanhoe Mines), a Canadian company that is now 51 per cent owned by Rio Tinto (Australia and United Kingdom). The mine started construction in 2010 and is expected to begin production in 2013. However, a dispute has recently emerged between the Mongolian Government and Rio Tinto over this mine, leading to uncertainties about the progress of the construction.[10]

In granting mining licenses, the Government of Mongolia has tried to involve more bidders. As a result, fierce competition was witnessed among international investors for the Tavan Tolgoi coal mine, one of the world's largest coking and thermal coal deposits. Involved in the bidding for the West Tsankhi section of the mine were companies from various countries.

In Myanmar, new investments in extractive industries have taken off. In the oil and gas industry, a number of Western companies are already operating; new players from India, the Republic of Korea, Thailand and Singapore have entered into oil and gas exploration as well and are ready to expand their operations (table II.3).[12] For instance, Total (France) and Chevron (United States) have long held stakes in oil and gas projects, but only after the recent easing of sanctions are the two companies expanding their operations in Myanmar. In metal mining, among others, a joint venture between a local company and Ivanhoe Mines (Canada) started operating a large copper mine in 2004; and later a Chinese investor has become involved instead of the Canadian company. Following the introduction of a new mining law in 2013, investors from China, India, the Philippines, the Russian Federation, Viet Nam and the United

Table II.3. Foreign participation in extractive industries in Mongolia and Myanmar, selected large projects

Project/target company	Industry	Investment ($ million)	Foreign investor	Home economy	Mode of entry (Share)	Year
Mongolia						
Tomortei Mining Co	Metal mining	160	Shougang	China	Greenfield	2005
Boroo Glod Mine	Metal mining	228	Centerra Gold	Canada	Greenfield	2005
Baruunbayan Uranium Project	Metal mining	..	Solomon Resources	Canada	Greenfield	2005
Khangai and Bayankhongor Project	Metal mining	..	Dragon Gold Resources	United Kingdom	Greenfield	2005
Bao Fung Investments Ltd	Metal mining	87	Asia Resources Holdings	Hong Kong, China	M&A (100%)	2009
Mountain Sky Resources	Metal mining	237	Green Global Resources	Hong Kong, China	M&A (100%)	2009
Oyu Tolgoi Mine	Metal mining	..	Ivanhoe Mines	Canada	Greenfield	2009
MRCMGL LLC	Metal mining	20	Alamar Resources Ltd	Australia	M&A (100%)	2011
Ar Zuun Gol & Zuun Gol Coking	Coal mining	35	Hunnu Coal Ltd	Australia	M&A (70%)	2011
Wolf Petroleum Ltd	Oil and gas	42	Strzelecki Metals Ltd	Australia	M&A (100%)	2012
Myanmar						
Blocks AD-2, AD-3 and AD-9	Oil and gas	337	ONGC	India	Greenfield	2007
Block M3 in the Gulf of Martaban	Oil and gas	1 000	PTTEP International	Thailand	Greenfield	2007
Letpadaung Copper Mine	Metal mining	600	Wanbao Mining	China	Greenfield	2008
Chauk Oil Field	Oil and gas	337	Interra Resources	Singapore	Greenfield	2008
Gas Project Block AD-7	Oil and gas	1 700	Daewoo	Korea, Republic of	Greenfield	2009
Dornod Uranium Mine	Metal mining	..	Rosatom	Russian Federation	Greenfield	2009

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database, and various media sources.

States have expressed interest in mining, expanding the number of possible contributors of FDI inflows to extractive industries in Myanmar.

Intraregional investment increases, particularly in infrastructure. The share of intraregional FDI flows has been on the rise, accounting for about 37 per cent and 24 per cent of foreign investment in greenfield projects and cross-border M&As, respectively (tables C and E).

In infrastructure industries, such as transport and telecommunications, intraregional investment has been particularly significant in East and South-East Asia over the past decade (UNCTAD, 2008). Companies headquartered in Hong Kong (China), Malaysia, Singapore and Thailand are major players from emerging economies in those industries (UNCTAD, 2013a). They have increasingly expanded their operations within the region and beyond it. For instance, telecom operators from Thailand and Singapore have actively invested in telecommunications in neighbouring South-East Asian countries, and companies from Malaysia and Singapore have been operating in the transport industry in China.

During the past few years, infrastructure investment from China in South-East Asia has also been on the rise. In the power industry, for instance, China Huadian Corporation, one of the country's five largest electricity generators, is investing $630 million in the first phase of the largest power plant in Bali, Indonesia. In total, Chinese enterprises have invested an estimated $7 billion in infrastructure development in Indonesia. In transport, China has decided to invest $7 billion in domestic railways in the Lao People's Democratic Republic; a 410-km high-speed railway linking Kunming and Vientiane may be operational by 2018. The China–Myanmar railway has started construction as well. A regional network of high-speed railways linking China and Singapore, to be built in the years to come, will contribute significantly to regional integration and economic progress in the area.

3. South Asia

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $10 billion	India	..
$1.0 to $9.9 billion	Islamic Republic of Iran	India
$0.1 to $0.9 billion	Bangladesh, Pakistan, Sri Lanka and Maldives	Islamic Republic of Iran
Below $0.1 billion	Afghanistan, Nepal and Bhutan	Sri Lanka, Pakistan and Bangladesh

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

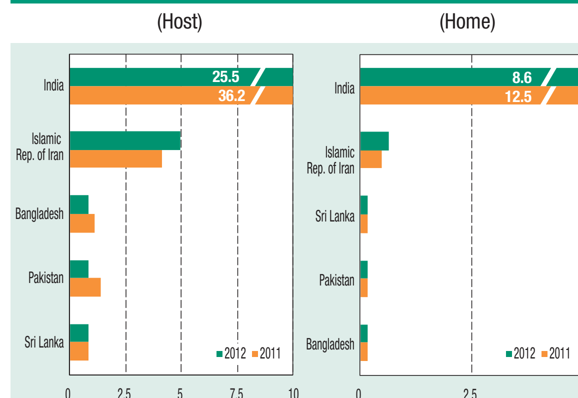


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

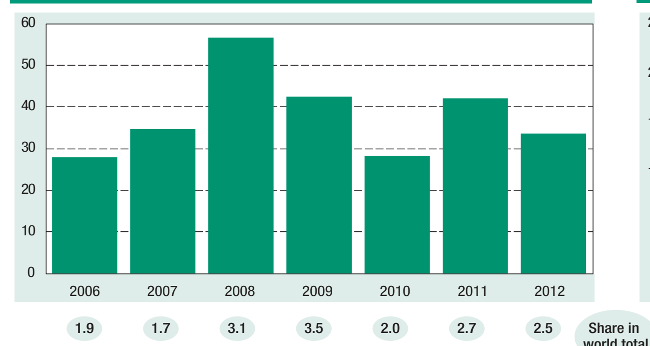


Figure C. FDI outflows, 2006–2012
(Billions of dollars)

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
Total	**13 181**	**2 637**	**6 143**	**2 651**
Primary	**8 997**	**130**	**834**	**- 70**
Mining, quarrying and petroleum	8 997	130	834	- 70
Manufacturing	**1 951**	**1 403**	**1 489**	**498**
Chemicals and chemical products	96	102	1 370	293
Metals and metal products	47	124	- 644	116
Electrical and electronic equipment	83	493	288	37
Motor vehicles and other transport equipment	977	197	470	58
Services	**2 233**	**1 104**	**3 820**	**2 223**
Transport, storage and communications	135	- 590	1 954	25
Finance	859	1 408	1 461	659
Business services	418	- 21	101	243
Health and social services	80	145	-	665

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
World	**13 181**	**2 637**	**6 143**	**2 651**
Developed economies	**15 732**	**1 161**	**5 304**	**1 967**
European Union	13 232	618	1 154	435
United Kingdom	13 184	- 782	682	- 172
United States	1 652	405	28	1 531
Australia	14	17	4 082	- 374
Japan	986	966	40	7
Developing economies	**- 2 573**	**1 462**	**1 083**	**683**
Africa	- 337	426	318	22
Mauritius	- 348	82	-	-
South, East and South-East Asia	- 2 373	- 39	585	625
Latin America and the Caribbean	4	-	180	119
Transition economies	**-**	**-**	**- 245**	**-**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	South Asia as destination 2011	South Asia as destination 2012	South Asia as investors 2011	South Asia as investors 2012
Total	**58 669**	**39 525**	**35 627**	**27 714**
Primary	**-**	**165**	**4 165**	**4 602**
Mining, quarrying and petroleum	-	165	4 165	4 602
Manufacturing	**37 813**	**16 333**	**19 469**	**11 367**
Chemicals and chemical products	4 567	1 786	1 370	1 668
Metals and metal products	9 595	3 317	8 287	2 178
Machinery and equipment	3 169	929	140	1 234
Motor vehicles and other transport equipment	11 396	4 248	2 628	2 938
Services	**20 857**	**23 027**	**11 993**	**11 745**
Electricity, gas and water	1 862	6 199	4 463	4 236
Transport, storage and communications	3 815	7 210	345	1 442
Finance	2 552	3 264	1 710	726
Business services	5 890	2 805	3 228	2 046

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	South Asia as destination 2011	South Asia as destination 2012	South Asia as investors 2011	South Asia as investors 2012
World	**58 669**	**39 525**	**35 627**	**27 714**
Developed economies	**42 036**	**23 579**	**4 529**	**8 592**
European Union	15 990	12 962	2 538	2 889
United States	14 121	5 559	1 497	829
Australia	1 049	23	62	4 576
Japan	8 787	3 147	8	84
Developing economies	**16 244**	**15 694**	**30 274**	**18 742**
Africa	980	149	11 113	9 315
East and South-East Asia	9 197	8 211	10 973	2 388
South Asia	1 910	2 328	1 910	2 328
West Asia	4 093	4 972	5 672	4 100
Latin America and the Caribbean	64	34	606	611
Transition economies	**389**	**252**	**824**	**380**

FDI inflows to South Asia dropped by 24 per cent to $34 billion as the region saw sharp declines in both cross-border M&As and greenfield investments. Meanwhile, outflows declined by 29 per cent, to $9 billion, due to the shrinking value of M&As by Indian companies.

FDI inflows to South Asia declined significantly in 2012 (figure B) because of decreases across a number of major recipient countries, including India, Pakistan and Sri Lanka (figure A). Inflows to the three countries dropped by 29, 36 and 21 per cent, to $26 billion, $847 million and $776 million, respectively. FDI to Bangladesh also decreased, by 13 per cent, to about $1 billion. Nonetheless, this country remained the third largest recipient of FDI in the region, after India and the Islamic Republic of Iran – where FDI increased by 17 per cent, reaching a historical high of $5 billion.

India continued to be the dominant recipient of FDI inflows to South Asia in 2012. However, the Indian economy experienced its slowest growth in a decade, and a high inflation rate increased risks for both domestic and foreign investors. As a result, investor confidence has been affected and FDI inflows to India declined significantly. A number of other factors, however, positively influenced FDI prospects in the country. Inflows to services are likely to grow, thanks to ongoing efforts to further open up key economic sectors, such as retailing (see chapter III).[13] Flows to manufacturing are expected to increase as well, as a number of major investing countries, including Japan and the Republic of Korea, are establishing country- or industry-specific industrial zones in India (box II.1).

A number of countries in the region, including Bangladesh, India, Pakistan and Sri Lanka, have emerged as important players in the manufacturing and export of ready-made garments (RMG). Contract manufacturing has helped boost the productive capacities in the RMG industry in South Asia, linking those countries to the global value chains and markets (see below). In particular, Bangladesh stands out as the sourcing hotspot in the industry by offering the advantages of both low costs and large capacity. However, working conditions and other labour issues are still a major concern, and a number of disastrous accidents recently underscore the daunting challenges facing the booming garment industry in the country.[14]

With regard to mode of entry, South Asia saw a sharp decline in both cross-border M&As and greenfield investments (tables B–E). In 2012, M&A sales dropped by almost four fifths to $2.6 billion. For the first time since 2007, acquirers from developing countries surpassed those from developed countries in the total value of M&A deals undertaken in South Asia (table C). This was mainly due to the expansion of companies from the United Arab Emirates in the region. In the meantime, the total value of recorded greenfield investment projects decreased by about one third to $40 billion, the lowest amount since 2004.

Overall, prospects for FDI inflows to South Asia are improving, mostly owing to an expected rise in investments in India.

FDI outflows from South Asia dropped sharply by 29 per cent in 2012 (figure C). Outflows from India, the region's largest FDI source (figure A), decreased to $8.6 billion (still 93 per cent of the regional total) owing to the shrinking value of cross-border M&As by Indian companies. In comparison with their Chinese counterparts (see section II.2), Indian companies – especially conglomerates – seemed much less active in international M&A markets than in previous years and increasingly focused on their domestic operations (for details, see below).

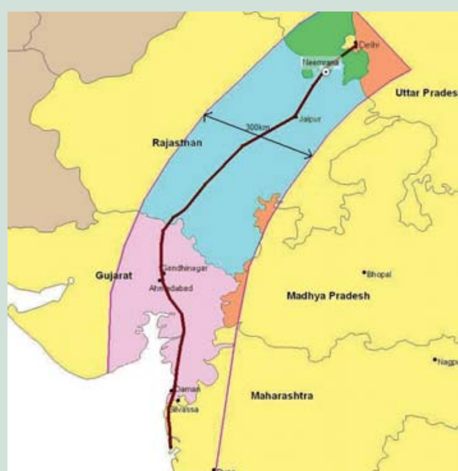
Local firms link to the global value chain in garments. Bangladesh, India, Pakistan and Sri Lanka have become important players in global apparel exports, and the first two rank fourth and fifth globally, after China, the EU and Turkey (WTO, 2010). Their significance has been further enhanced recently. The RMG industry provides good opportunities for export-driven industrialization. Using their locational advantages (e.g. large supply of low-cost labour) as well as government policy supports (e.g. FDI policies encouraging linkages), South Asian countries such as Bangladesh and Sri Lanka have been able to link to the global value chain and build their domestic productive capacities.

The RMG industry emerged in Bangladesh in the late 1970s and has become a key manufacturing industry in the country: its nearly 5,000 factories employ some 3 million workers and account for about three fourths of the country's total exports. FDI has played a central role in the early stage of the industrial development process, but local firms

Box.II.1. Country-specific economic zones in India

The Indian Government has strengthened its efforts to attract FDI by establishing industrial zones for investors from particular countries within the Delhi-Mumbai Industrial Corridor (DMIC) (box figure II.1.1).[a] Leveraging public funds from foreign countries, these bilateral efforts may result in an increasing amount of FDI inflows to industries such as electronics in India in the years to come.

Box figure II.1.1. Delhi-Mumbai Industrial Corridor: the geographical coverage



In February 2013, an agreement was reached between the Governments of India and Japan on the establishment of a special economic zone for Japanese electronics companies within the DMIC, most likely in Neemrana, Rajasthan.[b] It will be India's first industrial park officially established for firms in a single industry, as well as from a particular country. Japan's FDI stock in India is larger than that of the Republic of Korea, but in the electronics industry, Japanese companies have lagged far behind their Korean counterparts in the Indian market.[c] The establishment of the zone may help Japanese electronics companies expand their presence in India and narrow the gap with Korean companies.

In the meantime, the Republic of Korea tried to enhance its first-mover advantages. In March 2013, the Korea Trade-Investment Promotion Agency signed a Memorandum of Understanding with the Rajasthan State Industrial Development and Investment Corporation, setting up an industrial zone in Neemrana dedicated to Korean companies. It is expected to attract considerable FDI flows from the Republic of Korea in the near future.

Furthermore, the Government of India recently invited the Czech Republic to invest in an industrial zone in India. In this case, the targeted industry is automotives, in which the Czech Republic has established a strong competitive position.

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

now dominate the industry (Fernandez-Stark et al., 2011). By providing various contract manufacturing services, Bangladesh has been able to export to markets in the EU and the United States. Before 2000, most of the firms were involved in cut, make and trim (CMT) operations; more recently, many have been able to upgrade to original equipment manufacturing, thus being able to capture more value locally.

The RMG industry in Sri Lanka experienced a similar process of industrial emergence catalyzed by FDI. By 2000, however, domestic firms dominated the industry. In recent years, leading local contract manufacturers, such as Brandix and MAS,[15] have started to invest in production facilities in other regions, especially Africa. Starting with CMT production in the 1980s and 1990s, these firms established themselves in original design manufacturing in the 2000s, serving brand owners in developed countries, including Gap, M&S and Nike (Wijayasiri and Dissanayake, 2008; Fernandez-Stark et al., 2011). As "full package" garment suppliers,[16] they

have been particularly competitive in niche markets such as sportswear, swimwear and children's clothing. While the industry moves to higher stages of the value chain, the skills of the local workforce have further supported the internationalization of these firms (Kelegama, 2009).

Indian TNCs become less active in global M&A markets. Indian companies had been active players in the global M&A markets, particularly in the developed world, driven by a variety of motives. Among their 18 cross-border M&A deals with investment values over $1 billion since 2005, 13 were in developed countries, most notably the United States (6 deals), the United Kingdom (3 deals) and Australia (3 deals) (table II.4). These megadeals were mainly in extractive industries (oil and gas, and metal mining), infrastructure industries (telecom and transport) and heavy industries (automotive, chemicals and metal production). Most took place during 2007–2008, and none were recorded in 2012.

Through proactive cross-border M&As, Indian enterprises have achieved important strategic objectives, such as the acquisition of technologies and brands.[17] In the automotive industry, for instance, established brands such as Jaguar and Land Rover are now owned by Tata Group. In information technology (IT)–enabled services, Infosys and Wipro have expanded into new markets and areas of business through both international greenfield investments and M&As.[18] In telecommunications, through the acquisition of Zain's mobile operations in Africa, Bharti Airtel has expanded to mobile markets in 15 African countries and has become the world's fifth largest mobile telecom operator by number of subscribers. In extractive industries, Indian companies have been able to secure access to significant mineral resources worldwide, including through megadeals in countries such as Australia, Indonesia, the Sudan[19] and the Bolivarian Republic of Venezuela.

Some Indian companies, especially conglomerates, have pulled back from large outbound M&A deals in recent years, owing partly to financial constraints. Companies in telecom and transport services that became proactive players in global M&A markets during 2010–2011 have been focusing on domestic operations more recently.[20] As a result, the total value of cross-border M&As undertaken by Indian companies in 2012 dropped by nearly three fifths, to about $2.65 billion.

Table II.4. Largest cross-border M&As by Indian TNCs, 2005–2012

Year	Acquiring company	Target company	Target industry	Target nation	Value ($ million)	Shares (%)
2007	Tata Steel UK Ltd	Corus Group PLC	Steel	United Kingdom	11 791	100
2010	Bharti Airtel Ltd	Zain Africa BV	Telecommunications	Kuwait	10 700	100
2007	AV Aluminum Inc	Novelis Inc	Metal	United States	5 789	100
2010	Investor Group	Republic of Venezuela-Carabobo Block	Oil and gas	Venezuela (Bolivarian Republic of)	4 848	40
2010	Adani Mining Pty Ltd	Linc Energy Ltd	Mining	Australia	2 740	100
2008	Investor Group	Sabiha Gokcen International Airport	Transport	Turkey	2 656	100
2008	Jarpeno Ltd	Imperial Energy Corp PLC	Oil and gas	United Kingdom	2 608	100
2008	Tata Motors Ltd	Jaguar Cars Ltd	Automotives	United States	2 300	100
2011	Mundra Port & Special Economic Zone	Abbot Point Coal Terminal	Transport	Australia	1 951	100
2005	Ratnagiri Gas & Power Pvt Ltd	Dabhol Power Co	Power	United States	1 939	100
2010	Chennai Network Infrastructure Ltd	Aircel Ltd-Mobile Towers	Telecommunications	Malaysia	1 704	100
2007	Essar Steel Holdings Ltd	Algoma Steel Inc	Steel	Canada	1 603	100
2007	Tata Power Co Ltd	Kaltim Prima Coal PT	Mining	Indonesia	1 300	30
2011	GVK Power & Infrastructure Ltd	Hancock Coal Pty Ltd	Mining	Australia	1 260	100
2007	United Spirits Ltd	Whyte & Mackay Ltd	Food and beverages	United Kingdom	1 176	100
2010	Reliance Eagleford Upstream LP	Pioneer Natural Resources Co	Oil and gas	United States	1 145	38
2008	GMR Infrastructure Ltd	InterGen NV	Power	United States	1 107	50
2008	Tata Chemicals Ltd	General Chemical Industrial Products Inc	Chemicals	United States	1 005	100

Source: UNCTAD, FDI-TNC-GVC Information System, cross-border M&A database.

4. West Asia

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $10 billion	Turkey and Saudi Arabia	..
$5.0 to $9.9 billion	United Arab Emirates	Kuwait
$1.0 to $4.9 billion	Lebanon, Iraq, Kuwait, Oman and Jordan	Saudi Arabia, Turkey, United Arab Emirates, Qatar and Oman
Below $1.0 billion	Bahrain, Yemen, Qatar and Palestinian Territory	Bahrain, Lebanon, Iraq, Yemen, Jordan and Palestinian Territory

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

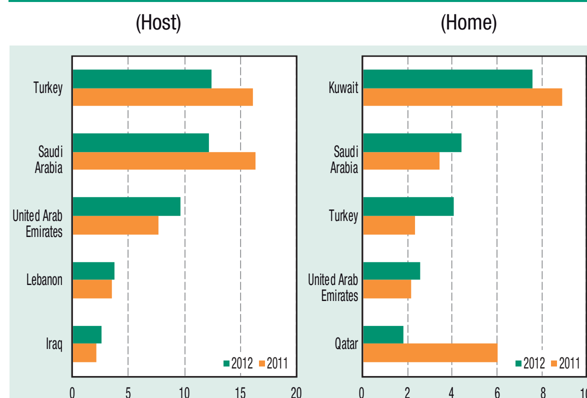
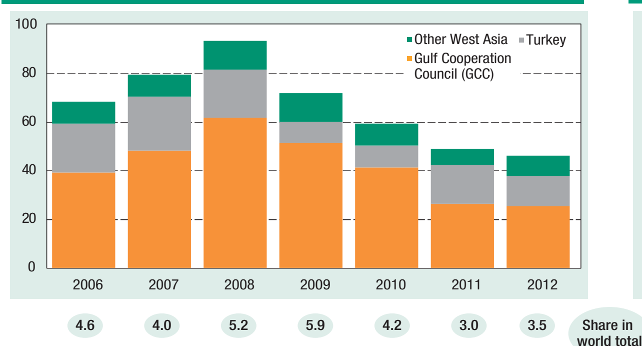


Figure B. FDI inflows, 2006–2012
(Billions of dollars)



Share in world total

Figure C. FDI outflows, 2006–2012
(Billions of dollars)

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
Total	**11 111**	**4 295**	**6 603**	**7 775**
Primary	**2 730**	**154**	**87**	**43**
Mining, quarrying and petroleum	2 682	154	87	43
Manufacturing	**703**	**2 556**	**969**	**1 702**
Food, beverages and tobacco	30	1 019	213	1 605
Non-metallic mineral products	- 69	137	332	-
Metals and metal products	198	39	22	-
Services	**7 678**	**1 585**	**5 547**	**6 030**
Electricity, gas and water	341	284	190	-
Construction	68	125	- 35	1 126
Transport, storage and communications	338	874	- 2 568	- 651
Finance	6 221	- 298	8 177	5 517
Business services	373	562	314	73

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
World	**11 111**	**4 295**	**6 603**	**7 775**
Developed economies	**9 719**	**- 1 083**	**3 252**	**5 458**
Belgium	- 522	- 3 862	- 587	140
Luxembourg	-	- 10	-	2 388
Spain	5 891	-	5 474	305
United Kingdom	4 622	- 214	- 621	1 318
United States	- 1 566	1 700	- 945	- 244
Developing economies	**1 088**	**543**	**3 234**	**735**
Asia	984	428	2 622	662
India	-	- 83	123	1 060
Malaysia	- 5	116	1 915	60
Transition economies	**5**	**3 862**	**117**	**1 582**
Russian Federation	-	3 862	40	1 582

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	West Asia as destination 2011	West Asia as destination 2012	West Asia as investors 2011	West Asia as investors 2012
Total	**70 248**	**44 978**	**45 171**	**35 095**
Primary	**915**	**2**	**503**	**37**
Manufacturing	**37 505**	**20 247**	**19 009**	**12 216**
Coke, petroleum products and nuclear fuel	3 618	5 002	7 633	5 768
Chemicals and chemical products	13 877	6 181	3 372	103
Metals and metal products	9 294	2 353	4 122	2 438
Services	**31 827**	**24 729**	**25 659**	**22 842**
Electricity, gas and water	7 598	2 920	2 611	601
Construction	6 620	6 693	12 520	5 284
Hotels and restaurants	4 686	3 809	1 920	3 302
Finance	2 680	2 226	2 357	4 029
Business services	3 259	2 038	901	587
Community, social and personal service activities	912	3 487	729	2 800

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	West Asia as destination 2011	West Asia as destination 2012	West Asia as investors 2011	West Asia as investors 2012
World	**70 248**	**44 978**	**45 171**	**35 095**
Developed economies	**39 119**	**15 649**	**9 615**	**2 066**
Europe	17 127	9 883	7 443	1 651
North America	18 736	5 099	1 979	342
Other developed countries	3 257	667	193	73
Developing economies	**30 433**	**26 173**	**34 339**	**30 889**
Africa	150	1 160	7 038	11 610
East and South-East Asia	5 930	8 025	3 965	1 247
South Asia	5 672	4 100	4 093	4 972
India	5 455	3 880	1 235	4 105
West Asia	18 503	12 761	18 503	12 761
Latin America and the Caribbean	178	127	699	300
Transition economies	**695**	**3 156**	**1 217**	**2 140**

FDI inflows to West Asia in 2012 have failed once again to recover from the downturn started in 2009, registering their fourth consecutive year of decline. This is due to persistent political uncertainties at the regional level and clouded economic prospects at the global level. State-owned firms in the Gulf Cooperation Council (GCC) countries are taking over delayed projects that were originally planned as joint ventures with foreign firms. Measures undertaken in Saudi Arabia to augment the employment of nationals in the private sector face the challenge of mismatched demand and supply in the private job market.

FDI inflows have failed once again to recover. FDI to West Asia in 2012 registered its fourth consecutive year of decline (figure B), although at a slower rate, decreasing by 4 per cent to $47 billion, half its 2008 level. Growing political uncertainty at the regional level and subdued economic prospects at the global level are holding back foreign investors' propensity and capacity to invest in the region. Significant diminution in FDI inflows was registered in the two main recipient countries – Turkey (-23 per cent to $12.4 billion) and Saudi Arabia (-25 per cent to $12.2 billion) – that accounted for 52 per cent of the region's overall inflows. For the first time since 2006, Saudi Arabia ceded its position as the region's largest recipient country to Turkey.

The FDI fall in Saudi Arabia occurred despite the 6.8 per cent economic growth registered in 2012, boosted by heavy Government spending – on upgrading infrastructure and increasing public sector employment and wages. Looming uncertainties related to social and political tensions, together with the shrinking availability of debt capital from the ailing banking sectors in developed countries, have restricted foreign investors' propensity and capacity to invest, putting the brakes on an FDI recovery.

Declining FDI to Turkey was due to a 70 per cent drop in cross-border M&A sales, which had surged the previous year (annex table I.3). At $12 billion in 2012, inflows to Turkey remained *much lower than their 2007 peak of $22 billion*. Lower global growth and a prolonged fiscal tightening in the EU – Turkey's largest market – have reduced demand for Turkey's exports, affecting export-led FDI such as that in the automobile sector (box II.2).

FDI to GCC countries as a whole remained at almost the same level as in 2011 ($26 billion), registering a slight 0.4 per cent increase, despite the strong decline registered in Saudi Arabia. The latter was offset by significant FDI growth in all other countries within this group. FDI to the United Arab Emirates – West Asia's third largest recipient country – increased 25 per cent, to $10 billion, continuing the recovery initiated in 2010 but remaining below the $14 billion reached in 2007. High public spending by Abu Dhabi and strong performance in Dubai's non-hydrocarbon sectors have helped rebuild foreign appetites for direct investment in the country. Saudi Arabia and the United Arab Emirates alone accounted for 83 per cent of FDI inflows to the GCC economies. FDI to Kuwait more than doubled, reaching $2 billion, boosted by Qatar Telecom's acquisition of additional shares in Kuwait's second mobile operator Wataniya, which raised its stake to 92 per cent. FDI inflows also increased in Bahrain, Oman and Qatar.

FDI to non-GCC countries overall declined by 9 per cent to $21 billion, because of the large drop in FDI to Turkey, which attracted 60 per cent of FDI to this group. However, most countries in this group saw an increase in FDI inflows. This was the case of Lebanon where FDI in 2012 registered positive growth (9 per cent), enhanced by foreign acquisitions in the insurance industry and in services related to real estate. New gas discoveries in Lebanese waters along the northern maritime boundary with Cyprus and Syria offer prospects for the country to attract FDI in oil exploration. About 46 international oil companies prequalified to bid for gas exploration in a licensing round that opened on 2 May 2013. FDI to Iraq was up for the second consecutive year, increasing by 22 per cent to $2.5 billion, attracted by the country's strong economic growth (8.4 per cent), which has been aided by significant increases in Government spending. With its considerable hydrocarbon wealth, large population and massive infrastructure investment needs, Iraq offers a wide range of opportunities for foreign investors. They are progressively investing despite the country's political instability and security challenges. Turkey, Lebanon and Iraq together attracted 90 per cent of FDI to non-GCC countries. FDI to Yemen returned to positive territory ($349 million), encouraged by the improvement in that country's political situation, while FDI to Jordan declined by 5 per cent.

Box II.2. Recession in Europe affects Turkey's automobile sector

After two years of strong recovery – during which low interest rates, easy access to credit and a domestic economic rebound compensated for the weak external demand and drove strong vehicle sales growth in 2010 (26 per cent) and 2011 (8.6 per cent) – Turkey's automotive industry registered a fall in production in 2012 (-9.8 per cent). This resulted from a sharp slowdown in economic activity and tighter credit conditions in addition to a prolonged fiscal tightening in the EU, the industry's largest export market.

The Turkish automotive cluster was developed through alliances with foreign partners, and the country has been included in the global value chain since joining the Customs Union with the EU in 1996. Turkey has been an attractive manufacturing export base for the car industry because of its low wage costs and favourable geographical location, with easy access to Western and Eastern Europe, the Russian Federation, North Africa and the Middle East.

Three manufacturers dominate the sector, accounting for about three quarters of all vehicles made in Turkey. The three are joint ventures between Turkish and major international producers: Tofas-Fiat, Oyak-Renault and Ford Otosan. The sector is highly export-oriented, with exports accounting for 68 per cent of all vehicles produced in the country in 2012 and directed mainly to Europe, which is the target of about three quarters of the total value of vehicle exports.

Given the negative outlook for European demand, which has been affected by drastic fiscal tightening, automotive TNCs in Turkey are starting to focus more on faster-growing emerging markets. Automotive TNCs, in particular Asian companies such as Toyota, Honda and Isuzu (Japan); Hyundai (Korea); and the Chery (China) are increasing or planning to increase their production capacity in Turkey for this purpose. In addition, Ford Otosan is building a third vehicle manufacturing plant in Turkey with a view to increasing exports to the United States market.

Source: UNCTAD, based on TKSB Research, "Turkish Automotive Industry, December 2012", 2013; TKSB Research, "Turkish Automotive Industry December 2012", 2012; Abylkassymova et al. (2011); Economist Intelligence Unit, "Turkey Automotive Report", April 2013; Economist Intelligence Unit, "Japan/Turkey business: Auto firms to increase investments in Turkey", 27 July 2012.

Foreign investors, mainly those from developed countries, are reluctant to engage in the region, especially in large projects. This reluctance is reflected in the significant decrease of greenfield project announcements by foreign companies, more in terms of value (-36 per cent) than quantity (-11 per cent). This reluctance presages negative FDI prospects for the region (see chapter I). The retreat was more accentuated in TNCs from developed countries, whose share in the number of announced projects declined from 67 per cent on average during the period 2003–2011, to 56 per cent in 2012. In value terms, their share slumped from 56 per cent on average in 2003–2011 to 35 per cent in 2012, well below the share of projects announced by developing-country TNCs (57 per cent in 2012). Almost half of the value of the latter's projects is intraregional, and the rest originate mostly from East Asia (mainly Republic of Korea and China) and South Asia (mainly India). Although these announced projects may not all materialize, they nevertheless reflect an ongoing trend: the increasing importance of developing Asian countries as potential investors in West Asia.

Outward FDI from West Asia decreased by 9 per cent to $24 billion in 2012 (figure C), putting a halt to the previous year's recovery. While GCC countries continued to account for most of the region's outward FDI flows, Turkey has emerged as a significant investor, with its outward investment amount growing by 73 per cent to a record $4 billion. This was mainly due to the $2 billion acquisition – by Anadolu Efes (Turkey) – of the Russian and Ukrainian beer businesses of SABMiller.[21]

State-owned firms in GCC countries take the lead on some delayed projects. FDI in GCC countries has been affected since the beginning of the global economic crisis, by the continued retreat of foreign banks – especially European ones – from project financing. Despite the recovery in oil prices in 2010–2011 and the strengthening of GCC economic indicators, foreign bank lending to the GCC on aggregate has declined by 5 per cent between September 2008 and March 2012 (Qatar being the notable exception to the declining trend). Syndicated loans, in which banks club together to provide financing to large corporations, are increasingly

faced with structural challenges because of the continuing retreat of many European banks from the market. In 2011, the regional syndicated loan market contracted by 11 per cent.[22] The pull-back in foreign bank lending partially explains the notable increase in the issuance of domestic sukuks (Islamic bonds) in the GCC in 2012 (IMF, 2012a).

Foreign investors' more cautious approach to large-scale projects has pushed some State-owned firms to move ahead alone on some key projects. This is how some refinery and petrochemical projects progressed in 2012. In Saudi Arabia, for example, the $4.6 billion Jizan refinery project announced in 2004 – originally planned as a joint venture between the State-owned oil company Aramco (40 per cent), with the Saudi private sector and an international oil company each taking a 30 per cent interest – was handed over to Aramco after generating limited interest for ownership participation from TNCs. TNCs are instead contributing to the project through construction contracts to build the refinery, which were awarded to a group of Korean, Japanese and Spanish firms. In Qatar – where all petrochemical projects are joint ventures with multinational energy firms – State-owned Qatar Petroleum chose its own unit over foreign giants as a partner in building and managing a $5.5 billion petrochemical project in Ras Laffan.

But 2012 also witnessed the start of some long-delayed or interrupted joint venture projects with foreign companies, such as the Sadara Chemical Company and the Yanbu refinery, both in Saudi Arabia. The first is a petrochemical megaproject carried out by an equal joint venture that was formed in 2011, after several years of negotiations, between Saudi Aramco and Dow Chemical. The joint venture will build, own and operate a $20 billion integrated chemicals complex (comprising 26 manufacturing units) in Al Jubail Industrial City. The second is a joint venture agreement between Sinopec (China) and Aramco (Saudi Arabia) to complete the construction of the $8.5 billion Yanbu refinery, which was delayed by the exit of ConocoPhillips – the original partner – in 2010.

Saudi Arabia takes measures to augment Saudi employment in the private sector. Faced with a demographic youth bulge and growing unemployment in a context of delicate social and political balance, the Government recently embarked on a new policy of "Saudization", with the introduction of a law known as Nitaqat. This law, announced in May 2011 and phased in between September 2011 and February 2012, is the latest effort in the Government's long-term plan to bolster Saudi employment in the private sector – an agenda that dates from the 1990s. It imposes limits on the number of foreign workers that companies can hire. Non-compliant companies could face a host of restrictions, such as limitations on issuing or renewing visas for expatriate workers, while compliant ones benefit from an expedited hiring process. Expatriate labour – the vast majority of workers in the private sector (90 per cent) – is more attractive for private enterprises than national labour because it is cheaper, more skilled and more flexible.

However, the fundamental challenge facing business in enforcing "Saudization" is the mismatch between national labour demand and supply in the private job market (*WIR12*). The types of jobs experiencing steady growth – such as those in services, construction and trade – are unappealing to nationals, while there is a paucity of suitably qualified graduates for more highly skilled jobs.[23]

5. Latin America and the Caribbean

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $10 billion	Brazil, British Virgin Islands, Chile, Colombia, Mexico, Argentina and Peru	British Virgin Islands, Mexico and Chile
$5.0 to $9.9 billion	..	Cayman Islands
$1.0 to $4.9 billion	Cayman Islands, Dominican Republic, Venezuela (Bolivarian Republic of), Panama, Uruguay, Trinidad and Tobago, Costa Rica, Guatemala, Bahamas, Bolivia (Plurinational State of) and Honduras	Venezuela (Bolivarian Republic of), Panama, Trinidad and Tobago and Argentina
$0.1 to $0.9 billion	Nicaragua, Ecuador, El Salvador, Jamaica, Barbados, Paraguay, Guyana, Belize, Haiti, Saint Vincent and the Grenadines, Saint Lucia and Saint Kitts and Nevis	Costa Rica and Bahamas
Less than $0.1 billion	Curaçao, Antigua and Barbuda, Suriname, Grenada, Sint Maarten, Dominica, Anguilla, Montserrat and Aruba	Guatemala, Ecuador, Jamaica, Honduras, Saint Lucia, Antigua and Barbuda, Aruba, Grenada, Uruguay, Belize, Suriname, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Montserrat, Dominica, Sint Maarten, Curaçao, Dominican Republic, Barbados, Peru, Colombia and Brazil

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

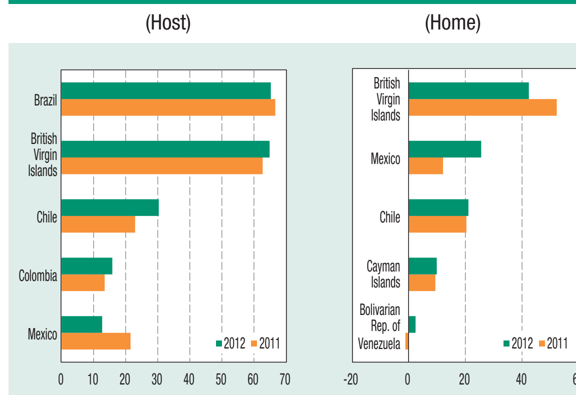


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

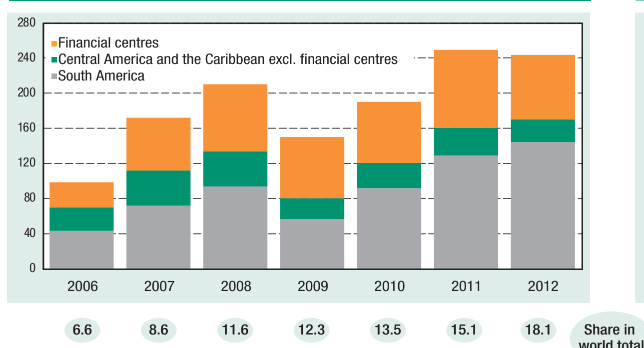
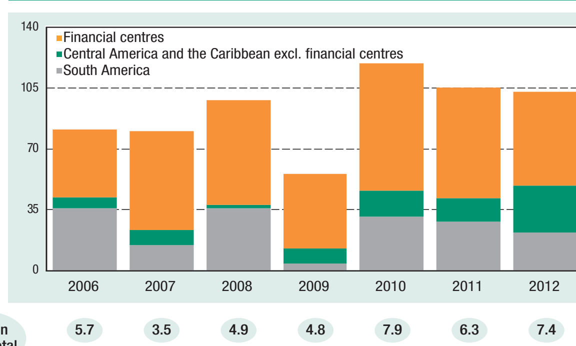


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



Share in world total

	2006	2007	2008	2009	2010	2011	2012
Inflows	6.6	8.6	11.6	12.3	13.5	15.1	18.1
Outflows	5.7	3.5	4.9	4.8	7.9	6.3	7.4

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
Total	**20 098**	**21 070**	**18 750**	**32 647**
Primary	**6 336**	**- 2 612**	**- 638**	**930**
Mining, quarrying and petroleum	6 027	- 2 942	- 733	930
Manufacturing	**2 905**	**9 566**	**6 691**	**4 188**
Food, beverages and tobacco	7 738	3 029	2 136	236
Chemicals and chemical products	- 4 664	1 643	2 453	771
Metals and metal products	33	4 367	863	1 326
Motor vehicles and other transport equipment	26	-	15	1 301
Services	**10 856**	**14 117**	**12 696**	**27 528**
Trade	1 029	1 224	- 437	3 112
Transport, storage and communications	2 710	4 813	6 123	3 443
Finance	2 522	4 623	5 092	19 607
Business services	1 415	1 585	138	1 089

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
World	**20 098**	**21 070**	**18 750**	**32 647**
Developed economies	**2 686**	**- 674**	**9 858**	**16 426**
Europe	- 3 468	- 11 563	1 652	10 762
North America	- 4 776	9 334	8 191	5 660
Developing economies	**17 015**	**21 405**	**7 563**	**16 370**
Asia	9 638	5 443	189	133
China	9 651	5 400	470	21
Latin America and the Caribbean	7 388	16 240	7 388	16 240
South America	5 307	15 345	3 318	14 449
Chile	- 464	8 961	80	608
Mexico	2 001	- 134	4 113	448
Caribbean	81	1 029	39	23
Transition economies	**319**	**-**	**1 329**	**- 149**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	LAC as destination 2011	LAC as destination 2012	LAC as investors 2011	LAC as investors 2012
Total	**138 531**	**65 728**	**20 773**	**9 074**
Primary	**21 481**	**5 297**	**2 300**	**159**
Mining, quarrying and petroleum	21 446	5 297	2 300	159
Manufacturing	**56 949**	**31 104**	**7 666**	**3 396**
Food, beverages and tobacco	8 775	3 467	1 084	592
Metals and metal products	15 233	5 172	1 731	823
Electrical and electronic equipment	2 794	2 797	139	48
Motor vehicles and other transport equipment	15 526	11 932	375	439
Services	**60 101**	**29 327**	**10 807**	**5 519**
Electricity, gas and water	11 989	10 782	156	1 040
Transport, storage and communications	20 643	2 979	3 678	559
Finance	2 978	2 129	1 290	413
Business services	20 570	9 250	5 130	1 945

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	LAC as destination 2011	LAC as destination 2012	LAC as investors 2011	LAC as investors 2012
World	**138 531**	**65 728**	**20 773**	**9 074**
Developed economies	**112 264**	**53 113**	**3 616**	**2 143**
Europe	60 380	25 673	1 474	356
Italy	5 251	8 106	68	-
United Kingdom	17 728	2 024	79	162
North America	39 338	21 441	2 049	1 780
Japan	9 550	3 177	93	-
Developing economies	**25 897**	**12 278**	**17 156**	**6 931**
Asia	10 264	5 638	917	518
Latin America and the Caribbean	14 466	6 171	14 466	6 171
Brazil	1 279	2 693	4 913	1 895
Mexico	8 192	1 259	493	676
Transition economies	**370**	**337**	**-**	**-**

The 2 per cent decline in FDI inflows to Latin America and the Caribbean in 2012 masked a 12 per cent increase in South America. Developed-country TNCs continued selling their assets in the region, increasingly acquired by Latin American TNCs that are also expanding into developed countries. Growing resource-seeking FDI in South America is contributing to the consolidation of an economic development model based on comparative advantages in natural resources. Brazil has taken new industrial policy measures aiming at greater development of its domestic industry and improved technological capabilities, which is encouraging investment by TNCs in industries such as automotives. Nearshoring is on the rise in Mexico, boosted by the rapid growth of labour costs in China and the volatility of rising fuel costs, which have made the shipment of goods across the Pacific less attractive.

South America continued to sustain FDI flows to the region. FDI flows to Latin America and the Caribbean in 2012 maintained almost the same level as in 2011, declining by a slight 2 per cent to $244 billion (figure B). However, this figure hides significant differences in subregional performance, as inward FDI grew significantly in South America (12 per cent to $144 billion) but declined in Central America and the Caribbean (-17 per cent to $99 billion).

The growth of FDI to South America took place despite the slowdown registered in Brazil (-2 per cent to $65 billion) – the subregion's main recipient – after two years of intensive growth. Growth was driven by countries such as Chile (32 per cent to $30 billion), Colombia (18 per cent to $16 billion), Argentina (27 per cent to $13 billion) and Peru (49 per cent to $12 billion), which were South America's main recipient countries after Brazil. A number of factors contributed to the subregion's FDI performance, including the presence of natural resources (such as oil, gas, metals and minerals) and a fast-expanding middle class that attracts market-seeking FDI.

Central America and the Caribbean, excluding the offshore financial centres, saw a 20 per cent decrease in FDI inflows to $25 billion (figure B), attributable mainly to a 41 per cent drop in inflows to Mexico. While Mexico remained a key recipient, its share of this group's inward FDI declined to 50 per cent in 2012, from 68 per cent in the previous year. A $4 billion or 25 per cent divestment of interest by the Spanish Banco Santander in its Mexican affiliate contributed to the decline. FDI to the Dominican Republic, the subregion's second main recipient, increased by 59 per cent to $3.6 billion, boosted in part by Ambev's (Belgium) acquisition of Cerveceria Nacional Dominicana, the country's main brewery, for $1 billion.

FDI to the offshore financial centres decreased by 16 per cent to $74 billion in 2012 (figure B) but remained at a higher value than before the global financial crisis. This group of countries has become a significant FDI recipient since the beginning of the crisis (*WIR12*). The share of offshore financial centres in the region's total FDI increased from 17 per cent in 2001–2006 to 36 per cent in 2007–2012.

Developed-country TNCs continued retreating from the region. Cross-border M&A sales increased by 5 per cent to $21 billion (tables B and C), with very uneven growth by investor regions. Developing-country TNCs continued to increase their acquisitions in 2012 (up 26 per cent), sustaining a trend that began in 2010. The trend was triggered by acquisitions from TNCs based in developing Asia that mainly targeted oil and gas companies (*WIR11*), joined in 2011 by the surge of acquisitions from intraregional sources. In 2012, strong intraregional acquisitions by Latin American TNCs (from Argentina, Brazil, Chile and Colombia) – which more than doubled from 2011 – helped push up M&A sales in this region, while those by developing Asian TNCs almost halved (figure II.3).

By contrast, developed-country TNCs continued retreating from the region, selling more assets than they acquired in 2012 (table C). This was the case in 2009 as well, when the global economic crisis kick-started the retrenchment of some developed-country TNCs from the region in sectors such as extractive industries, finance, chemicals, and electricity, gas and water distribution.

Latin American TNCs expanding in the region and in developed countries. Outward FDI from Latin America decreased by 2 per cent to $103 billion in 2012 (figure C), with uneven growth among countries. Outflows from offshore financial centres decreased

Figure II.3. Latin America and the Caribbean: cross-border M&A sales by geographical source, 1992–2012
(Billions of dollars)

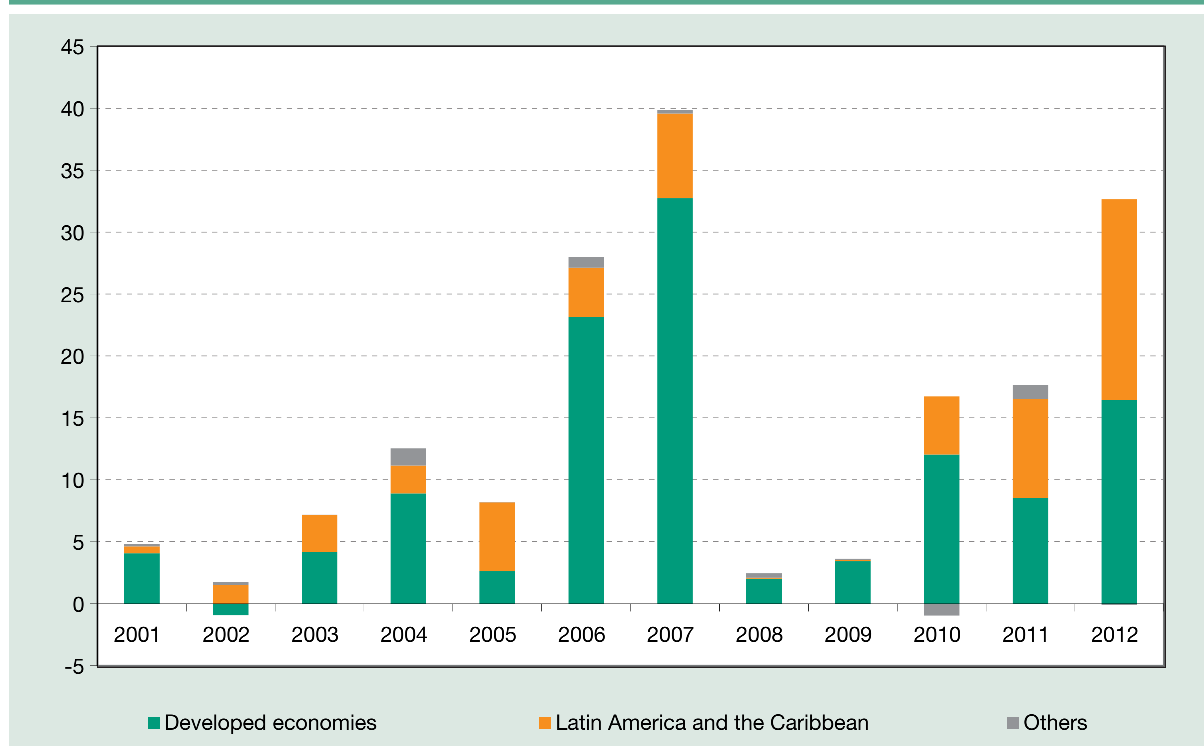
Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

by 15 per cent to $54 billion, and those from Brazil remained downscaled to negative values by the high levels of repayment of intercompany loans to parent companies by Brazilian affiliates abroad.[24] By contrast, outflows from Mexico registered a strong increase (111 per cent to $26 billion), and outflows from Chile continued growing in 2012 (4 per cent, to $21 billion) after the jump recorded in 2011 (115 per cent, to $20 billion).

However, outward FDI data do not properly reflect the dynamism of Latin American TNCs' productive activity abroad, as revealed by the 74 per cent increase in their cross-border acquisitions in 2012, which reached $33 billion. This activity was equally shared between acquisitions in developed countries and in Latin America and the Caribbean (table C). Increasing acquisitions abroad by Latin American TNCs is a trend that began in 2006, reached its peak in 2007 and was halted by the global financial crisis before resuming in 2010. Since 2010, Latin American companies have spent a net amount of $67 billion acquiring companies abroad (figure II.4).

Buoyant conditions at home, cash-rich balance sheets and saturated domestic markets encourage Latin American companies to seek new opportunities abroad. That is why companies from Chile, for example, are among the most active purchasers abroad, with the latest examples being the $3.4 billion acquisition of the Brazilian airlines TAM by LAN Chile and acquisitions by the Chilean retailer Cencosud in Colombia and Brazil for more than $3 billion.[25] Opportunities also arise when debt-strapped European companies sell panregional assets to raise cash for home – as was the case, for example, of Banco Santander (Spain), which sold a 95 per cent stake in its Colombian unit to CorpBanca (Chile) for about $1.2 billion. They also arise when such companies focus on core business and markets, as in the case of HSBC, which has been selling non-core assets worldwide to cope with new regulations in the wake of the financial crisis. Among the latest deals announced by HSBC (United Kingdom) is the sale in 2013 of its Panama business to Bancolombia for $2.1 billion. Latin American TNCs also launched

Figure II.4. Latin America and the Caribbean: cross-border M&A purchases by geographical target, 2001–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

into a European expansion, taking advantage of the continent's crisis to buy companies at depressed prices – as exemplified by América Móvil's (Mexico) acquisitions of about a quarter of KPN (the Netherlands) and Telekom Austria for a combined total of $4.5 billion – or to buy companies facing financial problems, as in the $2 billion acquisition of a 40 per cent stake in the cement producer Cimpor (Portugal) by Camargo Correa (Brazil).

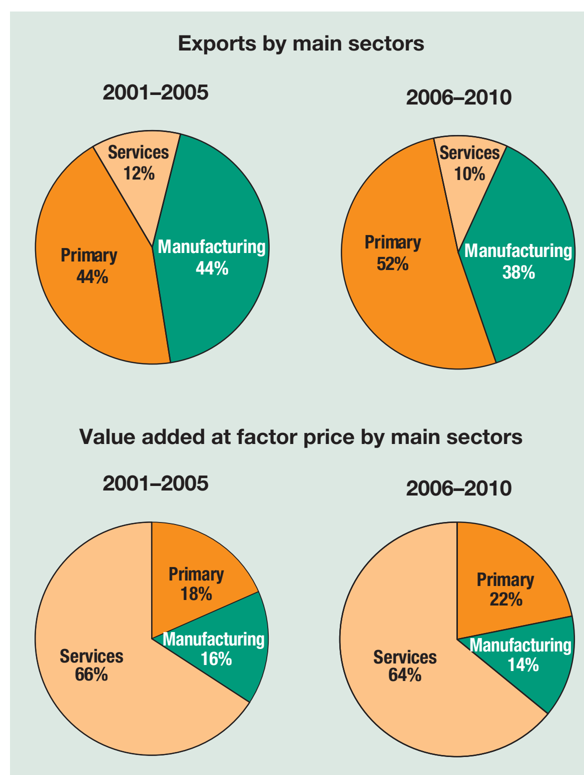
Foreign companies are important actors in the metal mining industry in South America, where they are increasingly focusing on the exploitation of natural resources. Foreign companies play an important role in the metal mining industry in South America, where they have a dominant position in all the metal-mineral-rich countries except Brazil. For example, in Peru they accounted for at least 75 per cent of all metal mining investment in 2011–2012 (Ministerio de Energia y Minas, 2013). In Chile, they accounted for 62 per cent of all investment in large-scale copper and gold mining in 2012 (up from an average share of 53 per cent in 2002–2011), while their share in all copper production increased from 48 per cent in 1991–2001 to 59 per cent in 2002–2012 (Comisión Chilena del Cobre, 2012).

FDI in South America is increasingly focusing on natural resources, mainly the extractive industry, as evidenced by its growing share in FDI: e.g. in Colombia, although the share of the extractive industry in FDI stock was 26 per cent in 2002, this industry attracted 53 per cent of total FDI flows between 2003 and 2012.[26] In Chile its share in FDI stock increased from 27 to 39 per cent between 2006 and 2011, while in Peru, it increased from 14 per cent in 2001 to 27 per cent in 2011. Only Argentina witnessed a decline in the share of the extractive industry in total FDI stock during the second half of the 2000s, from 40 per cent in 2005 to 31 per cent in 2011. The share of the extractive industry in FDI stock further decreased in 2012 after the nationalization of a 51 per cent stake in YPF (*WIR12*). Increases in shares in the extractive industry

in FDI in certain countries in South America[27] are in line with the increasing importance of this industry in exports and value added (figure II.5).

New industrial policy measures in Brazil. Concerned about the growing competition from low-cost manufactures – especially since the beginning of the global economic crisis – Brazil and Argentina have accelerated their shift towards industrial policy, aiming at greater development of their domestic industry and improved technological capabilities (*WIR12*). New measures have been undertaken in Brazil since April 2012, as a second phase of the Plano Brasil Maior.[28] They include a mixture of fiscal incentives for labour-intensive industries, loans to the automotive and IT industries from the Brazilian Development Bank (BNDES) at preferential rates, expansion of export financing programmes and tax relief for Internet broadband access, and measures for stimulating the national industry through Government procurement, where national goods and services will take priority over imported goods.[29] Furthermore, in October 2012, a new automobile incentive programme (Inovar-Auto) was approved to encourage investments in vehicle efficiency, national production, R&D and automotive technology.[30]

Figure II.5. Exports and value added from South America,[a] by sector, 2000–2005 and 2006–2011



Source: ECLAC, CEPALSTAT.
[a]Excludes Argentina and Brazil.

TNCs' investment in the automotive industry in Brazil is boosted by Government policy. The automotive industry – dominated by foreign TNCs – is among the select industries in which the Brazilian Government is focused on stimulating competitiveness and technology upgrading, developing local suppliers and slowing import growth. It has benefited from long-term financing from BNDES that disbursed to the industry (assembly and auto parts) loans worth about $35 billion between 2002 and 2012, or almost 6 per cent of all its loan disbursements in this period. In the first two months of 2013, two foreign car manufacturers – Fiat and Peugeot Citroën – received loan approvals from BNDES for $1.2 billion and $77 million, respectively.[31] The new auto regime (Inovar-Auto), together with BNDES loans to the sector at preferential rates and the continued expansion of Brazil's car market, has encouraged foreign car manufacturers to step up their investment plans[32] and increase FDI in the country. FDI to the automobile industry (assembly and auto parts) jumped from an annual average of $116 million in 2007–2010 to $1.6 billion in 2011–2012.[33]

Nearshoring to Mexico is on the rise. In Mexico, nearshoring – the practice of bringing manufacturing operations closer to a domestic market – is picking up momentum, as more manufacturing companies seek ways to reduce costs and bring products into the United States market more quickly by operating closer to it. This is due to the rapid growth of labour costs in China – the largest offshoring location – and to rising and volatile fuel costs that have made shipping goods across the Pacific less attractive. Currency has been an additional factor, with the yuan's appreciation against the dollar and euro in the past several years. When it comes to nearshoring, Mexico is the most favoured location among manufacturers – more so than the United States itself, although the gap in appeal between the two countries might be narrowing.[34] Companies that have moved some or all of their production in recent years from Asia to Mexico to be closer to the United

States include Emerson (electrical equipment), Meco Corporation (leisure goods), Coach Inc. (premium leather goods) and Axiom (fishing rods).

However, Mexico still lags behind China in terms of location choice for manufacturing. China offers the important advantage of deeper supply chains than Mexico, where international companies have trouble finding local suppliers for parts and packaging. Unlike in China, where the Government identifies "pillar industries" and supports them, smaller companies in Mexico that are eager to start or grow businesses and establish linkages with foreign companies suffer from a lack of affordable access to financing.[35]

Companies are now more likely to diversify their manufacturing presence to serve regional markets, as transportation costs increase and markets become more regionally focused. Mexico will always have the advantage of its proximity to and trade agreement with the United States.

6. Transition economies

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $5.0 billion	Russian Federation, Kazakhstan and Ukraine	Russian Federation
$1.0 to $4.9 billion	Turkmenistan, Azerbaijan, Belarus, Croatia and Uzbekistan	Kazakhstan, Ukraine and Azerbaijan
$0.5 to $0.9 billion	Albania, Georgia, Bosnia and Herzegovina and Montenegro	..
Below $0.5 billion	Armenia, Kyrgyzstan, Serbia, Tajikistan, Republic of Moldova and the FYR of Macedonia	Georgia, Belarus, Serbia, Bosnia and Herzegovina, Montenegro, Albania, Republic of Moldova, Armenia, Kyrgyzstan, the FYR of Macedonia and Croatia

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

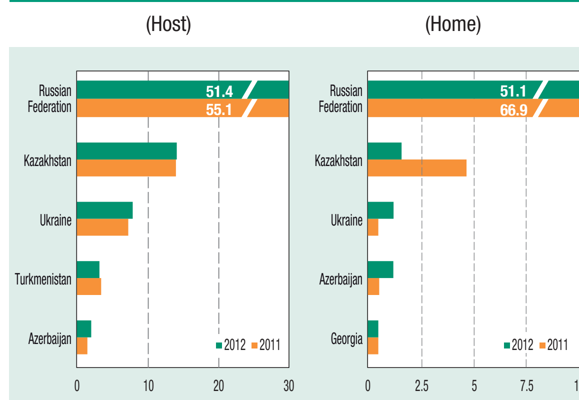


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

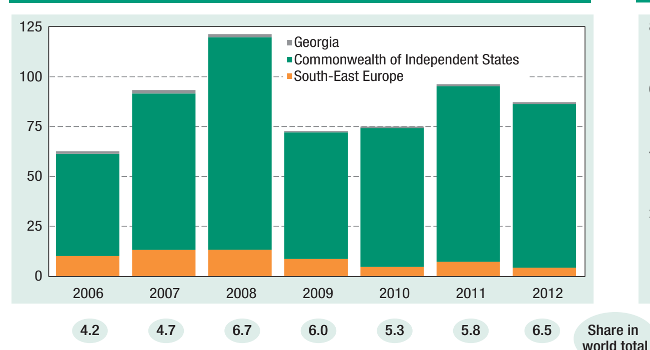
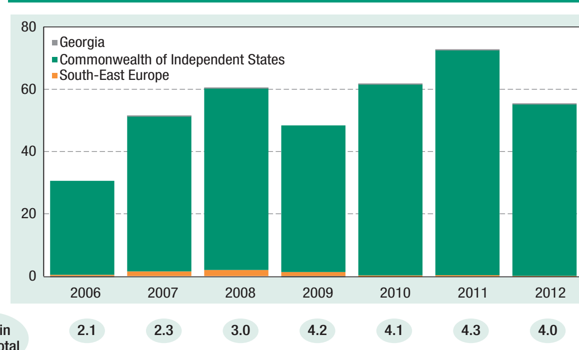


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



Share in world total

	2006	2007	2008	2009	2010	2011	2012
Inflows	4.2	4.7	6.7	6.0	5.3	5.8	6.5
Outflows	2.1	2.3	3.0	4.2	4.1	4.3	4.0

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales		Purchases	
	2011	2012	2011	2012
Total	**32 815**	**- 1 569**	**11 692**	**8 651**
Primary	**17 508**	**- 1 193**	**10 095**	**1 500**
Mining, quarrying and petroleum	17 450	- 1 212	10 046	1 500
Manufacturing	**6 449**	**340**	**- 1 387**	**- 518**
Food, beverages and tobacco	5 306	6	111	-
Chemicals and chemical products	984	368	- 106	-
Metals and metal products	-	5	- 1 401	- 193
Motor vehicles and other transport equipment	-	- 390	-	-
Services	**8 858**	**- 717**	**2 984**	**7 669**
Electricity, gas and water	68	- 451	-	-
Trade	2 664	112	-	20
Transport, storage and communications	5 836	- 65	14	1 313
Finance	198	- 168	2 468	6 314

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales		Purchases	
	2011	2012	2011	2012
World	**32 815**	**- 1 569**	**11 692**	**8 651**
Developed economies	**22 410**	**1 496**	**1 300**	**4 365**
European Union	9 927	1 013	1 898	4 640
United Kingdom	- 87	- 4 242	86	288
United States	7 032	- 197	- 894	- 283
Other developed countries	317	- 548	-5	-
Developing economies	**1 935**	**- 3 511**	**1 855**	**3 862**
Africa	-	-	-	-
East and South-East Asia	734	- 4 944	1 531	-
South Asia	- 245	-	-	-
West Asia	117	1 582	5	3 862
Latin America and the Caribbean	1 329	- 149	319	-
Transition economies	**8 537**	**424**	**8 537**	**424**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	Transition economies as destination		Transition economies as investors	
	2011	2012	2011	2012
Total	**59 546**	**40 529**	**17 991**	**10 042**
Primary	**4 844**	**2 629**	**1 658**	**145**
Mining, quarrying and petroleum	4 844	2 629	1 658	145
Manufacturing	**33 716**	**18 316**	**11 755**	**6 471**
Food, beverages and tobacco	1 259	2 377	220	257
Coke, petroleum products and nuclear fuel	10 134	424	7 801	3 747
Chemicals and chemical products	2 724	5 340	68	186
Motor vehicles and other transport equipment	7 601	4 229	1 358	1 682
Services	**20 986**	**19 585**	**4 578**	**3 426**
Electricity, gas and water	4 945	4 160	740	594
Trade	2 674	2 375	714	252
Transport, storage and communications	4 720	4 390	890	891
Finance	2 907	2 056	1 981	1 171

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	Transition economies as destination		Transition economies as investors	
	2011	2012	2011	2012
World	**59 546**	**40 529**	**17 991**	**10 042**
Developed economies	**40 907**	**30 091**	**4 544**	**2 985**
European Union	31 471	21 208	2 264	2 362
Germany	6 215	4 612	136	24
United States	3 550	4 725	2 014	179
Other developed countries	2 232	2 402	138	156
Developing economies	**8 604**	**7 888**	**3 412**	**4 506**
Africa	-	-	725	67
East and South-East Asia	6 563	5 368	1 232	694
South Asia	824	380	389	252
West Asia	1 217	2 140	695	3 156
Latin America and the Caribbean	-	-	370	337
Transition economies	**10 035**	**2 550**	**10 035**	**2 550**

In 2012, inward FDI flows in transition economies fell by 9 per cent to $87 billion, due in part to a slump in cross-border M&A sales. Flows to South-East Europe almost halved, while those to the Commonwealth of Independent States (CIS) remained relatively resilient. FDI flows to the Russian Federation remained at a high level, although a large part of this is accounted for by "round-tripping". As the share of the EU in inward FDI to South-East Europe is high, its economic woes have had particularly negative impacts on investment in this subregion.

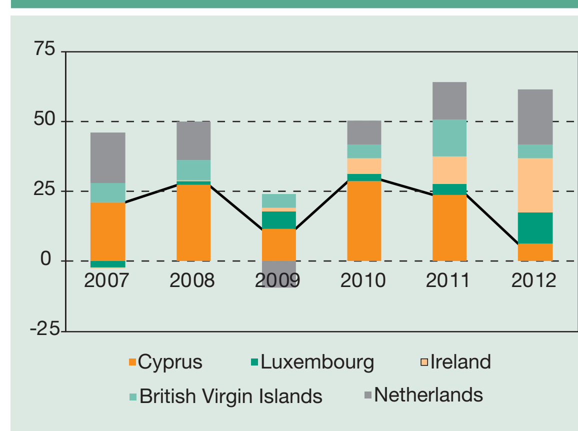
The transition economies of South-East Europe, the CIS and Georgia[36] saw their FDI flows decline in 2012 compared with the previous year (figure B). In South-East Europe, the 41 per cent drop in FDI flows was due primarily to a decline in investments from neighbouring countries, which are the main investors in this subregion. In the CIS, FDI flows fell by only 7 per cent as foreign investors continued to be attracted by that subregion's growing consumer markets and vast natural resources. Inflows remained concentrated in a few economies, with the top three destinations (Russian Federation, Kazakhstan and Ukraine) accounting for 84 per cent of the subregion's total inflows (figure A).

Despite declining by 7 per cent, FDI inflows to the Russian Federation remained high at $51 billion (table A). Foreign investors were motivated by the growing domestic market, as reflected by high reinvestments in the automotive and financial industries. The Russian Federation's accession to the World Trade Organization (WTO) has also had an impact on investors' decision-making for certain projects, such as the acquisition of Global Ports by the Dutch company APM Terminals. Developed economies, mainly EU members, remained the largest sources of inward FDI in the country. Investment flows from offshore financial centres are also significant (see chapter I). A substantial proportion of FDI stock continues to be a return of offshore capital held by Russian residents in various financial hubs around the world (figure II.6). The largest investments in the Russian Federation originate from Russian investors based in Cyprus, taking advantage of that country's financial facilities and favourable tax conditions. However, as the economic situation in Cyprus has recently deteriorated, some Russian investors have begun using other countries as a base for their investments at home. In 2012, Cyprus accounted for only 6 per cent of FDI flows to the Russian Federation, compared with 25 and 28 per cent in 2010 and 2011, respectively (figure II.6).

FDI inflows into *Kazakhstan* rose by 1 per cent, reaching $14 billion – the second highest level ever recorded – owing to its vast natural resources and economic growth. In addition to extractive industries, which accounted for almost one fifth of FDI flows in 2012, financial services attracted 12 per cent of flows. Despite uncertainties surrounding the domestic political situation, *Ukraine* attracted almost $8 billion in FDI inflows, a record. Cyprus accounted for the bulk of those inward flows.

The sluggishness of FDI in transition economies as a whole in 2012 was caused by a slump in cross-border M&A sales, whose net value (new M&As less divested M&As) turned negative for the first time ever. Among the reasons was the large reduction in participation by BG Group Plc (United Kingdom), an integrated natural gas company, in the Karachaganak gas-condensate field in north-west Kazakhstan: the company reduced its participation from 32.5 per cent to 29.25 per cent for a value of $3 billion in favour of KazMunaiGaz, the State-owned oil and gas TNC (see also section II.B.2).[37] Greenfield projects also declined considerably.

Figure II.6. Shares of the five largest investors in FDI inflows to the Russian Federation, 2007–2012
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

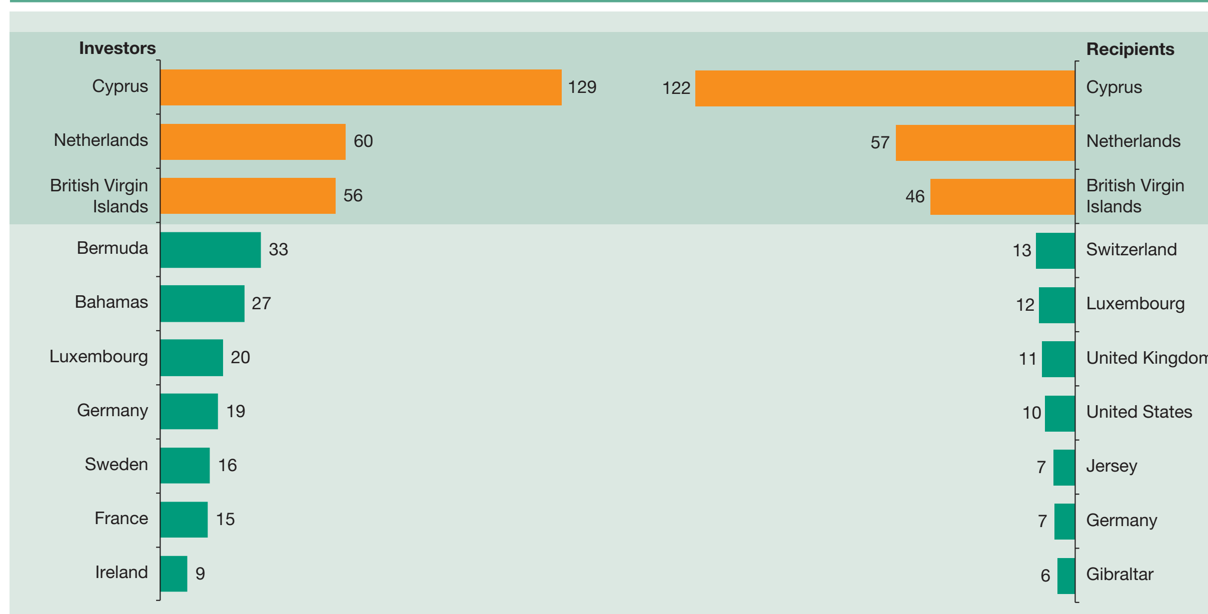
Outward FDI flows from transition economies also declined in 2012. The Russian Federation continued to dominate outward FDI from the region, accounting for 92 per cent of outflows in 2012 (table B). Outflows from Kazakhstan, Ukraine and Azerbaijan exceeded $1 billion (table A). Although TNCs from natural-resource-based economies, supported by high commodity prices, continued their expansion abroad, the largest acquisitions took place in the financial industry. For example, Sberbank – the largest Russian Bank – acquired Turkey's Denizbank for $3.9 billion.

Prospects for inward FDI remain positive in the medium term (see chapter I). FDI inflows are expected to increase moderately in 2013 on the back of an investor-friendly environment and the continuing round of privatizations in the major host countries in the region (the Russian Federation and Ukraine).

A large part of FDI in the Russian Federation is accounted for by "round-tripping". In addition to the usual sources of FDI, a distinctive feature of FDI patterns in the Russian Federation is the phenomenon of "round-tripping", implied by a very high correlation of inward and outward investment flows between the country and financial hubs such as Cyprus and the British Virgin Islands. These two economies are persistently among the major source countries for inward FDI and also the major destination of Russian investments. A closer look at the FDI stock in and from the Russian Federation, for example, reveals that the three largest investors – Cyprus, the Netherlands and the British Virgin Islands – are also the largest recipients of FDI stock, with roughly the same amounts in both directions (figure II.7). Together, they account for about 60 per cent of both inward and outward FDI stock.

Cyprus is the largest investor in and recipient of FDI from the Russian Federation. Russian commodity-based shell companies established in Cyprus send funds to their legal affiliates engaged in oil, mineral and metals exports, often for the purpose of tax minimization (see chapter I). For example, the second largest Russian steel company, Evraz, is owned by offshore companies in Cyprus in which Russian investors have key interests. The fourth largest Russian steel company, NLMK, is also controlled by Fletcher Group Holding from Cyprus (85.5 per cent), which belongs to another Russian investor. In the case of the Netherlands – the

Figure II.7 Russian Federation: top 10 investors and recipients of FDI stock, 2011
(Billions of dollars)



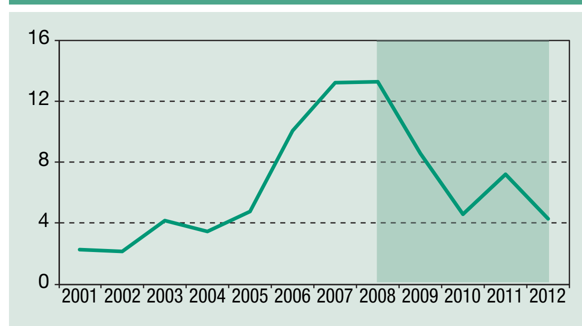
Source: UNCTAD.

second largest investor in the Russian Federation and recipient of Russian FDI stock – some of the investment might be related to Gazprom's financial services affiliate in that country, which channels funds to and from the Russian energy industry.

Double-dip recession in FDI flows to South-East Europe. In contrast to the CIS, FDI flows to *South-East Europe* dropped again in 2012 (figure B), after a temporary recovery in 2011, reaching $4.2 billion – values last seen almost 10 years ago. The decline was due to the sluggishness of investment from EU countries (traditionally the dominant source of FDI in this subregion).

Before the onset of the financial and economic crisis, South-East European countries made significant progress in attracting FDI, resulting in an increase in inflows from $2.1 billion in 2002 to $13.3 billion in 2008 (figure II.8). The surge in FDI to the subregion, especially after 2006, was driven largely by the economic recovery, a better investment climate and the start of association (and accession) negotiations with the EU in 2005. In addition, relatively low labour costs, easy access to European markets and the privatization of the remaining State-owned enterprises gave a boost to FDI flows. Croatia and Albania were the largest recipients of FDI flows in the subregion.

Figure II.8. FDI inflows to South-East Europe, 2001–2012
(Billions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

This positive trend was reversed in 2009, with FDI inflows falling sharply by 35 per cent in 2009 and 46 per cent in 2010. During this period, many projects were cancelled or postponed. Croatia – the country hit most seriously – saw FDI flows fall from $6 billion in 2008 to $432 million in 2010. TNCs from Austria and the Netherlands, deterred by economic developments and turmoil in sovereign debt markets, moved resources out of Croatia, withdrawing loans from their affiliates in order to strengthen their balance sheets at home. FDI flows also declined significantly in the former Yugoslav Republic of Macedonia. In contrast, Albania bucked the trend, mainly because of its investor-friendly business environment and opportunities opened up by the privatization of State-owned enterprises.

The fragility of FDI flows to South-East Europe was related partly to the large share of inward FDI from the EU, where economic woes have particularly negative knock-on effects for FDI in the subregion. Non-EU large global investors such as the United States, Japan and China are not significant investors in the subregion. The industry composition of inflows to South-East Europe has also worked against it in the current crisis; investment has not been diversified and is concentrated mainly in industries such as finance and retail.

7. Developed countries

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $100 billion	United States	United States and Japan
$50 to $99 billion	United Kingdom and Australia	United Kingdom, Germany and Canada
$10 to $49 billion	Canada, Ireland, Luxembourg, Spain, France, Sweden, Hungary, Norway, Czech Republic and Israel	Switzerland, France, Sweden, Italy, Norway, Ireland, Luxembourg, Austria, Australia, Belgium and Hungary
$1 to $9 billion	Italy, Portugal, Germany, Austria, Switzerland, Poland, Greece, New Zealand, Denmark, Slovakia, Romania, Bulgaria, Japan and Estonia	Denmark, Finland, Israel, Portugal and Czech Republic
Below $1 billion	Latvia, Cyprus, Lithuania, Iceland, Gibraltar, Malta, Slovenia, Bermuda, Netherlands, Belgium and Finland	Estonia, Lithuania, Bulgaria, Bermuda, Latvia, Romania, Greece, Slovakia, Malta, Slovenia, New Zealand, Poland, Cyprus, Iceland, Netherlands and Spain

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

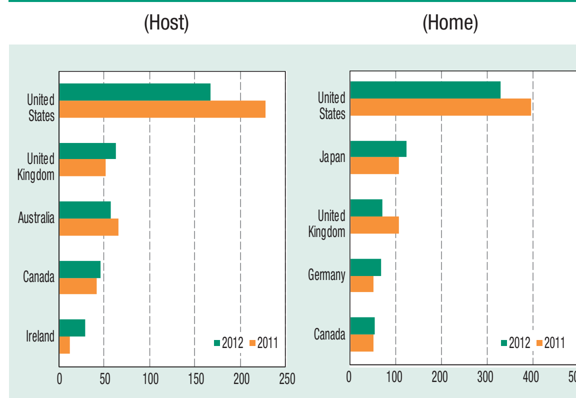


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

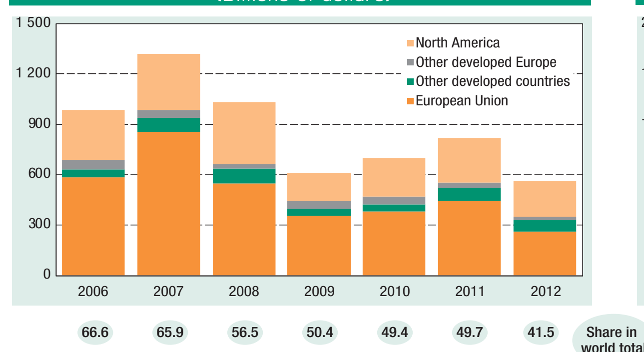
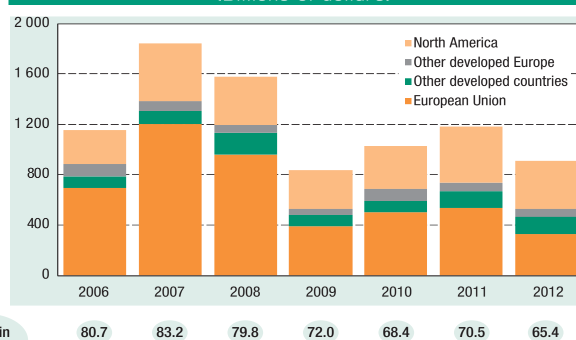


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



Share in world total

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
Total	**433 839**	**260 282**	**428 075**	**175 555**
Primary	92 581	50 606	47 973	- 1 700
Mining, quarrying and petroleum	91 692	43 498	47 777	- 1 840
Manufacturing	179 395	109 978	201 828	122 920
Food, beverages and tobacco	27 992	20 207	27 804	28 198
Chemicals and chemical products	78 971	30 621	77 747	40 319
Metals and metal products	13 889	13 083	14 137	11 164
Electrical and electronic equipment	22 743	20 608	27 046	16 274
Services	161 863	99 698	178 273	54 335
Trade	13 004	12 453	5 622	18 555
Transport, storage and communications	23 682	15 702	21 081	3 283
Finance	22 541	9 564	107 607	26 703
Business services	48 617	32 476	32 942	18 152

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
World	**433 839**	**260 282**	**428 075**	**175 555**
Developed economies	356 417	172 983	356 417	172 983
European Union	103 792	10 896	156 671	79 604
United States	131 763	72 042	124 372	49 639
Japan	43 499	30 267	3 779	- 1 733
Other developed countries	77 363	59 778	71 595	45 473
Developing economies	70 220	74 631	49 247	1 076
Africa	4 288	634	4 397	- 3 412
East and South-East Asia	47 518	50 102	16 708	5 148
South Asia	5 304	1 967	15 732	1 161
West Asia	3 252	5 458	9 719	- 1 083
Latin America and the Caribbean	9 858	16 426	2 686	- 674
Transition economies	1 300	4 365	22 410	1 496

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	Developed countries as destination 2011	Developed countries as destination 2012	Developed countries as investors 2011	Developed countries as investors 2012
Total	**294 560**	**225 537**	**643 354**	**404 307**
Primary	18 512	9 195	57 596	16 617
Mining, quarrying and petroleum	18 431	9 195	57 479	16 717
Manufacturing	127 712	85 659	298 069	183 174
Food, beverages and tobacco	6 514	5 593	17 853	15 637
Chemicals and chemical products	11 998	12 744	51 768	25 688
Metals and metal products	6 667	4 973	32 781	16 383
Motor vehicles and other transport equipment	25 470	20 926	69 779	52 401
Services	148 336	130 683	287 689	204 416
Electricity, gas and water	53 418	33 458	77 754	39 240
Construction	18 173	24 204	22 300	22 919
Transport, storage & communications	18 112	16 273	58 151	38 563
Business services	24 899	30 657	59 211	49 349

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	Developed countries as destination 2011	Developed countries as destination 2012	Developed countries as investors 2011	Developed countries as investors 2012
World	**294 560**	**225 537**	**643 354**	**404 307**
Developed economies	236 532	164 206	236 532	164 206
European Union	131 971	93 667	148 504	100 377
United States	52 699	38 790	40 519	36 883
Japan	21 231	9 306	5 423	4 279
Other developed countries	30 631	22 442	42 086	22 717
Developing economies	53 484	58 346	365 915	210 010
Africa	18 983	1 683	39 181	17 314
East and South-East Asia	16 726	43 863	133 212	99 091
South Asia	4 529	8 592	42 036	23 579
West Asia	9 615	2 066	39 119	15 649
Latin America and the Caribbean	3 616	2 143	112 264	53 113
Transition economies	4 544	2 985	40 907	30 091

FDI from and to developed countries nosedived in 2012. Inflows to the group of 38 economies, in aggregate, declined by 32 per cent to $561 billion (figure B); outflows fell by 23 per cent to $909 billion (figure C). At a time of weak growth prospects and policy uncertainty, especially in Europe, many TNCs pursued a strategy of disposing of non-core businesses and assets. The commodity boom, which had driven FDI in resource-rich developed countries in the recent past, began to cool. In addition, intracompany transactions, which tend to be volatile, had the effect of reducing flows in 2012. The prevalence of such intracompany transactions has further weakened the link between the value of FDI and capital formation by foreign affiliates. The most recent experience suggests that the level of capital formation by foreign affiliates is more stable and more resilient to the business cycle than the level of FDI.

By region, inflows to Europe contracted by 42 per cent and to North America by 21 per cent. Inflows to Australia and New Zealand together declined by 14 per cent. Outflows from Europe fell by 37 per cent and from North America by 14 per cent. Outflows from Japan, in contrast, held their momentum, growing by 14 per cent.

The sharp decline in inflows effectively reversed the recovery of FDI over 2010–2011. The share of developed economies in global inflows declined from 50 per cent in 2011 to 42 per cent. Within the group, 23 economies saw a decline in their inflows, including the two largest recipients in 2011, Belgium and the United States (figure A; *WIR12*). The fall in FDI to European countries was particularly marked; it diminished to $276 billion, which was considerably lower than the recent low ($405 billion) in 2009. The EU alone accounted for almost two thirds of the global FDI decline. A number of countries, however, confounded the general downward trends. The United Kingdom saw its inflows extend their recovery, rising by 22 per cent. Inflows to the Czech Republic reached the highest level since 2005, while those to Hungary hit a record high. Ireland has seen a doubling of inflows with a revival of TNC activities.[38] Japan eked out positive, though still relatively small, inflows after two successive years of recording a net divestment.

The decline in FDI outflows from developed countries accounted for almost all the decline in global outflows in 2012. Outflows declined in 22 developed economies, including four of the top five investor countries in 2011 (figure A; *WIR12*). Outflows from the United States, which had been driving the recovery of FDI in developed countries, saw a large decline. Outflows from the European countries were less than one third of their peak ($1.33 trillion) in 2007. Among the countries that bucked the trend were Ireland, Japan and Germany. In the case of Ireland, however, over 70 per cent of its outflows were accounted for by reinvested earnings, suggesting that this recovery was due mostly to the network of affiliates established by foreign TNCs to manage profits in Europe and neighbouring regions.

Divestments reduce cross-border M&As. Given the uncertain economic outlook, many TNCs chose a strategy of consolidating their assets with a view to focusing on core businesses and geographical areas, which resulted in a large number of divestments. In particular, the restructuring of the banking industry, which started in the aftermath of the financial crisis, continued into 2012 and impacted significantly on global FDI flows. Another set of important players in this regard were private equity funds. These funds acquire distressed assets to restructure and sell later on. Thus, cross-border acquisitions by these investment funds generate FDI but are followed by divestment, which has the effect of reducing the value of FDI – as was the case in 2012.

The wave of divestments significantly dented both inflows and outflows of FDI for the *United States* in 2012. The net M&A sales of United States assets (i.e. foreign TNCs acquiring United States firms) declined by $78 billion. The acquisition by United States firms of foreign-owned assets in the United States (i.e. divestment by foreign TNCs) shot up to $71 billion, from $34 billion in 2011. Among the largest divestment deals was the sale by ING Group (the Netherlands) of its affiliate ING Direct USA for $8.9 billion and the spin-off of ADT North America Residential Business by Tyco International (Switzerland) for $8.3 billion.

Net M&A purchases (i.e. United States firms acquiring foreign firms) declined by $57 billion.

Divestment of foreign assets by United States TNCs amounted to $55 billion. Investor funds were often involved in those divestment deals, e.g. the sale of a $3.5 billion stake in the Korea Exchange Bank by Lone Star and the sale valued at $2.4 billion of the Nordic manufacturing supplier Ahlsell by a fund controlled by Goldman Sachs.

Divestment also curtailed the growth of outward FDI from *Japan*, which nevertheless grew by 14 per cent to reach $123 billion in 2012, thus maintaining the country's position as the second largest investor in the world. In net terms, acquisitions of foreign firms by Japanese TNCs decreased from $63 billion to $36 billion, as reflected in the fall of the equity component of FDI (down $21 billion). Contributing to this decline were deals such as the sale by Hitachi of its United States–based hard disk drive business Viviti Technologies, for $4.8 billion and the sale by Nomura of its United Kingdom residential property company Annington Homes for $5.1 billion. The overall increase in outflows was due to a rise in retained earnings and reduced repayment of intracompany loans.

The divestments by United States and Japanese TNCs had repercussions on M&A deals in *Europe*. M&A sales in Europe (firms in European countries acquired by foreign TNCs) were down by $76 billion from 2011. As European TNCs also divested their assets abroad, their net foreign acquisitions declined by more than $140 billion. Divestment was particularly pronounced in the financial industry. European banks continued to shed their non-core – often overseas – assets in order to strengthen their capital base. In addition to the sale of ING Direct USA, ING Group (the Netherlands) sold its Canadian affiliate for $3.2 billion and its insurance businesses in Hong Kong (China), Macao (China) and Thailand for $2.14 billion. Another major European bank, Banco Santander (Spain), reportedly sold assets worth $8 billion across the Americas, including the initial public offering of Grupo Financiero Santander Mexico.

Increased volume and volatility of intracompany transactions in revenues and loans. Along with divestment, another factor explaining the large decline in 2012, particularly in Europe, was the increasing and highly volatile transfer of funds executed by TNCs to manage their retained earnings. One of the countries where such transfers of funds appear to have had a large bearing on FDI flows is Belgium.

Both inflows and outflows of Belgium – the largest European recipient of FDI in 2011 – have been volatile in the recent past. A large part of the decline in Europe in 2012 was attributable to diminished flows in and out of Belgium: inflows decreased from $103 billion in 2011 to -$1.6 billion in 2012, while outflows fell from $82 billion to $15 billion. Intracompany loans from Germany and Luxembourg to Belgium alone, for instance, declined by $56 billion in 2012 compared with the previous year, suggesting the special nature of FDI in the country. The outflows also exhibited a peculiar pattern. Over the two-year period 2011–2012, Belgian TNCs invested $44 billion in Luxembourg in the form of equity and pulled out $41 billion from Luxembourg in the form of "other" capital (intracompany loans). Much of the equity investment in Luxembourg took place in 2011 while "other" capital was taken out mostly in 2012, resulting in a decline of $75 billion in 2012. Another notable decline was the flows of intracompany loans to the United States, which declined from $26 billion in 2011 to $2.9 billion in 2012.[39]

In addition to those of Belgium, FDI flows of Ireland, Luxembourg and the Netherlands accounted for a significant part – and a large one in comparison to the size of their GDP – of the changes in FDI flows in Europe. The reason for the concentration of FDI is twofold. First, these countries offer TNCs a favourable tax regime, especially for locating their cash-pooling facilities. The existence of cash-pooling facilities, in turn, creates the problem of possible double-counting of FDI flows that artificially inflates FDI flows.[40]

The commodity boom slows down. The slowdown of the commodity boom impacted resource-rich developed countries, namely Australia, Canada and the United States, which benefited from increased FDI flows to this sector in recent years. Inflows to Australia declined by 13 per cent. M&A sales in the Australian mining industry, which averaged $16 billion over the period 2008–2011, fell to $11 billion in 2012. Although inflows to Canada rose modestly in 2012, inflows to the energy and mining industry, which had been a major part of inward FDI in Canada, fell from $17 billion in 2011 to $8

billion in 2012. Of the $78 billion fall in M&A sales in the United States, the mining industry accounted for $35 billion. For developed economies as a whole, M&A sales in mining more than halved, from $92 billion in 2011 to $43 billion in 2012, while M&A purchases in the industry declined from $48 billion to a net divestment of -$2 billion. This pattern of FDI flows suggests that FDI driven by the recent commodity boom may have peaked.

FDI in the crisis-hit countries in the Eurozone. Apart from Ireland, the four Eurozone countries that have been most affected by the financial crisis – namely Greece, Italy, Portugal and Spain – showed a generally low level of FDI flows in 2012.[41] Three aspects of recent FDI in those countries are worth highlighting: foreign acquisition of distressed assets, injection of capital to foreign-owned banks, and exit and relocation of firms from the crisis-hit countries.

First, severe economic downturns have created buying opportunities among distressed assets. For example, Italy was a recipient of large inflows of FDI in 2011. There were a number of high-profile M&As such as the acquisitions of Parmalat by Group Lactalis (France) and of Bulgari by LVMH (France) along with the purchase of a string of brand names (e.g. De Tomaso, Ferretti, Coccinelle) by Asian investors. The momentum, however, appears to have petered out in 2012, with M&A sales declining from $15 billion in 2011 to $2 billion in 2012.[42] In Spain, various investment funds were active in the acquisition of Spanish assets. Examples include the sale of wind farms by Actividades de Construcción y Servicios to the United Kingdom–based private equity firm, Bridgepoint Capital (completed in January 2012); the acquisition of USP Hospitales by the United Kingdom–based private equity firm, Doughty Hanson; and the sale of a loan portfolio by Banco Santander to the United States investment management firm, Fortress Investment. Investment funds were involved in nearly half (by value) of cross-border M&A deals entailing sales of Spanish assets in 2012.

The second aspect to highlight is inflows of FDI in the form of injection of capital to banks with a weakened balance sheet. In Greece, for instance, inward FDI more than doubled from 2011 to reach $2.9 billion in 2012. This is explained mostly by injections of capital by parent TNCs to cover losses of their affiliates. The losses at the Greek bank Emporiki had reportedly amounted to €6 billion over the period 2008–2012. In response, the parent company, Crédit Agricole, injected capital worth €2.85 billion, as required by the Greek regulator, before it sold off the unit. Foreign banks such as Barclays, Deutsche Bank and ING are thought to have injected more capital into their Spanish operations to cover for the losses. The exact extent of capital injected in 2012 is not known, but media reports suggested that Barclays, for example, planned to inject €1.3 billion to shore up the capital of its Spanish affiliates.[43]

The third aspect is the withdrawal and relocation of TNCs from the countries that are most severely hit by the debt crisis, namely Greece and Portugal, which had potentially serious repercussions on the tax revenues of those governments. The most notable exit of foreign TNCs was the decision by the French retailer Carrefour to withdraw from Greece in 2012. Although Greece was the second largest market for the retailer, it chose to exit from the loss-making operation, handing the assets to its Greek joint venture partner for a nominal sum.

Leading domestic firms in those two economies are eager to expand abroad, given the poor growth prospects of their domestic markets, but they are constrained by the difficulty in raising financing. Consequently, some of those firms have decided to relocate their headquarters abroad. For instance, Coca-Cola Hellenic, the world's second largest bottler of Coca-Cola, announced its plans to move its headquarters to Switzerland and its primary listing to London.

Such relocation is particularly pertinent to the recent pattern of Portuguese FDI. Outward FDI from Portugal recorded a net divestment of -$7.5 billion in 2010 and then shot up to $15 billion in 2011. It fell back to just $1.9 billion in 2012. This unusually large movement was due mostly to outward FDI to the Netherlands, which swung from -€7.5 billion in 2010 to €8.9 billion in 2011. Portuguese firms' relocation of capital to the Netherlands is likely to have created this peculiar pattern of outward FDI from Portugal. As an example, a case that received much attention was the transfer of the ownership of the Jerónimo Martins group, which operates Pingo Doce, a major supermarket

chain in Portugal. The holding company that had a controlling stake in Jerónimo Martins was relocated to the Netherlands in 2011. Most, if not all of companies in the PSI-20, the main stock exchange index in Portugal, are thought to have a holding company in the Netherlands. As such, the Netherlands has become the largest inward investor in Portugal and the largest destination for Portuguese outward FDI in recent years.

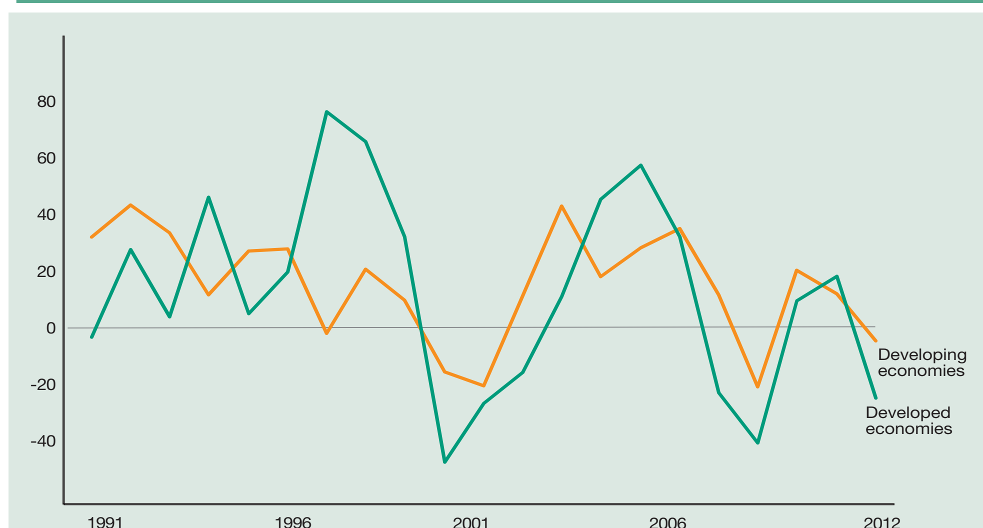
Large jumps in FDI flows among developed economies become the norm, as exemplified by the recent patterns of Portuguese FDI. In the past 20 years, FDI flows of developed countries have been much more volatile than FDI flows of developing economies (figure II.9). At the same time, the components of foreign affiliates' investments that affect host countries' real economy, namely capital expenditures and investments in R&D, turned out to be much more stable over time. The divergence between FDI flows and capital expenditure in developed economies can be explained by several factors, most importantly the use of local financing by foreign affiliates, the relevance of cross-border M&As and the role played by special-purpose entities (SPEs). These considerations suggest that interpreting FDI flows as indicators of real economic activities, particularly in the case of developed countries, requires caution.

In the past two decades, FDI flows in developed countries have been prone to significant volatility. The annual growth rates of FDI inflows to developed countries ranged from -47 per cent in 2001 to 78 per cent in 1998, with a historic trend characterized by large fluctuations. This phenomenon is much more critical for developed than for developing economies: although the FDI dynamics of developed and developing countries are generally aligned, in developed countries individual movements are much more amplified (see figure II.9).

The average fluctuations of developed-country FDI are almost twice those of developing-country FDI, as estimated by the standard deviations of the annual growth rates of FDI flows.[44] At the level of individual countries, the effect is confirmed. The median standard deviation of FDI growth rates for developed countries is in fact higher than that of developing countries.[45]

Notably, capital expenditure (and also investments in R&D), identifiable as the core impact of the foreign investments on the real economy of host countries, displays much lower volatility than FDI flows (figure II.10). Capital expenditure has also exhibited higher resilience to the current crisis. This evidence supports the idea that FDI flows among developed countries have evolved in a way that does not fully reflect activities in the real economy.

Figure II.9. Trends in annual growth rates of FDI inflows, by groups of economies, 1991–2012
(Per cent)



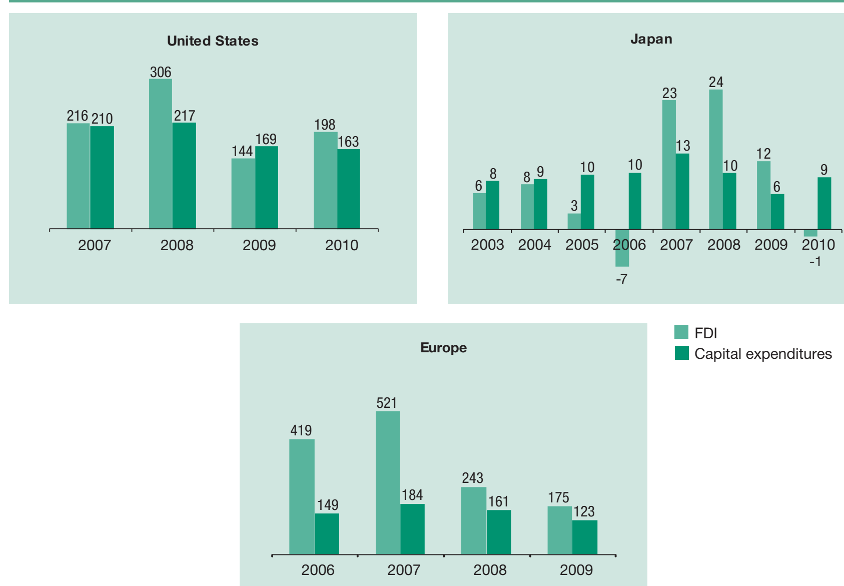
Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

In developed countries, three main factors explain the divergence between what foreign affiliates invest in the host economies and inward FDI: local sources of financing, the impact of cross-border M&As and the role of SPE-favourable countries.

- *Local sources of financing.* Foreign affiliates can borrow from financial institutions in the host economy or issue bonds to local investors.[46]
- *Cross-border M&As.* A large number of cross-border M&A deals are financed by means of FDI.[47] Thus cross-border M&As account for a significant part of FDI flows (see chapter I.B for an overview of FDI flows by mode of entry). However, this part might not translate into capital expenditure or R&D expenditure, as the change of ownership does not imply capital formation.
- *SPE-favourable countries.* A number of European countries, namely Belgium, Ireland, Luxembourg and the Netherlands, hold a disproportionately large stock of FDI (annex table 2). The reason for the high concentration is that many TNCs establish cash pooling facilities in the form of SPEs, because of favourable national tax legislation (see chapter I.A.d). Annual changes of FDI flows to and from those countries have had an important role in FDI flows changes in developed countries in recent years. In 2012, for instance, the fall of FDI flows to and from Belgium and the Netherlands was the main reason for the overall retreat in the FDI flows of developed economies.

Given the depth of the contraction in cross-border direct investment in 2012, it is unlikely that the FDI flows of developed countries will decline much further in 2013. The economic downturn in Europe might create opportunities for buyout firms to acquire undervalued assets. Companies with stressed corporate balance sheets might be under pressure to sell assets at a discount. However, overall, the recovery of FDI flows of developed economies in 2013, if it occurs at all, is likely to be modest.

Figure II.10. Comparison of the trends in FDI inflows and capital expenditures of foreign affiliates in the United States, Japan and Europe, various periods
(Billions of dollars)



Source: UNCTAD; United States Bureau of Economic Analysis; Japanese Ministry of Economy, Trade and Industry; Eurostat.
Note: Capital expenditure for Europe is taken from Eurostat data on gross investment in tangible goods. Europe aggregate data are based on a selection of European countries: Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Italy, Latvia, Portugal, Romania, Slovenia, Slovakia, Sweden and the United Kingdom.

B. TRENDS IN STRUCTURALLY WEAK, VULNERABLE AND SMALL ECONOMIES

1. Least developed countries

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $2.0 billion	Mozambique, Democratic Republic of the Congo, Sudan, Myanmar and Equatorial Guinea	Angola
$1.0 to $1.9 billion	Uganda, United Republic of Tanzania, Cambodia, Liberia, Mauritania and Zambia	Liberia
$0.5 to $0.9 billion	Bangladesh, Ethiopia, Madagascar, Niger, Guinea and Sierra Leone	..
$0.1 to $0.4 billion	Yemen, Senegal, Chad, Mali, Lao People's Democratic Republic, Haiti, Lesotho, Togo, Rwanda, Benin, Malawi, Somalia and Djibouti	Democratic Republic of the Congo, Zambia and Togo
Below $0.1 billion	Afghanistan, Nepal, Gambia, Eritrea, Central African Republic, Solomon Islands, São Tomé and Principe, Timor-Leste, Burkina Faso, Vanuatu, Samoa, Comoros, Guinea-Bissau, Bhutan, Burundi, Kiribati and Angola	Sudan, Yemen, Bangladesh, Malawi, Senegal, Cambodia, Samoa, Niger, Mali, Mauritania, Guinea, Solomon Islands, Guinea-Bissau, Burkina Faso, Vanuatu, São Tomé and Principe, Mozambique, Lao People's Democratic Republic, Lesotho and Benin

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

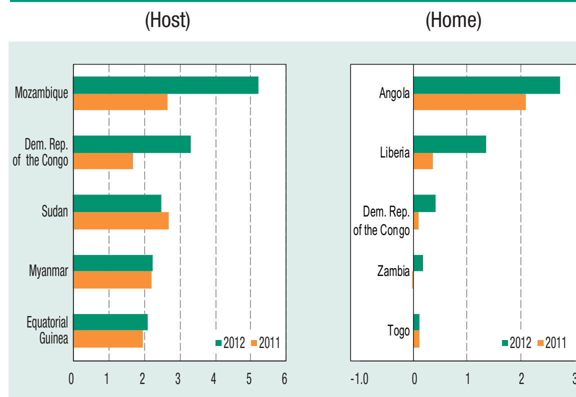


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

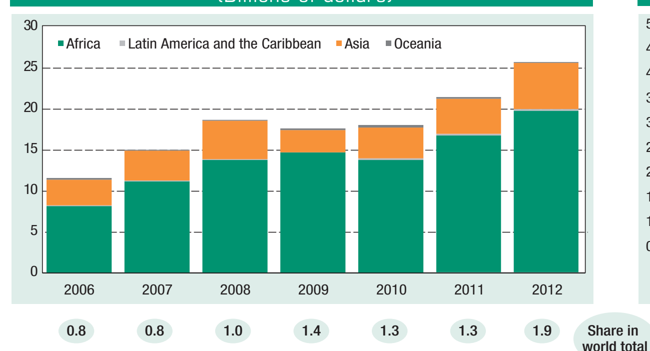
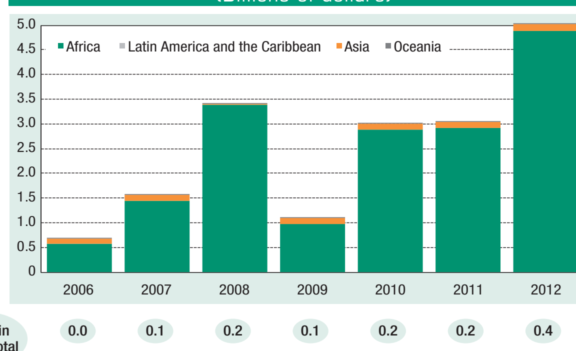


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



Share in world total	2006	2007	2008	2009	2010	2011	2012
Inflows	0.8	0.8	1.0	1.4	1.3	1.3	1.9
Outflows	0.0	0.1	0.2	0.1	0.2	0.2	0.4

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales		Purchases	
	2011	2012	2011	2012
Total	**501**	**354**	**353**	**- 102**
Primary	**- 191**	**11**	**-**	**-**
Mining, quarrying and petroleum	- 191	11	-	-
Manufacturing	**624**	**342**	**-**	**- 185**
Food, beverages and tobacco	632	351	-	-
Chemicals and chemical products	4	-	-	- 185
Non-metallic mineral products	-	90	-	-
Electrical and electronic equipment	-	-100	-	-
Services	**68**	**2**	**353**	**83**
Electricity, gas and water	-	1	-	-
Trade	6	-	-	-
Transport, storage and communications	50	-	-	-
Finance	11	1	353	83

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales		Purchases	
	2011	2012	2011	2012
World	**501**	**354**	**353**	**- 102**
Developed economies	**428**	**- 1 217**	**-**	**88**
European Union	180	264	-	88
Canada	- 161	- 1 258		
United States	- 10	- 109	-	-
Australia	53	- 115	-	-
Japan	450	1	-	-
Developing economies	**73**	**1 478**	**353**	**- 190**
Africa	-	90	353	- 190
East and South-East Asia	75	1 574	-	-
South Asia	4	- 90	-	-
Latin America and the Caribbean	- 6	- 3	-	-
Transition economies	**-**	**-**	**-**	**-**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	LDCs as destination		LDCs as investors	
	2011	2012	2011	2012
Total	**33 654**	**21 824**	**923**	**1 020**
Primary	**11 796**	**4 390**	**-**	**-**
Mining, quarrying and petroleum	11 796	4 390	-	-
Manufacturing	**11 767**	**6 618**	**424**	**97**
Food, beverages and tobacco	1 058	1 053	31	74
Coke, petroleum products and nuclear fuel	5 197	1 970	393	-
Non-metallic mineral products	1 505	1 156	-	-
Metals and metal products	1 205	642	-	-
Services	**10 091**	**10 815**	**499**	**923**
Electricity, gas and water	4 499	3 905	-	-
Transport, storage and communications	1 997	2 234	-	168
Finance	1 572	1 919	426	336
Business services	943	725	26	418

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	LDCs as destination		LDCs as investors	
	2011	2012	2011	2012
World	**33 654**	**21 824**	**923**	**1 020**
Developed economies	**16 886**	**8 822**	**122**	**32**
European Union	9 510	3 195	33	32
Canada	1 314	569	-	-
United States	3 611	3 251	89	-
Japan	896	1 371	-	-
Developing economies	**16 052**	**12 972**	**802**	**989**
Africa	3 841	2 584	572	419
East and South-East Asia	5 736	4 373	151	227
South Asia	4 219	4 424	70	-
West Asia	568	1 583	8	60
Latin America and the Caribbean	1 637	9	-	282
Transition economies	**716**	**30**	**-**	**-**

FDI inflows to LDCs rose by 20 per cent to $26 billion, while FDI outflows increased by 66 per cent to $5 billion. The majority of FDI in LDCs is from developing countries, especially from Asia, as indicated by greenfield project data, with India increasingly significant by both value and range of industries. Financial services continued attracting the largest number of greenfield projects in LDCs. The relative share of primary-sector investments in LDCs is falling, but the degree of industrial diversification is limited.

FDI inflows to LDCs[48] hit a record high of $26 billion. Flows to LDCs grew by 20 per cent to hit a new peak of $26 billion in 2012 (figure B). This growth in FDI inflows from 2011 to 2012[49] was led by strong gains in Cambodia (inflows were up 73 per cent), the Democratic Republic of the Congo (96 per cent), Liberia (167 per cent), Mauritania (105 per cent), Mozambique (96 per cent) and Uganda (93 per cent). At the same time, more than 20 LDCs reported negative growth, although TNC participation through other modes has risen in some cases.[50] The negative growth of FDI was particularly high in Angola (negative inflows more than doubled to -$6.9 billion), Burundi (-82 per cent), Mali (-44 per cent) and the Solomon Islands (-53 per cent)). The share of inflows to LDCs in global inflows increased from 1.3 per cent in 2011 to 1.9 per cent in 2012. However, the concentration of inflows to the top five recipients (table A and figure A) remains high.[51] M&As were small (tables B and C); most FDI inflows in LDCs occurred through greenfield investment (tables D and E). FDI outflows from LDCs grew 66 per cent to $5 billion, though this was concentrated in two countries: Angola (increased by 31 per cent) and Liberia (264 per cent) (figures A and C).

Despite increases in FDI inflows to LDCs, the estimated value of greenfield investment projects in LDCs – which are indicative of trends and are available by geographical and sectoral breakdowns – fell to $22 billion, the lowest level in six years, because of a severe contraction of announced projects in the primary sector and related processing industries (tables D and F). For the first time since 2003, when greenfield projects data were first collected, the value of these projects in LDCs was below actual FDI inflows.[52] By sector, the primary sector attracted 20 per cent of all greenfield investments in LDCs in 2012; the services sector accounted for 50 per cent; and manufacturing made up the remaining 30 percent (table D). Most investments in the services sector are essentially "infrastructural", relating to electricity, gas and water; transport and communications; and financial services (together they accounted for 75 per cent of investment in the sector).

Nearly 60 per cent of greenfield investment in LDCs came from developing economies, and India became the largest single investor. Developing economies, with 59 per cent of the value of greenfield projects, were the largest investors in LDCs in 2012, 80 per cent from Asia and most of the rest from Africa (table E). Sustained investment (over the past decade) has come primarily from nine developing countries: Brazil, China, India, Malaysia, the Republic of Korea, South Africa, Thailand, the United Arab Emirates and Viet Nam.[53]

Companies from India were responsible for 20 per cent of the total value of greenfield projects in LDCs in 2012. The next five largest investing countries were the United States (15 per cent), Japan (6 per cent), the United Kingdom (6 per cent), the Republic of Korea (5 per cent) and China (4 per cent). While the value of India's greenfield projects in 2012 rose by 4 per cent from 2011, the value of China's projects fell, from $2.8 billion to $0.9 billion – although greenfield projects from Hong Kong (China) reached a new high ($0.7 billion in 7 projects), driven by a $0.5 billion real estate project in Mozambique (table II.5). Among African investors, while South Africa's greenfield investment in LDCs fell by two thirds, Nigeria's investment in cement and concrete products held steady, owing to a $0.6 billion project in Senegal (table II.5). At the same time, the number of Kenya's greenfield projects in LDCs more than doubled, and its value of investment rose from $0.2 billion in 2011 to $0.7 billion in 2012, led by two projects in air transport ($168 million each) in Uganda and the United Republic of Tanzania.

India's investments in LDCs are diversified geographically and sectorally. Reflecting the destinations of large-scale projects presented in table II.5, Mozambique was the largest recipient of Indian greenfield investments (45 per cent), followed by Bangladesh (37 per cent) and Madagascar

Table II.5. The 10 largest greenfield projects in LDCs, 2012

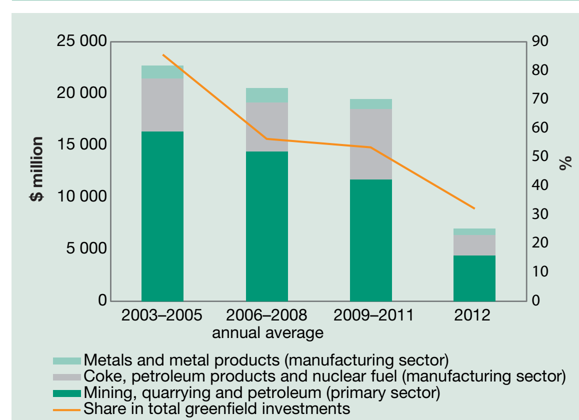
Host economy	Industry	Investing company	Home economy	Estimated investment ($ million)	Estimated jobs created
Angola	Oil and gas extraction	Esso Exploration Angola (Block 15)	United States	2 500	219
Mozambique	Natural, liquefied and compressed gas	Bharat Petroleum	India	1 961	158
Bangladesh	Fossil fuel electric power	NTPC Limited (National Thermal Power)	India	1 500	184
Senegal	Fossil fuel electric power	Korea Electric Power	Republic of Korea	597	73
Senegal	Building and construction materials, cement and concrete products	Dangote Group	Nigeria	596	900
Mozambique	Fossil fuel electric power	Ncondezi Coal	United Kingdom	504	58
Mozambique	Real estate, commercial and institutional building construction	Dingsheng International Investment	Hong Kong, China	500	3 000
Democratic Republic of the Congo	Metals, gold ore and silver ore mining	AngloGold Ashanti	South Africa	455	1 543
Madagascar	Wireless telecommunication carriers	Airtel Madagascar	India	351	97
United Republic of Tanzania	Alternative/renewable energy, wind electric power	Aldwych International	United Kingdom	321	88

Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).

(8 per cent). In Bangladesh, India has invested in various industries, including automotives, IT, pharmaceuticals, textiles and tyres. In Africa, Indian investors are targeting East and Southern Africa. In addition to extractive and heavy industries, Indian companies are also prominent in pharmaceuticals. For instance, two pharmaceutical projects ($5 million each for sales and marketing support) were recently announced, in Uganda and the United Republic of Tanzania, as were two health-care projects in Uganda and Rwanda.[54] Along with India, a growing number of developing countries have announced health-care investment in LDCs (box II.3).

The relative share of primary-sector investments in LDCs is falling, but the degree of industrial diversification is limited. Over the past decade, the importance of greenfield investments in the primary sector, represented by the mining, quarrying and petroleum industry, has diminished (figure II.11). In consequence, the shares of greenfield projects in the manufacturing and services sectors are gaining ground. However, the manufacturing sector is not very diversified in relative terms. Due to the dependence on extractive activities of resource-based LDCs, the two industries that attracted the largest share of manufacturing greenfield investment in LDCs during 2003–2011 were coke, petroleum products; and metals and metal products. The non-metallic mineral products industry had also made a sizable contribution to the manufacturing sector, driven by large-scale investment in building and construction materials. Despite a substantial fall in the value of greenfield projects in the extractive industries and related processing activities in 2012 (figure II.11), 57 per cent (compared with 67 per cent in 2011) of greenfield investment in the manufacturing sector remained in three industries (namely, coke, petroleum products and nuclear

Figure II.11. Greenfield investments in extractive industries and related processing activities[a] in LDCs, 2003–2012
(Millions of dollars and per cent)



Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).
[a] The non-metallic mineral products industry, which contains a subindustry called "minerals, other non-metallic mineral products", was excluded because of its insignificant contribution to this industry.

fuel; non-metallic mineral products; and metals and metal products) (table D).

In services, in a similar vein, large-scale projects in fossil fuel generation rely on the primary sector. Even though greenfield projects in finance, transport and communications are growing, the electricity industry has been the dominant source of services-sector investment in LDCs (table D). Moreover, investment in transportation and logistics includes oil pipelines, petroleum bulk stations and terminals, which are support services for the primary sector. While the number and scale of such greenfield projects in LDCs have been small, their immediate and potential contributions are not negligible. For example, the Angola-Zambia Refined Petroleum Multi-Product Project involves Ba Liseli Resources (Zambia) constructing a 1,400-km pipeline and related infrastructure from a refinery in Lobito, Angola, to Lusaka, Zambia.[55] The overall project represents an investment of $2.5 billion, within the framework of a public-private partnership, of which $168 million was announced in 2012 as Zambia's first greenfield project in Angola since 2003.

In financial services, investors from developing economies have been prominent in greenfield projects in retail banking. Financial services continued attracting the largest number of greenfield projects in LDCs, representing 25 per cent of all projects (361) in 2012 and generating 9 per cent of their value. Over the past decade, 86 per cent of all greenfield projects in financial services were directed at retail banking (with 497 projects recorded in 40 LDCs for the period 2003–2012). Angola attracted by far the largest number of retail banking projects (135, of which 76 per cent came from Portugal), followed by Cambodia (56 projects) and Uganda (39 projects). By value, Cambodia attracted the largest amount: $2.3 billion, or 28 per cent of the aggregate value of retail banking investment plans ($8.0 billion), followed by Bangladesh (12 per cent).

With the exception of Angola, where Portuguese banks have had a strong presence, [56] the leading investors in banking and finance in LDCs are from developing economies. During the period 2003–2012, 70 per cent of all projects in retail banking were announced by investors from 39 developing economies (11 of these being LDCs themselves).[57] The developing-country TNC with the biggest investments in LDCs was Maybank (Malaysia). Among African investors, Kenya Commercial Bank was the largest investor in LDCs. It announced a total of $0.3 billion in investments over 2005–2012, with 31 projects in five African LDCs. In 2012, the largest project announced was a $265 million project in retail banking by Dubai Islamic Bank (United Arab Emirates) in South Sudan, which was also the second largest project recorded in LDCs since 2003.

In corporate and investment banking, where the first LDC project from a developing-country investor was recorded in 2008, 55 per cent of the 40 greenfield projects announced in 2003–2012 came from developing economies, representing 68 per cent of the aggregate value ($974 million). Between 2008 and 2011, just four developing economies (China, India, Togo and Viet Nam) announced greenfield

Box II.3. South–South FDI in health care

Although their contribution to overall receipts in LDCs remains relatively low, South–South greenfield projects in health care in LDCs have been on the rise since 2006.[a] In 2012, owing largely to a $0.3 billion project announced by Hamed Medical (Qatar) in Yemen for the construction of general and surgical hospitals, the value of health-care greenfield investments in LDCs hit a record high. In 2006, that value was only 1 per cent of such investments in developing economies;[b] the current share is 17 per cent.

Of 25 health-care projects in LDCs registered in the greenfield database during 2006–2012, a dozen originated from India, contributing one quarter of the aggregate value of health-care investments in LDCs. By value, Qatar's 2012 investment in Yemen made this country the largest investor, contributing 33 per cent of the aggregate health-care investments in LDCs. Other key investors from the South in this sector include Thailand (with $108 million invested in six projects in Cambodia, Ethiopia, the Lao People's Democratic Republic and Nepal), the United Arab Emirates (with $49 million invested in Malawi) and Viet Nam (with $76 million invested in Cambodia).

Source: UNCTAD, based on information from the Financial Times Ltd, fDi Markets (www.fDimarkets.com).
Note: Notes appear at the end of this chapter.

investments: 13 projects in 9 LDCs (including 4 African LDCs), and one (in Rwanda) by the Russian Federation. In 2012, eight developing economies joined the ranks of large greenfield investors.[58] As a result, greenfield investment in corporate and investment banking in LDCs reached the highest level ($392 million in 16 projects targeted to 8 African and 5 Asian LDCs).

In sub-Saharan Africa, where a large number of LDCs are present, the credit gap – defined as the level of underfinancing through loans and/or overdrafts from financial institutions – for formal small and medium-sized enterprises (SMEs) is the largest in the world. It is estimated at 300–360 per cent of SMEs' current outstanding credit, compared with 29–35 per cent for SMEs in South Asia (Stein et al., 2010). Given the role played by SMEs in economic development, improving financial infrastructure for underserved SMEs and microenterprises in LDCs is a powerful way to support development. Some LDCs are encouraging investment from foreign banks in support of this process. The recent regulatory change that has taken place in Angola to influence the financial management of oil TNCs operating in that country is an example of such initiatives (box II.4).

Box II.4. Leveraging foreign banks and oil TNCs for domestic finance: case of Angola

Under a new foreign exchange law enforced in October 2012 (with a grace period of 12 months), oil TNCs, which are also the major investors in large-scale liquefied natural gas (LNG) projects in the country, are required to use local banks – including foreign-owned banks operating in Angola – to pay their taxes and make payments to foreign suppliers and subcontractors. The main purpose of the new law is to generate additional liquidity, estimated at $10 billion annually, in the domestic banking system.[a]

Before this law came into force, oil TNCs were allowed to hold revenues from Angolan operations in overseas banks and to transfer foreign currency to the central bank for tax payments, because the domestic banking system was underdeveloped. Enforcement of this new law signals the Government's confidence in the domestic financial system, which has been now developed sufficiently to handle transactions required by TNCs. Considering that Angola has been the recipient of the largest number of greenfield projects in retail banking in LDCs in the past decade, and that more than 40 per cent of commercial banks in the country are foreign owned,[b] the level of development achieved by the Angolan banking system may be credited partly to these foreign banks.

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

2. Landlocked developing countries

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $1 billion	Kazakhstan, Mongolia, Turkmenistan, Azerbaijan, Uganda, Uzbekistan, Zambia and Bolivia (Plurinational State of)	Kazakhstan and Azerbaijan
$500 to $999 million	Ethiopia and Niger	..
$100 to $499 million	Armenia, Zimbabwe, Kyrgyzstan, Chad, Paraguay, Mali, Lao People's Democratic Republic, Botswana, Tajikistan, Lesotho, Rwanda, Republic of Moldova, the FYR of Macedonia and Malawi	Zambia
$10 to $99 million	Afghanistan, Nepal, Swaziland, Central African Republic, Burkina Faso and Bhutan	Malawi, Zimbabwe, Mongolia, Republic of Moldova and Armenia
Below $10 million	Burundi	Niger, Swaziland, Mali, Burkina Faso, Kyrgyzstan, the FYR of Macedonia, Botswana, Lao People's Democratic Republic and Lesotho

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

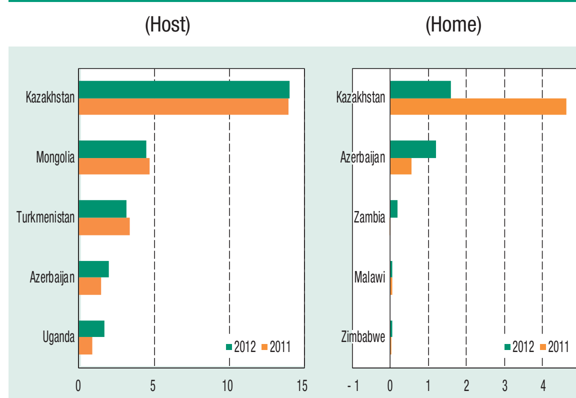


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

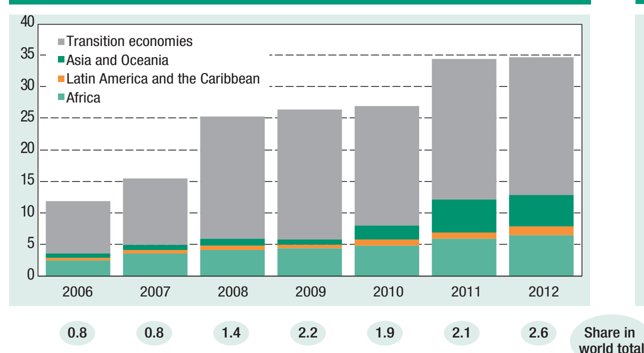
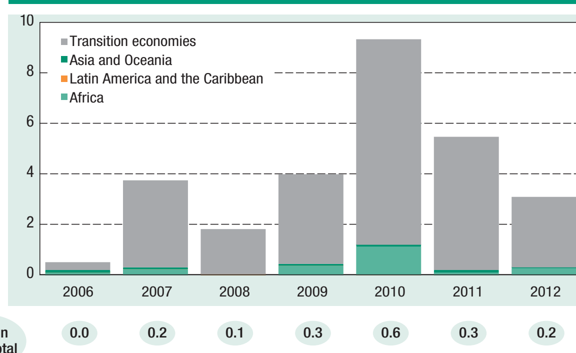


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



	2006	2007	2008	2009	2010	2011	2012
Share in world total (Figure B)	0.8	0.8	1.4	2.2	1.9	2.1	2.6
Share in world total (Figure C)	0.0	0.2	0.1	0.3	0.6	0.3	0.2

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
Total	**700**	**- 2 105**	**8 076**	**394**
Primary	**357**	**- 2 612**	**7 921**	**10**
Mining, quarrying and petroleum	312	- 2 614	7 921	10
Manufacturing	**189**	**468**	**-**	**- 183**
Food, beverages and tobacco	163	377	-	-
Textiles, clothing and leather	-	-	-	-
Chemicals and chemical products	10	-	-	- 185
Metals and metal products	33	-	-	2
Services	**154**	**40**	**155**	**566**
Trade	1	-	-	20
Transport, storage and communications	77	-	7	-
Finance	50	7	148	598
Health and social services	27	7	-	-

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales 2011	Sales 2012	Purchases 2011	Purchases 2012
World	**700**	**- 2 105**	**8 076**	**394**
Developed economies	**- 121**	**- 2 342**	**159**	**445**
European Union	258	- 2 342	159	435
United States	- 4	- 22	-	-
Japan	-	-	-	-
Other developed countries	- 375	41	-	10
Developing economies	**879**	**179**	**- 9**	**- 185**
Africa	- 14	94	- 14	- 185
East and South-East Asia	783	235	-	-
South Asia	32	-	-	-
West Asia	77	-	5	-
Latin America and the Caribbean	-	- 150	-	-
Transition economies	**- 59**	**23**	**7 926**	**133**

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	LLDCs as destination 2011	LLDCs as destination 2012	LLDCs as investors 2011	LLDCs as investors 2012
Total	**39 438**	**17 931**	**1 137**	**4 011**
Primary	**13 062**	**1 443**	**-**	**-**
Mining, quarrying and petroleum	13 062	1 443	-	-
Manufacturing	**18 226**	**8 931**	**150**	**3 282**
Chemicals and chemical products	1 284	4 781	17	-
Rubber and plastic products	1 324	186	-	-
Metals and metal products	386	1 784	-	-
Motor vehicles and other transport equipment	1 996	940	3	-
Services	**8 150**	**7 558**	**987**	**729**
Electricity, gas and water	1 315	2 300	100	-
Transport, storage and communications	2 467	1 823	5	168
Finance	1 528	1 306	366	240
Business services	2 013	467	39	125

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

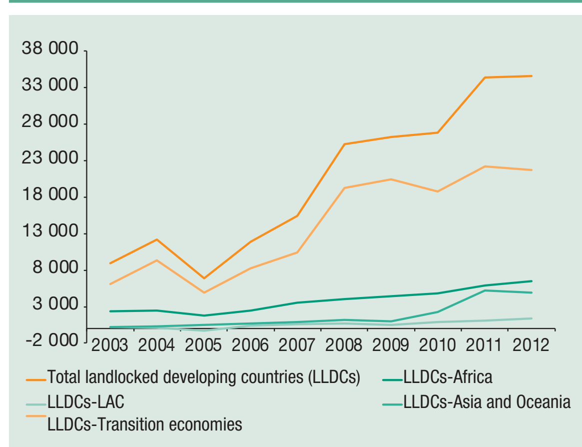
Partner region/economy	LLDCs as destination 2011	LLDCs as destination 2012	LLDCs as investors 2011	LLDCs as investors 2012
World	**39 438**	**17 931**	**1 137**	**4 011**
Developed economies	**15 706**	**5 260**	**231**	**178**
European Union	11 832	3 090	221	128
United States	1 117	1 131	10	50
Japan	97	105	-	-
Other developed countries	2 661	934	-	-
Developing economies	**16 253**	**11 853**	**205**	**3 593**
Africa	2 746	679	143	308
East and South-East Asia	7 022	5 561	-	246
South Asia	5 367	3 643	31	-
West Asia	720	1 962	31	3 034
Latin America and the Caribbean	398	10	-	4
Transition economies	**7 479**	**818**	**701**	**240**

FDI flows to the landlocked developing countries (LLDCs) in 2012 bucked global trends by rising 0.6 per cent from $34.4 billion to $34.6 billion. Investment activity was concentrated in the resource-rich countries, particularly the "Silk Road economies", which accounted for 54 per cent of FDI inflows. Developing countries became the largest regional investors in LLDCs as a share of total flows, with particular interest from West Asian economies and the Republic of Korea, the largest investor in LLDCs in 2012. Greater regional cooperation, such as that occurring along the modern Silk Road, the pursuit of alternative infrastructure options and targeted industrial development remain the key policy objectives of LLDCs for overcoming their structural disadvantages and building competitiveness.

Following a trend of continually increasing FDI flows to LLDCs as a whole, since 2005, FDI flows to these countries remained resilient in 2012 (figure II.12).

Looking at the regional trends in FDI inflows since 2003, when the Almaty Programme of Action for LLDCs was established, only African LLDCs had been able to avoid a fall in FDI in the immediate aftermath of the global economic crisis. Last year they continued their upward trajectory, rising 11 per cent from $5.9 billion to $6.5 billion. Despite low levels of FDI inflows to Latin American LLDCs, they also still managed to buck the global downward trend last year and registered an increase of 28 per cent, from $1.1 billion to $1.4 billion. In line with other Latin American economies, their prospects for future FDI growth look promising. Equally encouraging, and despite last year's fall, has been the recent rapid acceleration of FDI flows to South and South-East Asian LLDC economies in recent years, in particular to the Lao Democratic People's Republic, which has the potential to attract further FDI.

Figure II.12. FDI inflows to LLDCs, 2003–2012
(Millions of dollars)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

FDI to LLDCs historically accounts for a small share of global flows (2.6 per cent in 2012), with the natural-resource-rich Silk Road economies (see below) making up the bulk of this investment. There are still vast disparities between the LLDC regions (see figure II.12). Kazakhstan, Mongolia, Turkmenistan and Azerbaijan account for almost 54 per cent of LLDC FDI inflows (figure A). Of this subgroup, Kazakhstan alone accounted for over 40 per cent of these flows in 2012.

Kazakhstan remained dominant in LLDC FDI flows mainly because of the interests of investors in its oil and gas industry. In 2012, the four largest LLDC M&A deals took place in this country, amounting to over $6.5 billion. Three were in the hydrocarbons sector. However, there was also the $3 billion divestment of Karachaganak Petroleum, formerly owned by BG Group Plc (United Kingdom), to NK KazMunaiGaz – Kazakhstan's State energy company. This divestment, the largest deal in the LLDCs last year, gave the State energy company a 10 per cent stake in the Karachaganak oil exploration venture, along with co-owners Chevron Corp., Eni SpA and OAO Lukoil.[59] Other large M&A deals concerned the purchase of an additional 19 per cent stake by Glencore[60] in its Kazakh copper firm, Kazzinc.

The divestment pattern continued in Africa: Zimbabwe produced the largest M&A deal among LLDCs on the continent with the divestment of gold ore producer Unki Mines, owned by Anglo American (United Kingdom), to Zimbabwe's own Investor Group for over $300 million. The second largest deal in Africa was the purchase by Diageo (United Kingdom) of Meta Abo Brewery S.C. (Ethiopia) for $255 million. These and 13 other deals in Africa were among the top 30 M&A deals in all LLDCs.

Despite a fall in M&A activity, the services sector remains buoyant. Overall, M&A activity in the LLDCs remained down relative to 2011 in all sectors except services (table B), which was boosted by the $1.5 billion acquisition of GSM Kazakhstan by TeliaSonera (Sweden). Other large deals in the services sector in the LLDCs include the purchase of Cablevision (Paraguay) for $150 million and a number of food and beverages deals, particularly for brewers.

More than half of M&As in LLDCs made by developing countries. The main foreign investors in LLDCs, through M&As, included Eurasian Natural Resources (United Kingdom) which acquired a 75 per cent stake in Shubarkol Komir, and the deals by Glencore (Switzerland) and TeliaSonera (Sweden). Of the top FDI M&A deals for which data on the transaction value exist, more than half were made by other developing countries. Among these, the purchase by Xinjiang Guanghui (China) of AlgaCapiyGas (Kazahkstan) was by far the largest transaction, at $200 million, followed by the $69 million acquisition of Cimerwa (Rwanda) by Pretoria Portland Cement (South Africa).

West Asian economies and the Republic of Korea increase their investment in LLDCs, while flows from the Russian Federation fall. Trends in greenfield investment in the LLDCs are similar to those of M&A activity, with the value of projects declining by almost 55 per cent in 2012 (tables D and E), although the total number of projects dipped by only 26 per cent. At a regional level, it is noteworthy that the majority (66 per cent) of greenfield FDI flows in 2012 came from developing countries – up from 41 per cent in 2011. Although overall greenfield investment from developing countries to LLDCs fell by 27 per cent, at the subregional level investment from West Asia went up by 172 per cent to $2 billion. Investment from India, the largest developing-country greenfield investor in 2011, declined in 2012 as the Republic of Korea became the largest investor in LLDCs globally, with flows of $4.3 billion – an increase of 220 per cent on the previous year. In transition LLDCs, the large increases in investment from the Russian Federation seen in 2011 fell away precipitously in 2012, dropping from $7.2 billion to $720 million.

Despite falls across all sectors generally, a number of individual industries registered increases in greenfield investment. Greenfield FDI in chemicals and chemical products increased from $1.3 billion to $4.8 billion, making it the largest industry for greenfield deals in the manufacturing sector; greenfield investment in metals and metal products also rose significantly, from $386 million in 2011 to $1.8 billion last year. In the services sector, only two main industries registered increases in greenfield investment: FDI in electricity, gas and water rose from $1.3 billion to $2.3 billion in 2012, and FDI in hotels and restaurants saw a large increase albeit from low levels – from $123 million to $652 million.

Silk Road countries in Central Asia saw FDI flows on the rise. FDI inflows to the economies of the Silk Road[61] (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan and the Chinese provinces of Gansu, Ningxia A.R., Shanxi and Uygur) have been rising in recent years. Abundant natural resources, such as petroleum and gas, and expanding intraregional and interregional linkages are contributing to attract growing attention from investors.

The Silk Road is by no means a homogenous investment destination. Across the individual economies, there is diversity in sector opportunities, but there are also extensive prospects for combining factors of production across these economies for regional investment opportunities in selected sectors. The region's rich natural resources have helped attract a significant level of extraction and processing activities. Light industries (mostly related to processing), trade and retail, energy and real estate have also brought in foreign investors.

The Silk Road attracted more than $23 billion in FDI in 2012. Driven largely by FDI into Kazakhstan and Turkmenistan, flows to the Silk Road countries had jumped to $13 billion in 2007 and just over $17 billion in 2008, more than five times their level during the period 2000–2005 (table II.6). The characteristics of TNCs investing in the Silk Road economies vary: in Kazakhstan, FDI has been dominated by investors from EU countries and the United States in manufacturing and extractive industries. Chinese and Russian investors have also been active in recent years, especially as the oil and gas sector has expanded. In Turkmenistan, Chinese and Turkish investors have invested mainly in the energy sector. In Uzbekistan, China and the Russian Federation are currently the largest sources of foreign investment, with most foreign investors

Table II.6. FDI inflows to the Silk Road, 2000–2012
(Millions of dollars)

Country/province	average 2000-2005	2006	2007	2008	2009	2010	2011	2012	average 2009-2012
Central Asian countries:	2 979	7 704	13 248	17 063	18 843	17 233	19 474	18 807	18 589
Kazakhstan	2 488	6 278	11 119	14 322	13 243	11 551	13 903	14 022	13 180
Kyrgyzstan	45	182	208	377	189	438	694	372	423
Tajikistan	71	339	360	376	16	- 15	11	160	43
Turkmenistan	262	731	856	1 277	4 553	3 631	3 399	3 159	3 686
Uzbekistan	112	174	705	711	842	1 628	1 467	1 094	1 258
Chinese provinces:	..	1 275	1 510	1 791	1 991	2 276	2 930	3662	2 715
Gansu Prov.	..	100	106	128	150	135	70	100	114
Ningxia A.R.	..	150	80	88	100	81	202	218	150
Shaanxi Prov.	..	925	1 195	1 370	1 511	1 820	2 354	2936	2 155
Xinjiang Uygur	..	100	129	205	230	240	303	408	295
Total	..	8 979	14 758	18 854	20 834	19 508	22 404	22 469	21 304

Source: UNCTAD FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics); and China's Ministry of Commerce.

operating in the oil, gas and telecommunications sectors. Other large foreign investors in Uzbekistan include Malaysian PETRONAS, Swiss-owned Nestlé and British American Tobacco. In Kyrgyzstan, where investment is much smaller, there have been investments by Canadian firms (in mining and petroleum), Chinese firms (in mining), German firms (in agro-industry), and Turkish and Russian firms (in finance). The Silk Road provinces of China received about $3.7 billion of FDI in 2012, an increase of 25 per cent over 2011, with leading TNCs from around the world continuing to expand their presence in the subregion.[62]

Despite the remote geography of Silk Road economies, they enjoy a number of competitive advantages. Some are ranked among the top 10 countries for ease of doing business. Among other possibilities, the Silk Road area has the potential to become a significant supplier of the world's energy needs. For example, Kazakhstan has some of the world's largest oil reserves; Kyrgyzstan and Tajikistan have vast hydropower potential that has barely been tapped; and the Xinjiang Uygur Autonomous Region has the largest reserves of oil, natural gas and coal in China.

Further regional integration and cooperation still seen as key to addressing the structural disadvantages of LLDCs. The structural and geographic disadvantages that affect LLDCs are well known. In LLDCs that are not rich in mineral resources, these challenges are a major obstacle for investors and largely determine the low rates of FDI. Regional integration and cooperation efforts such as the modern Silk Road have therefore been at the heart of strategies to overcome these problems and boost trade and investment.

LLDCs as a group represent a total market of more than 370 million people, although it is not a contiguous market like the EU or other regional groupings. Greater regional integration and the development of larger regional markets will be essential for LLDCs to attract more investment, particularly market-seeking FDI. However, even as members of a regional agreement, LLDCs can still struggle to benefit fully from increased FDI flows. For example, foreign firms may seek market access through investment and production in one member country with the intent to export to other members of the agreement. This case has been observed, for example, in the Southern African Development Community, where South Africa receives the highest share of regional FDI flows – $4.6 billion in 2012. Although other variables will also determine countries' FDI inflows, the weight of large economies in a regional grouping may have an impact on the ability of smaller members to attract FDI (for example, the two LLDCs Zambia and Zimbabwe together received $1.5 billion in FDI in 2012).[63]

In addition to trying to create larger markets, and thereby demand, LLDCs therefore need to use

regional integration and cooperation to strengthen the investment climate and support investment attraction. In this respect, key recommendations for LLDCs include the harmonization of policies, including procedures for the transit of goods, which can have a significant impact on transport times;[64] greater coordination with neighbouring countries to overcome infrastructure problems (e.g. standardization of infrastructure, like rail gauges); better regulation (e.g. of regional supply chains); cooperation on macroeconomic policy problems (such as currency volatility and taxes).

The Almaty Programme of Action for LLDCs also recognizes the importance of integration at the multilateral level and calls for the fast-tracked accession of LLDCs to the WTO, the provision of some kind of enhanced access to all markets (which many would benefit from, as LDCs and under the Generalized System of Preferences) and assistance on trade facilitation. Trade liberalization in itself does not necessarily create a dynamic growth path, but as part of comprehensive policy reforms it may provide incentives for investors and increase the perception of a safer investment climate with a strong rule of law and the protection of property rights, similar to the negotiation of international and bilateral investment agreements.

Alternative infrastructure options and industrial policy are key to building competitiveness. In subregions such as Central Asia, proximity to a port for bulk goods might not be critical if alternative, competitor routes to the sea can be developed along an east-west axis, especially rail or a so-called "Iron Silk Road" (box II.5). Although the bulk of current transport projects in Asia and also in Africa and Latin America are developing highways for road haulage, rail offers some specific advantages over sea transport in terms of its responsiveness in the supply chain because of the regular transportation of smaller volumes of goods over long distances.

Alternatively, LLDCs can explore ways to link their economies via air and IT-enabled services, based on strong industrial policy and domestic investment in skills and technology. LLDCs could develop industries producing and exporting low-bulk, high-value goods (such as pharmaceuticals, organic agriculture, cut flowers and watches) that can be linked via air routes or services industries that are not sensitive to geography and do not rely on access to the sea. Here, FDI has an active potential role to play: as industrial opportunities and infrastructure are created, FDI to these activities may increase. Government policy could help in attracting FDI at the initial stage of industrial transformation through support to public-private partnerships, concessions, credit and insurance.

In all of these scenarios, it is clear that in order to attract FDI, countries will need a proactive industrial policy and significant public investment in infrastructure, supported by multilateral institutions and also by the private sector. FDI thus can play a large role in the development of infrastructure in LLDCs as well as its operation and maintenance. At the same time, it should be noted that improving the domestic business (investment) environment can have a significant effect on exports and make a country attractive to further investment. Such improvements may have an impact on export competitiveness of a magnitude similar to trade and transport facilitation measures, through for example, simplifying domestic contract enforcement procedures and producing a more integrated approach to trade and business facilitation (Duval and Utoktham, 2009). It is clear that coherence between FDI-related policies and other areas is essential in order to increase FDI flows to LLDC economies.

Box II.5. Land-linked economies

To overcome their geographical disadvantages, LLDCs need to move towards becoming land-linked economies. In part this can be achieved by developing regional markets through greater integration, but more fundamentally it means investing in transport infrastructure and reorienting industrial policy.

Box figure II.5.1. Six Central Asia regional economic cooperation corridors

Source: Asian Development Bank, 2012.

The World Bank and the Asian Development Bank (ADB), through its Central Asian Regional Economic Cooperation programme (box figure II.5.1), have highlighted a number of trade and transport corridors that are instrumental in creating land-linked economies. They incorporate, for example, the aspirations of a number of LLDCs to become pivotal land bridges between regions: (i) Central Asia to Iran and Pakistan via Afghanistan; (ii) China to Europe via Central Asia and Kazakhstan – the so-called new Silk Road, or even Iron Silk Road, after the completion of the rail route via Urumqi in China; (iii) China to Thailand via the Lao People's Democratic Republic; (iv) the Atlantic to Pacific route via the Plurinational State of Bolivia; and (v) China to India via Nepal (Arvis et al., 2011). Nevertheless, the cost of upgrading infrastructure on these routes may prove prohibitive.

Often one of the biggest problems that transport corridors seek to address is the time and money lost in the trans-shipment of goods between borders or modes of transport. Trans-shipment problems also occur between the same modes of transport; for example, due to differences in gauges of rail track in Asia. One solution requires a move towards standardization and greater cooperation between countries, such as the recent agreement on the trans-shipment of goods by Afghani and Pakistani trucks, which permits Afghan trucks to continue all the way to Pakistani ports (Arvis et al., 2011).

Over time, economic development efforts will need to shift from transport corridors to more integrated economic corridors that incorporate new trade and settlement patterns, including corridor town development and corridor value chains (ADB, 2012).

Source: UNCTAD, based on Arvis et al. (2011) and ADB (2012).

3. Small island developing States

Table A. Distribution of FDI flows among economies, by range,[a] 2012

Range	Inflows	Outflows
Above $1 billion	Trinidad and Tobago and Bahamas	Trinidad and Tobago
$500 to $999 million	..	..
$100 to $499 million	Jamaica, Mauritius, Barbados, Maldives, Fiji, Saint Vincent and the Grenadines, Seychelles, Saint Lucia and Saint Kitts and Nevis	Bahamas
$50 to $99 million	Antigua and Barbuda, Cape Verde and Solomon Islands	Mauritius
$1 to $49 million	São Tomé and Principe, Timor-Leste, Marshall Islands, Vanuatu, Grenada, Papua New Guinea, Samoa, Dominica, Comoros, Tonga and Palau	Jamaica, Marshall Islands, Samoa, Seychelles, Saint Lucia, Antigua and Barbuda, Solomon Islands, Grenada, Fiji and Tonga
Below $1 million	Federated States of Micronesia and Kiribati	Vanuatu, São Tomé and Principe, Saint Kitts and Nevis, Saint Vincent and the Grenadines, Dominica, Cape Verde and Barbados

[a] Economies are listed according to the magnitude of their FDI flows.

Figure A. FDI flows, top 5 host and home economies, 2011–2012
(Billions of dollars)

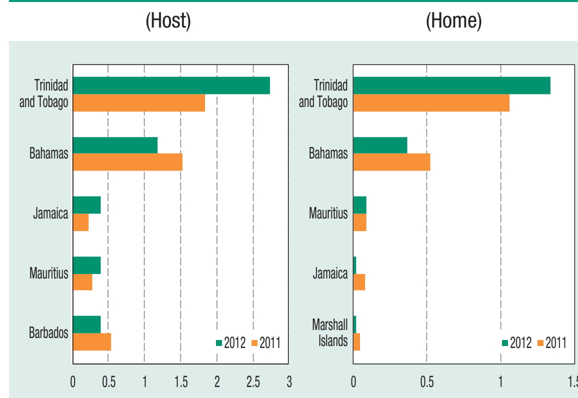


Figure B. FDI inflows, 2006–2012
(Billions of dollars)

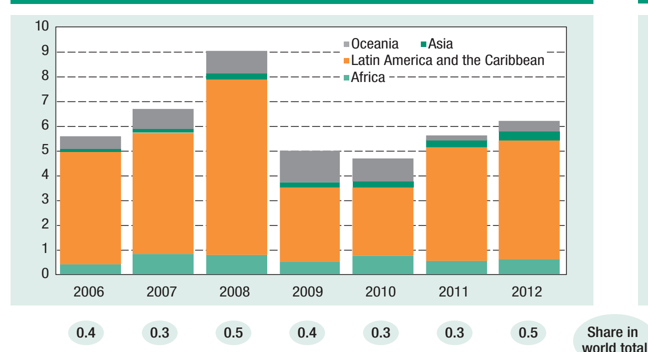
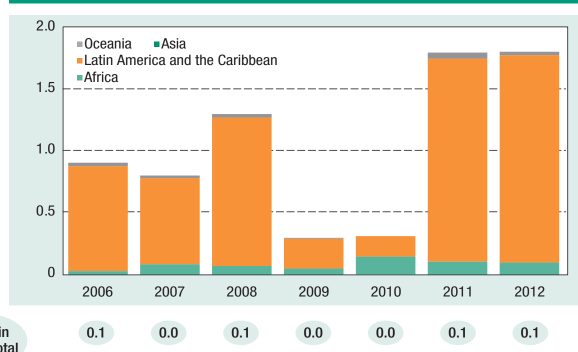


Figure C. FDI outflows, 2006–2012
(Billions of dollars)



Share in world total	2006	2007	2008	2009	2010	2011	2012
Inflows (Figure B)	0.4	0.3	0.5	0.4	0.3	0.3	0.5
Outflows (Figure C)	0.1	0.0	0.1	0.0	0.0	0.1	0.1

Table B. Cross-border M&As by industry, 2011–2012
(Millions of dollars)

Sector/industry	Sales		Purchases	
	2011	2012	2011	2012
Total	**1 223**	**148**	**- 651**	**- 16**
Primary	**938**	**- 10**	**-**	**25**
Mining, quarrying and petroleum	929	- 15	-	-5
Manufacturing	**19**	**-**	**549**	**-**
Food, beverages and tobacco	19	-	-	-
Chemical and chemical products		-	25	-
Non-metallic mineral products	-	-	- 78	-
Metals and metal products		-	603	-
Services	**266**	**158**	**- 1 201**	**- 41**
Electricity, gas and water	-	-	-	- 228
Trade	210	20	-	-
Transport, storage and communications	-	13	- 1 409	- 268
Business services	56	-	-	-

Table C. Cross-border M&As by region/country, 2011–2012
(Millions of dollars)

Region/country	Sales		Purchases	
	2011	2012	2011	2012
World	**1 223**	**148**	**- 651**	**- 16**
Developed economies	**- 992**	**- 42**	**193**	**5**
Europe	216	- 48	-	-
North America	- 995	- 59	193	-
Australia	75	54	-	5
Developing economies	**2 215**	**170**	**- 283**	**- 21**
Africa	-	-	79	20
Latin America and the Caribbean	-	-	-10	330
Caribbean	-	-	- 35	-
Asia	2 215	170	- 351	- 371
China	1 908	-	- 16	-
Transition economies	**-**	**-**	**- 561**	**-**
Russian Federation	-	-	- 561	-

Table D. Greenfield FDI projects by industry, 2011–2012
(Millions of dollars)

Sector/industry	SIDS as destination		SIDS as investors	
	2011	2012	2011	2012
Total	**7 429**	**2 283**	**3 591**	**175**
Primary	**3 000**	**8**	**-**	**-**
Mining, quarrying and petroleum	3 000	8	-	-
Manufacturing	**160**	**1 169**	**78**	**130**
Food, beverages and tobacco	138	24	15	-
Coke, petroleum products and nuclear fuel	-	929	-	-
Services	**4 270**	**1 106**	**3 514**	**45**
Electricity, gas and water	-	156	1 441	-
Construction	1 966	-	-	-
Hotels and restaurants	270	475	2	-
Transport, storage and communications	1 057	116	-	-
Finance	277	201	180	12
Business services	618	92	1 891	33

Table E. Greenfield FDI projects by region/country, 2011–2012
(Millions of dollars)

Partner region/economy	SIDS as destination		SIDS as investors	
	2011	2012	2011	2012
World	**7 429**	**2 283**	**3 591**	**175**
Developed economies	**1 884**	**1 508**	**42**	**26**
Australia	70	1 005	-	-
France	100	54	-	-
United Kingdom	1 056	92	15	19
United States	564	196	20	-
Developing economies	**5 545**	**775**	**3 549**	**149**
India	810	104	-	-
South Africa	4 223	16	19	130
Thailand	206	54	-	-
United Arab Emirates	74	213	-	-
Oceania	134	-	134	-
Transition economies	**-**	**-**	**-**	**-**

FDI flows into small island developing States (SIDS) continued to recover for the second consecutive year, with two natural-resources-rich countries accounting for most of the increase. Besides a strong FDI increase in oil and gas, a slow recovery of the tourism activity that is largely dominated by foreign investors is taking shape, with a diversification towards more visitors from Asia. While some countries promote offshore finance as a way to diversify their economies, others are supporting the information, communication and technology (ICT) industry, which is attracting the interest of foreign investors.

FDI inflows continued recovering. FDI inflows into SIDS pursued their recovery in 2012, registering positive growth for the second consecutive year after the 45 per cent fall registered in 2009. They increased by 10 per cent, to $6.2 billion, mainly as a result of strong increases registered in two natural-resource-rich countries. The first was Trinidad and Tobago, the group's main recipient, which accounted for 41 per cent of the total in 2012, and where FDI inflows increased by 38 per cent. The second was Papua New Guinea, where FDI inflows swung back to positive territory, reaching a modest value of $29 million, up from a high negative amount in 2011 (-$309 million). These two countries together explain 178 per cent of total FDI increase to the SIDS in 2012, suggesting highly uneven growth among countries.

FDI flows to Caribbean SIDS increased by 5 per cent, to $4.8 billion in 2012 (figure B). These countries – which have traditionally attracted the bulk of FDI into SIDS, with an average share of 77 per cent over the period 2001–2011 – maintained their importance as FDI targets (77 per cent in 2012). The significant increase of FDI to Trinidad and Tobago is due to greater reinvested earnings by energy TNCs. Besides important oil and gas wealth in Trinidad and Tobago, the subregion's geographical proximity to, commonly shared language with, and economic dependence on the large North American market are among the factors explaining its attractiveness as an FDI destination compared with the other SIDS countries.

FDI to other SIDS countries – in Africa, Asia and the Pacific – increased by 31 per cent to $1.4 billion, largely due to increases in Papua New Guinea. Of the other relatively big recipients in this subgroup, FDI to Mauritius and the Maldives increased by 32 per cent and 11 per cent to $361 billion and $284 billion, respectively, while that to Fiji and the Seychelles fell (-36 per cent and -21 per cent to $268 billion and $114 billion, respectively).

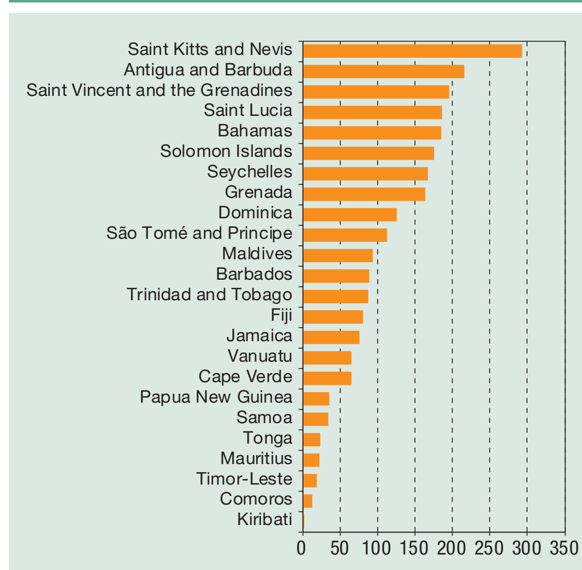
Among African SIDS, Mauritius has diversified from an economy focused on agriculture, tourism and garments towards offshore banking, business outsourcing, luxury real estate and medical tourism. Mauritius offers investors the advantage of an offshore financial centre in the Indian Ocean, with a substantial network of treaties and double-taxation avoidance agreements, making it a gateway for routing funds into Africa and India.[65] In the Seychelles, also, FDI is increasingly focused in the real estate sector, as well as financial and insurance activities.

The Pacific SIDS countries – which attracted 8 percent of all FDI in SIDS in 2012 – are typically different from other members of this group in that they are extremely isolated geographically. The islands are very remote, not only from the nearest continent (except for Papua New Guinea), but also from each other.[66] Their remoteness and small populations are structural obstacles to their competitiveness in general, as well as to their attractiveness to foreign investors. Most FDI inflows to the Pacific SIDS are directed primarily to natural resource exploitation, especially those to Papua New Guinea (oil and gas) and Fiji (gold, bauxite and fishing).

FDI inflows are substantial relative to the size of the economy. In absolute terms, FDI flows may appear small but they are quite substantial relative to the size of most SIDS economies. The ratio of FDI stock to GDP for SIDS was 86 per cent in 2011, with a very wide variation among subgroups and countries. The 10 Caribbean SIDS together had the highest ratio (109 per cent), followed by the 2 Asian SIDS (64 per cent), the 7 (of 12) Pacific SIDS for which data were available (50 per cent), and the 5 African SIDS (39 per cent). The variations are wider by country, ranging from 2 per cent for Kiribati to 292 per cent in Saint Kitts and Nevis (figure II.13).

Although the SIDS economies are highly dependent on FDI, very little is known about the impact of FDI inflows on them, and especially how these impacts interact with the group's structural vulnerabilities.

Figure II.13. Ratio of FDI stock to GDP of small island developing States, 2011
(Per cent)



Source: UNCTAD FDI-TNC-GVC Information System, FDI database; and IMF (for GDP).

FDI outflows are concentrated in two countries. FDI outflows from SIDS increased by 0.5 per cent in 2012 to $1.8 billion, 74 per cent of which corresponded to Trinidad and Tobago, which registered a 26 per cent increase. The Bahamas – the second largest investor abroad, accounting for 20 per cent of the total – saw a 30 per cent decline to $367 million.

Tourism is diversifying towards new markets. Tourism experienced strong growth during 2003–2008 in most of the Caribbean islands, as well as in some other islands, such as in Mauritius, the Seychelles and the Maldives, which led to a construction boom in hotels, resorts and villas, mainly driven by foreign investors. Although the global economic crisis affected FDI in tourism seriously – through reduced tourist numbers, as well as the availability of credit financing for hotel and tourist projects – there have been signs of a limited recovery. In the Caribbean, for example, tourist arrival figures improved in the first half of 2012.[67] However, the strong growth seen in 2003–2008 may not return until demand in markets such as the United Kingdom and the United States solidifies further and/or new demand in other markets rises, and until delayed investment in new hotels and related infrastructure resumes.

Countries such as the Seychelles, which has also experienced a gradual revival in tourism activity, are already diversifying away from developed markets towards visitors from Asia. This is reflected, for instance, in the acquisition of a 40 per cent stake in Air Seychelles for $20 million by Abu Dhabi-based Etihad Airways in 2012.[68] The new management restructured the company's flight routes, terminating flights to Europe in favour of a regionally based strategy, centred on international flights to Mauritius, Johannesburg and Abu Dhabi.

More countries aspire to become offshore financial centres. A large number of SIDS countries have actively marketed themselves as hosts to offshore business as a development tool (see chapter I), which has especially attracted FDI into the finance industry and boosted investments in sectors such as tourism and ICT that directly or indirectly benefit from the expansion of offshore finance. This interest in promoting offshore business reflects a number of factors, including a desire for economic diversification to provide employment opportunities and contribute to fiscal revenue. Other SIDS are also aspiring to become offshore financial centres in the near future; for example, the Maldives, where the economic authorities announced plans to establish an offshore financial centre in 2012, with the aim of generating activity and revenue outside of the tourism industry.

Jamaica continues to promote the ICT industry. Some FDI has recently been directed to the ICT industry in some SIDS countries – most notably Jamaica, where the sector experienced significant growth during the 2000s, spurred by substantial foreign investment in the telecommunications infrastructure. Jamaica is a premier "nearshore" investment location (for North America) and provides a diverse number of informatics services, ranging from basic data entry to multimedia and software development services. The Montego Bay Free Zone has been perceived as particularly conducive to investments in the ICT industry, owing

to the presence of powerful data transfer facilities as well as sophisticated imaging, voice and facsimile services. Following the Government's creation in 2011 of a $20 million loan fund for the expansion of the ICT industry, two United States–based information solutions companies – Convergys Corporation and Aegis Communications Ltd – announced that they would set up call centres in Montego Bay.

FDI into the extractive industry is recovering and prospects are positive. The availability of primary commodities has been an important FDI driver in countries such as Papua New Guinea and Trinidad and Tobago. In Papua New Guinea, a $15.7 billion LNG project, being developed by ExxonMobil (United States), is scheduled to start production in 2014. Once completed, it will significantly increase the country's exports and to provide substantial income to the Government. Although there is a significant opportunity for Papua New Guinea to benefit from the project, worries remain about possible social conflicts arising from adverse environmental impacts and inadequate compensation for landowners. There are also risks that the country could be affected by the so-called Dutch Disease that the Government is trying to address with a newly created sovereign wealth fund (SWF). This comprises a development fund that will receive dividends from the Government's equity participation in the project, and a stabilisation fund that will receive all mining and petroleum revenue, with a spending limit at 4 per cent of GDP in any one year.[69]

Trinidad and Tobago's oil and gas industry remains at the heart of the country's economy; it is in the hands of both private and State-owned companies, with a significant level of foreign participation (box II.6). In recent years, however, the energy sector has seen falling production, limited exploration activity and declining reserves.[70] FDI into the sector – which represented 85 per cent of total inflows during the period 1999–2010[71] – has also declined since 2005; by 2010, it was just over half of the level in 2004. This is partly because of depressed natural gas prices and market prospects for gas, owing to the expansion of shale gas in the United States and elsewhere. The impact of falling oil and gas production, combined with the global economic crisis, has weighed heavily on the country's economic growth, which has been negative or nil since 2009. The Government has addressed these challenges through revisions to the fiscal regime and initiatives to promote upstream and downstream activity in the oil and gas sector. FDI to the sector resumed growth in 2011 and 2012, driven by strong increases in reinvested earnings.[72] This has coincided with the revival of drilling activity, as evidenced by the increased number of exploratory wells, which were up from nothing in October 2010–June 2011 to 73 in October 2011–June 2012 (Government of the Republic of Trinidad and Tobago, 2013).

Box II.6. The importance of FDI in Trinidad and Tobago's oil and gas sector

The energy sector is critical to Trinidad and Tobago's economy. It accounted for 44 per cent of nominal GDP and 83 per cent of merchandise exports in 2010, and 58 per cent of Government revenue in 2010–2011. The sector comprises the exploration and production of crude oil and natural gas (47 per cent of energy sector GDP), petrochemicals (24 per cent), refining (15 per cent) and services (13 per cent). Notwithstanding its central role in the economy, though, the sector employs only 3 per cent of the labour force.

Natural gas production is dominated by three foreign companies (BP, British Gas and EOG Resources Trinidad), which accounted for 95 percent of production in 2010. About 60 per cent of crude oil was produced by private companies, of which almost 80 per cent was accounted for by three foreign companies (BP, REPSOL and BHP Billiton), with the remaining 40 per cent produced by the State-owned oil and gas company, Petrotrin. About half of all crude oil produced in the country is refined locally by Petrotrin, which also refines imported crude oil.

About 60 percent of natural gas output is used for the export of LNG; the rest is for the domestic petrochemical industry and power generation. Atlantic LNG (owned by British Petroleum, British Gas, France's GDF Suez, Spain's Repsol and Trinidad's State-owned NGC) is the sole producer of LNG. It purchases gas from suppliers and processes it into LNG that is exported to other affiliates and operations of its foreign owners.

Source: IMF (2012b).

Notes

[1] Data are from Preqin, http://www.preqin.com.

[2] McKinsey, 2012, pp. 3–4.

[3] According to China's State Administration of Foreign Exchange; however, FDI inflows to China amounted to $254 billion in 2012. The large discrepancy with data from the Ministry of Commerce, which reports FDI data to UNCTAD, reflects differences in the compilation methodology of the two Government agencies.

[4] Chris Cooper, "Thailand beating China with Toyota means shipping boom", Bloomberg, 21 February 2013.

[5] For instance, in the automotive industry, both State-owned SAIC and privately owned Chery invested in large assembly facilities in Brazil.

[6] Source of data: Ministry of Commerce of China.

[7] A recent survey of American investors shows that, despite the growing importance of the Chinese market and an overall optimistic view on business prospects in the country, about 15 per cent have relocated or plan to relocate their production out of China, while 13 per cent have been relocating within the country. Covering 420 U.S. companies, the survey was conducted by the Shanghai American Business Council in 2012.

[8] In the meantime, the outflow of capital was also caused by the adjustment of firms' foreign exchange management and financial operation in reaction to global economic uncertainties (Zhao, 2012).

[9] Source: Nike annual reports from 2005 to 2012.

[10] Similar disputes emerged later. In February 2013, for instance, the Government suspended two mining permits for Entree Gold, an explorer partly owned by Rio Tinto by way of Turquoise Hill Resources – signalling a possible deepening in the dispute. (Robb M. Stewart, "Mongolia fuels Oyu Tolgoi dispute by scrapping Entree Gold's permits", Dow Jones, 28 February 2013.)

[11] Dan Levin, "In Mongolia, a new, penned-in wealth", *New York Times*, 26 June 2012.

[12] Simon Hall, "Energy titans look to Myanmar", *Wall Street Journal*, 7 June 2012.

[13] After the opening up of the single-brand segment of the retail industry, significant FDI inflows have been seen in the industry. The change in Government policies on the multiple-brand segment demonstrates that policymaking concerning inward FDI is at a crossroads in India. With the opening up of this segment, more FDI is expected in the retail industry. This demonstrates the Government's efforts to bring in more FDI to the country.

[14] More than 700 workers have died in fires in garment factories since 2005, according to labour groups. The collapse of the Rana Plaza complex on 24 April 2013 led to the death of more than 1000 garment workers. (Source: media coverage, including, for instance, Syed Zain Al-Mahmood and Jason Burke, "Bangladesh factory fire puts renewed pressure on clothing firms: Blaze follows collapse of Rana Plaza complex in Dhaka last month which left hundreds dead", *The Guardian*, 9 May 2013.)

[15] For instance, with annual sales over $1 billion, MAS has 38 apparel facilities in more than 10 countries and provides employment to more than 55,000 people. Brandix employs more than 40,000 across 38 manufacturing locations in Sri Lanka, India and Bangladesh.

[16] A full-package garment supplier carries out all activities in the production of finished garments – including design, fabric purchasing, cutting, sewing, trimming, packaging, etc.

[17] This is particularly true for service companies and conglomerates like the Tata Group. As the largest private company in India, Tata Group has operations in automotive, chemicals, communications, food and beverage, information technologies and steel.

[18] For instance, Wipro acquired the oil and gas IT services of SAIC (United States) in 2011 and Promax Application Group (Australia) in 2012.

[19] Following geopolitical disputes in Sudan and South Sudan, ONGC Videsh has discontinued crude oil production in South Sudan and reduced production in Sudan.

[20] Some Indian TNCs seek to concentrate more on domestic markets and consolidate their Indian operations by integrating a series of smaller domestic M&As (BCG, 2013).

[21] The deal was an asset swap that gave SABMiller a 24 per cent stake in Anadolu Efes, with the Turkish Anadolu Group preserving a controlling 42.8 per cent share.

[22] *Arab News*, "Segments of the GCC financial markets are beginning to develop fraction", 25 January 2012, http://www.arabnews.com/node/404874.

[23] See Raghu (2012), and the Economist Intelligence Unit, "Nitaqat employment quotas face backlash", 3 August 2012.

[24] Net intercompany loans totalled $10.4 billion in 2012, more than equity capital, which totalled $7.6 billion, pushing total Brazilian FDI outflows to negative values.

[25] In 2012, Cencosud acquired the Colombian affiliate of Carrefour (France) for $2.6 billion, and the Prezunic grocery store in Brazil for $495 million.

[26] Sectoral FDI stock data are only available until 2002.

[27] Argentina and Brazil are excluded because in the case of Argentina, the importance of FDI in natural resources, compared with other sectors, has been decreasing and the sectoral composition of its value added has been the same in 2001–2005 compared with 2006–2010. In the case of Brazil, it is because the extractive industry is dominated by national companies.

[28] In August 2011, the Government presented its new industrial, technological and foreign trade policy in the Plano Brasil Maior. Its main purpose is to boost investments, stimulate technological growth and increase the competitiveness of national goods and services, with a view to countering the decline of the industrial sector participation in the country's economy (see *WIR12*).

[29] Secretariat of the Federal Revenue of Brazil, "Plano Brasil Maior: Governo lança novas medidas para fortalecer indústria nacional, Folha de pagamento é desonerada para mais onze setores". Available at http://www.receita.fazenda.gov.br/inot/2012/04/05/2012_04_05_11_49_16_693391637.html.

[30] It first increases a tax on industrialized products (the IPI) by 30 per cent for all light-duty vehicles and light commercial vehicles. Second, it imposes a series of requirements for automakers to qualify for up to a 30 per cent discount in the IPI. In other words, IPI taxes will remain unchanged for those manufacturers that meet the requirements. The programme is limited to vehicles manufactured between 2013 and 2017, after which IPI rates return to pre-2013 levels unless the decree is modified. See Presidência da República, Casa Civil, Subchefia para Assuntos Jurídicos, DECRETO Nº 7.819, DE 3 DE OUTUBRO DE 2012, http://www.planalto.gov.br/ccivil_03/_ato2011–2014/2012/Decreto/D7819.html.

[31] See Chiari Barros and Silvestre Pedro (2012), BNDES Performance per Sector, http://www.bndes.gov.br/SiteBNDES/export/sites/default/bndes_en/Galerias/Download/Desempenho_setorial_ingles_US$.pdf; BNDES Press Room, "BNDES approves R$ 154 million in financing for Peugeot Citroën Brazil", 5 February 2013, and "BNDES approves R$ 2.4 billion for new Fiat plant in Pernambuco", 4 January 2013.

[32] Chinese automakers – Chery and JAC – are building plants, and Hyundai is building two new assembly lines. Other companies have announced plans to build new plants or to expand their existing operations. They include BMW, General Motors, Volkswagen, Fiat and PSA Peugeot Citroen. See Economist Intelligence Unit, "Industry Report, Automotive, Brazil", November 2012.

[33] Source: Central Bank of Brazil.

[34] According to a 2011 survey, 63 per cent of senior manufacturing executives selected Mexico as the most attractive country for re-

sourcing manufacturing operations closer to the United States, with only 19 per cent citing the United States itself as the best location. However, the margin narrowed to just 15 points in the 2012 survey. See AlixPartners (2012).

35 Dussel Peters (2009); Moreno-Brid et al. (2006); McClatchy, "As China's wages climb, Mexico stands to win new manufacturing business", 10 September 2012; *Financial Times*, "Mexico: China's unlikely challenger", 19 September 2012; Inter-American Dialogue, "Reassessing China-Mexico Competition", 16 September 2011.

36 Georgia is listed separately under transition economies, since it formally ceased to be a member of the CIS in 2009.

37 In Kazakhstan, the natural resource law approved in 2009 allows the Government to change existing contracts unilaterally if they adversely affect the country's economic interests in the oil, metals and minerals industries.

38 According to IDA Ireland, the Government agency responsible for attracting FDI, net job creation by its client TNCs rose from 5,934 in 2011 to 6,570 in 2012, bringing their total employment to 153,785, a level last recorded before the crisis.

39 An investigation by the United States Senate highlighted a certain type of transactions that go through Belgium. According to the Senate report, the United States TNC Hewlett-Packard held most of its cash abroad, which were accumulated profits of its foreign operations. Had it repatriated this cash to the United States, it would have been subjected to taxes in the United States. Therefore, instead of repatriating the funds, its affiliates in Belgium and the Cayman Islands alternately provided short-term loans to the parent company in the United States. As short-term loans are exempted from tax, the parent company had access to the funds continuously without having to pay taxes.

40 As a remedy, the 2008 edition of the OECD Benchmark Definition of FDI recommends that (i) resident SPEs' FDI transactions should be presented separately; and (ii) the directional principle should be extended to cover loans between fellow enterprises. However, the new methodology recommended by OECD has not yet been adopted by many countries. FDI data compiled by UNCTAD exclude FDI flows related to SPEs for countries for which such data are available (see chapter I).The "extended" directional principle has been adopted in only a handful of countries and therefore has not been adopted in UNCTAD FDI statistics.

41 Some signs of recovery are beginning to appear, however. For instance, attracted by a decline in labour costs, a number of auto manufacturers are shifting production to Spain from other parts of Europe. In the case of Nissan, the group is injecting more capital to expand the capacity, creating more jobs. See CNN.com, "Auto industry revs up recovery in Spain", 28 February 2013.

42 There was a degree of popular backlash against such foreign takeovers, which might have contributed to the reduced number of such deals. Some media reports attributed the decision by the Italian bank, UniCredit, to halt its plan to sell its asset management arm, Pioneer Investments, to such popular sentiment.

43 "European banks are facing more pain in Spain", *Wall Street Journal*, 29 June 2012.

44 Estimated standard deviations of annual growth in FDI inflows (1990–2012) of developed countries is 0.34, while for developing countries it is 0.19.

45 The median standard deviation of FDI inflows' annual growth for developed countries is 1.51 and for developing countries is 1.33. Estimation of median standard deviation for developing economies is based on the top 40 developing economies as reflected in 2011 FDI stock.

46 The amount of local financing can be quite significant. According to data from the Japanese Ministry of Economy Trade and Industry in 2007, 70 per cent of short-term borrowing by foreign affiliates in Japan was from local sources. The extent of their reliance on local sources for long-term borrowing was less but still over 50 per cent. Furthermore, over three quarters of corporate bonds issued by foreign affiliates were held by local investors.

47 Funds for M&As may be raised from local sources in the same country as the acquired firm, but data from the United Kingdom suggest that local sources play a relatively small role. Of deals involving United Kingdom TNCs making acquisitions abroad in 2001–2010, 66 per cent were financed by funds paid directly by the parent company and 22 per cent by loans from the parent company; and funds raised locally abroad accounted for only 12 per cent (Office of National Statistics).

48 The number of countries included in this group has increased from 48 to 49 with the addition of South Sudan in December 2012. Accordingly, this group now consists of Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, the Niger, Rwanda, Samoa, São Tomé and Principe, Senegal, Sierra Leone, the Solomon Islands, Somalia, the Sudan, South Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia. South Sudan is excluded in statistics except for greenfield investments.

49 Because of the upward revisions of 2010–2011 data in some major recipients (e.g. Equatorial Guinea, Mozambique, Myanmar, the Sudan, the United Republic of Tanzania and Uganda), the inflows to LDCs reported in *WIR12* were revised upward from $16.9 billion to $18.8 billion in 2010 and from $15.0 billion to $21.4 billion in 2011.

50 In some LDCs, where growth has been stimulated by industries in which non-equity modes (NEMs) are the prominent form of TNC involvement (*WIR11*), the falls in FDI inflows may have masked the rapid growth in NEMs (e.g. garments in Bangladesh). NEMs in the extractive industries (e.g. production-sharing agreements and concessions) are also common in many natural-resource-rich LDCs (*WIR07*).

51 In 2012, the inflows to the top five recipients accounted for 60 per cent, compared with 52 per cent in 2011 and 60 per cent in 2010.

52 Owing to the data collection method applied to the greenfield projects database, the announced values of projects tend to overestimate the actual investment values, and not all announced projects have been realized.

53 Among transition economies, the Russian Federation has been the largest investor, whose aggregate value of greenfield projects in LDCs exceeds $4 billion for the period 2003–2012, of which of $2.5 billion represents a single mining project in Liberia announced in 2010.

54 Madras Institute of Orthopaedics and Traumatology announced a $40 million construction project in Rwanda, and Apollo Hospitals Group announced a $49 million construction project in Uganda.

55 Reuters, "Zambia firm to build oil pipeline from Angola", 12 April 2012. Available at www.reuters.com/article/2012/04/12/zambia-oil-idAFL6E8FC3T320120412; *Lusaka Times*, "Zambia and Angola sign $2.5bn oil deal", 16 April 2012. Available at www.lusakatimes.com/2012/04/16/zambia-angola-sign-25bn-oil-deal/.

56 In Angola, greenfield investments by Banco BPI (Portugal) (with 68 projects registered in 2004–2012) generated 45 per cent of the total retail banking investments ($285 million) in 2003–2012, followed by two other Portuguese banks, Finibanco (whose 11 projects, announced in 2008, contributed to 17 per cent of Angola's greenfield investments in retail banking) and Banco Comercial Portugues (Millennium BCP) (15 per cent). Yet, as far as the retail banking projects in 2012 are concerned, the dominance of Portuguese banks has faded. Banque du Commerce et Industrie (Mauritania) – with the first

greenfield projects in financial services in LDCs ever recorded by Mauritania – became the largest investor, followed by Standard Bank Group (South Africa).

57 Eleven LDCs registered retail banking projects in other LDCs: Angola (1 project), Cambodia (7), the Democratic Republic of the Congo (1), Ethiopia (6), Mali (6), Mauritania (4), Rwanda (1), Togo (26), the United Republic of Tanzania (6), Uganda (4) and Yemen (1).

58 The eight developing economies are Bangladesh, Hong Kong (China), Kenya, the Philippines, Saudi Arabia, South Africa, Thailand and Yemen.

59 With regard to investment policy, Kazakhstan recently approved a new law establishing the priority right of the State to take part in any new trunk pipeline being built in the country (see chapter III).

60 In February 2013, the main Kazakh SWF bought a 28 per cent stake in the firm, preventing Glencore's total ownership of the company.

61 The term "Silk Road" is tied to images of traders from long ago, but although the romanticism has been replaced by the hard realities that many of its current inhabitants face, the Silk Road is gradually being "reconstructed" to offer a number of potential business opportunities in a region linked by burgeoning infrastructure as well as economic and cultural ties (UNCTAD, 2009).

62 For example, the high-tech centre in Western China, Xi'an, capital city of Shanxi Province, attracted FDI projects by major TNCs, such as new manufacturing facilities for Alstom (France), Bosch (Germany) and Daiwa (Japan), and a research centre for 3M (United States). Other FDI projects in the region included Cola-Cola's investment in a new factory in Xinjiang and new shops built by Metro (Germany) in Ningxia.

63 The Southern African Development Community is negotiating a tripartite free trade area with the East African Community and COMESA (the Common Market for Eastern and Southern Africa). Investment talks are scheduled to form part of the second phase of negotiations (envisaged to commence in the latter half of 2014) which, it is hoped, will boost investment to the area as a whole. For a discussion of investment policies and the growing trend towards regional approaches to investment policymaking, see chapter III.

64 See UNCTAD (2003) and also Limão and Venables (2001). The European Transit System and the TIR (Transports Internationaux Routiers) are the only fully operational transit systems globally. Others that are in place but not fully implemented include the Acuerdo Sobre Transporte Internacional Terestre in Latin America, and the Greater Mekong Subregion Agreement on the Transit of Goods and People in South-East Asia.

65 In Africa, Mauritius signed double-taxation avoidance agreements with Botswana, Congo, Lesotho, Madagascar, Mozambique, Namibia, Rwanda, Senegal, the Seychelles, South Africa, Swaziland, Uganda and Zimbabwe. It has also signed a double-taxation avoidance agreement with India.

66 The average distance to the nearest continent for Pacific islands is more than four to five times that applicable to the average country in the Caribbean or sub-Saharan Africa.

67 Economist Intelligence Unit, "Caribbean economy: Caribbean tourism recovering slowly", 21 August 2012.

68 Etihad Airways also assumed management control of a five-year contract and, in addition, made a fresh capital injection of $25 million.

69 Economist Intelligence Unit, "Bumpy road ahead for PNG LNG project", 26 September 2012.

70 Total natural gas reserves declined from 34.9 trillion cubic feet (tcf) in 2005 to 27.1 tcf in 2010 (equivalent to about nine years of production). Total oil reserves also declined, from 2.7 billion barrels in 2005 to 2.5 billion barrels in 2007 (equivalent to about 14 years of production) (IMF, 2012).

71 Central Bank of Trinidad and Tobago, 2013.

72 FDI increased strongly in 2011 (233 per cent) and 2012 (70 per cent). According to Central Bank estimates, the energy sector received roughly 85 per cent of FDI inflows between January 2011 and September 2012 (Central Bank of Trinidad and Tobago, 2013).

Box II.1

a The DMIC is an infrastructure project as well as an industrial development project, spanning six states. It involves investment of about $90 billion with financial and technical aid from Japan. The project covers about 1,500 km between Delhi and Mumbai.

b An industrial park already exists in Neemrana, with significant Japanese investments in industries such as automotive components.

c See, for instance, Makoto Kojima, "Prospects and challenges for expanding India-Japan economic relations", *IDSA Issue Brief*, 3 October 2011.

Box II.3

a The first ever health-care project in LDCs was recorded by Bumrungrad International (Thailand), for sales and marketing support of general medical and surgical hospitals in Ethiopia at a value of $2.3 million.

b This share remained the same in 2007–2008 but increased to 4 per cent in 2009, when the United Kingdom announced a $49 million construction project in the United Republic of Tanzania and the first Indian health-care projects in LDCs (namely, Bangladesh and Yemen) were recorded. By 2010, seven projects in LDCs accounted for 10 per cent of the health-care greenfield investments in all developing economies. the share increased further to 15 per cent in 2011, led by greenfield projects from India and Thailand.

Box II.4

a Economist Intelligence Unit, "Country Forecast: Angola", October 2012. Available at www.eiu.com.

b Nine of the 22 commercial banks are foreign owned, taking up 40 per cent of assets, loans, deposits and capital in the country (IMF, Country Report No. 12/215, August 2012).

RECENT POLICY DEVELOPMENTS

CHAPTER III

Mobilizing investment to ensure that it contributes to sustainable development and inclusive growth is becoming a priority for all countries. Consequently, investment policymaking is in a transition phase.

Investment policy developments in 2012 show that countries are eager to attract foreign investment but that they have also become more selective. Countries specifically target those investments that generate jobs, deliver concrete contributions to alleviate poverty (e.g. investment in the poor, with the poor and for the poor), or help tackle environmental challenges (*WIR10*). Or they regulate investment with a view to maximizing positive and minimizing negative effects, guided by the recognition that liberalization needs to be accompanied – if not preceded – by a solid regulatory framework. Increasing emphasis on responsible investment and corporate social responsibility (CSR) reinforces the inclination of a new generation of investment policies to place sustainable development and inclusive growth at the heart of efforts to attract and benefit from such investment (*WIR12*). Yet, increasing State intervention also poses a risk that countries will resort to investment protectionism, in tackling economic crises and addressing other challenges.

Civil society and other stakeholders are taking an increasingly active part in the development of investment policies. This is particularly so for international investment policies, where the negotiation of international investment agreements (IIAs) and the growing number of investment arbitrations have gained the attention of parliaments and civil society. Similarly, foreign investors and business are adjusting their business models, emphasizing the contribution that their role as responsible investors entails (*WIR10*).

A. NATIONAL INVESTMENT POLICIES

1. Overall trends

Most countries are keen to attract and facilitate FDI but have become more selective and continue to reinforce their regulatory frameworks.

In 2012, according to UNCTAD's count, at least 53 countries and economies around the globe adopted 86 policy measures affecting foreign investment – an increase in measures of almost 30 per cent compared with the previous year (table III.1). Of these measures, 61 related to investment liberalization, promotion and facilitation to create a more favourable environment for foreign investment, while 20 introduced new restrictions or regulations.

As in previous years, most governments in 2012 were keen to attract and facilitate foreign investment. At the same time, numerous countries reinforced the regulatory environment for foreign investment. The share of new investment regulations and restrictions increased from 22 per cent in 2011 to 25 per cent in 2012, reaffirming a long-term trend after a temporary reverse in 2011 (figure III.1). In the first four months of 2013, this percentage rose to

Table III.1. Changes in national investment policies, 2000–2012
(Number of measures)

Item	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Number of countries that introduced changes	45	51	43	59	80	77	74	49	41	45	57	44	53
Number of regulatory changes	**81**	**97**	**94**	**126**	**166**	**145**	**132**	**80**	**69**	**89**	**112**	**67**	**86**
Liberalization/promotion	75	85	79	114	144	119	107	59	51	61	75	52	61
Restriction/regulation	5	2	12	12	20	25	25	19	16	24	36	15	20
Neutral/indeterminate[a]	1	10	3	0	2	1	0	2	2	4	1	0	5

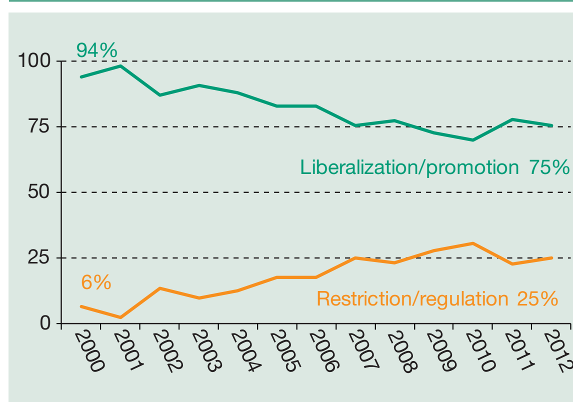
Source: UNCTAD, Investment Policy Monitor database.
[a] In some cases, the expected impact of the policy measure on the investment is undetermined.

38 per cent. The largest share of new restrictions or regulations appeared in developed countries (31 per cent), followed by developing countries (23 per cent) and transition economies (10 per cent). Although relatively small in quantity, investment restrictions and regulations particularly affected strategic industries (see section III.A.2.b).

In light of the persistent economic crisis, countries worldwide pursued FDI *liberalization policies.* These policies covered a broad range of industries, with a particular focus on services (box III.1). Privatization policies, for instance in air transportation and power generation, were an important component of this move.

Numerous countries adopted *investment promotion and facilitation* measures (box III.2). At least 16 countries introduced new investment incentive programs. Others – such as Armenia, Belarus, the Cayman Islands, Pakistan and Uzbekistan – established special economic zones (SEZs), introduced one-stop shops to attract and facilitate foreign investors (e.g. in Costa Rica and Ukraine), or supported outward investments. Several countries reduced corporate taxation rates.

Figure III.1. Changes in national investment policies, 2000–2012
(Per cent)



Source: UNCTAD, Investment Policy Monitor database.

The dominant trend of liberalizing and promoting investment contrasts with the move in several countries towards fostering a regulatory framework for investments in general (box III.3) and FDI more specifically (box III.4).

Box III.1. Examples of investment liberalization and privatization measures, 2012–2013

China raised the ownership ceiling for foreign investors in joint-venture securities firms to 49 per cent from 33 per cent.[a]

India took liberalization measures in several industries, including single- and multi-brand retail trading, power exchanges, broadcasting, civil aviation, foreign-owned non-banking financial companies, as well as in FDI to and from Pakistan.[b] It also raised the foreign ownership ceiling for FDI in asset reconstruction companies from 49 per cent to 74 per cent, subject to certain conditions.[c]

The Emirate of Dubai in the *United Arab Emirates* issued a regulation (Regulation No. 2 of 2012) expanding the area where non-UAE nationals may own real estate. According to this regulation, non-citizens are allowed to acquire a usufruct right (life interest) to property for a period not exceeding 85 years.[d]

Myanmar launched a new foreign investment law allowing 100 per cent foreign capital in businesses given permission by the Investment Commission.[e]

Portugal sold 100 per cent of the shares of ANA-Aeroportos de Portugal – the State-owned company managing Portuguese airports – to the French group Vinci Concessions SAS.[f]

Ukraine adopted a resolution to privatize six regional power companies.[g]

Source: UNCTAD, Investment Policy Monitor database. Additional examples of investment-related policy measures can be found in UNCTAD's *Investment Policy Monitors* published in 2012 and 2013.
Note: Notes appear at the end of this chapter.

Box III.2. Examples of investment promotion and facilitation measures, 2012–2013

China simplified review procedures related to capital flows and currency exchange quotas for foreign enterprises. They only need to register the relevant data with the relevant authorities; for instance, with regard to opening foreign currency accounts or reinvesting foreign exchange reserves.[a]

Costa Rica implemented a business facilitation programme that simplified the registration of companies. All formalities have been concentrated in one place and the time required to register a company has been reduced from nearly 90 days to 20 days or less.[b]

Japan adopted "Emergency Economic Measures for the Revitalization of the Japanese Economy", which, among other steps, facilitate the expansion of Japanese businesses into overseas markets.[c]

Pakistan enacted a Special Economic Zones (SEZs) Act. It allows for the establishment of SEZs anywhere in the country over a minimum area of 50 acres and offers several tax incentives to domestic and foreign investors in such zones.[d]

The Sudan ratified the Investment Act 2013, which offers tax and customs privileges in strategic industries. It also provides for the establishment of special courts to deal with investment-related issues and disputes, and offers guarantees to investors in cases of nationalization or confiscation.[e]

Source: UNCTAD, Investment Policy Monitor database. Additional examples of investment-related policy measures can be found in UNCTAD's *Investment Policy Monitors* published in 2012 and 2013.
Note: Notes appear at the end of this chapter.

Box III.3. Examples of new regulations for domestic and foreign investment, 2012–2013

Argentina established a committee to supervise investments by insurance and reinsurance companies. The measure is part of a Strategic National Insurance Plan, requiring that insurance companies use part of their invested funds for investment in the real economy.[a]

Indonesia introduced new regulations limiting private bank ownership. They restrict, in principle, ownership in new acquisitions of private banks by financial institutions to 40 per cent, by non-financial institutions to 30 per cent and by individual shareholders in conventional banks to 20 per cent.[b]

Kazakhstan approved a law that establishes the priority right of the State to take part in any new trunk pipeline built in the country, with at least a 51 per cent share.[c]

The Philippines released an executive order putting new mining contracts on hold until new legislation that modifies existing revenue-sharing schemes and mechanisms has taken effect. To ensure compliance with environmental standards, the order also requires a review of the performance of existing mining operations.[d]

Source: UNCTAD, Investment Policy Monitor database. Additional examples of investment-related policy measures can be found in UNCTAD's *Investment Policy Monitors* published in 2012 and 2013.
Note: Notes appear at the end of this chapter.

2. Iindustry-specific investment policies

FDI liberalization and promotion policies predominate in the services industries, while restrictive policies apply particularly in strategic industries.

Most of the investment policy measures undertaken in 2012 related to specific sectors or industries (table III.2). Almost all cross-industry measures were liberalizing and almost all restrictive measures were industry-specific.

a. Services sector

One focus of investment policies was the services sector. As in previous years, FDI liberalization and promotion policies dominated and targeted specific services, including wholesale and retail services and financial services. Between 2003 and 2012, on average approximately 68 per cent of all sector-specific liberalization and promotion policies have related to the service sector. In 2012, this development was most apparent in India, which relaxed FDI regulations in several industries (see box III.1).

Box III.4. Examples of specific FDI regulations and restrictions, 2012–2013

Benin prohibited land ownership by foreign entities, although they are still allowed to enter into long-term leases.[a]

The *Plurinational State of Bolivia* issued a decree that provided for the transfer to the State-owned Empresa Nacional de Electricidad (ENDE) of all the shares of the electricity distribution companies of La Paz (Electropaz) and Light and Power Corporation of Oruro (ELFEO SA), as well as all the shares of the management and investment service companies Business Bolivia SA (Cadeb) and Corporation Service Company (Edeser), all of which were held by Iberbolivia Investment Corporation, belonging to Iberdrola of Spain.[b] It also nationalized Bolivian Airport Services (SABSA), a subsidiary of the Spanish firms Abertis and Aena, which operated the Bolivian airports of El Alto, Cochabamba and Santa Cruz.[c]

The Government of *Canada* has clarified how it applies the Investment Canada Act to investments by foreign State-owned enterprises (SOE). In particular, it announced that it will find the acquisition of control of a Canadian oil-sands business by a foreign SOE to be of net benefit to Canada on an exceptional basis only.[d]

Hungary amended its Constitution to ensure that only citizens can purchase domestic farmland.[e]

Italy established a review mechanism for transactions involving assets of companies operating in the defence or national security sectors, as well as in strategic activities in the energy, transport and communications sectors.[f]

Source: UNCTAD, Investment Policy Monitor database. Additional examples of investment-related policy measures can be found in UNCTAD's *Investment Policy Monitors* published in 2012 and 2013.
Note: Notes appear at the end of this chapter.

b. Strategic industries

Restrictive policies vis-à-vis foreign investors were applied particularly in strategic industries, with a special focus on extractive industries. Almost 40 per cent of all industry-specific regulations and restrictions between 2000 and 2012 were targeted to extractive industries (figure III.2). Other industries frequently exposed to investment-related regulations or restrictions because of their political or economic sensitivity include, for instance, electricity, gas and water supply, and financial services. In addition, all these industries may be subject to non-industry-specific measures, such as limitations on land ownership. The real share of regulatory or restrictive measures that affect strategic or otherwise sensitive industries may therefore be higher (see also section A.3).

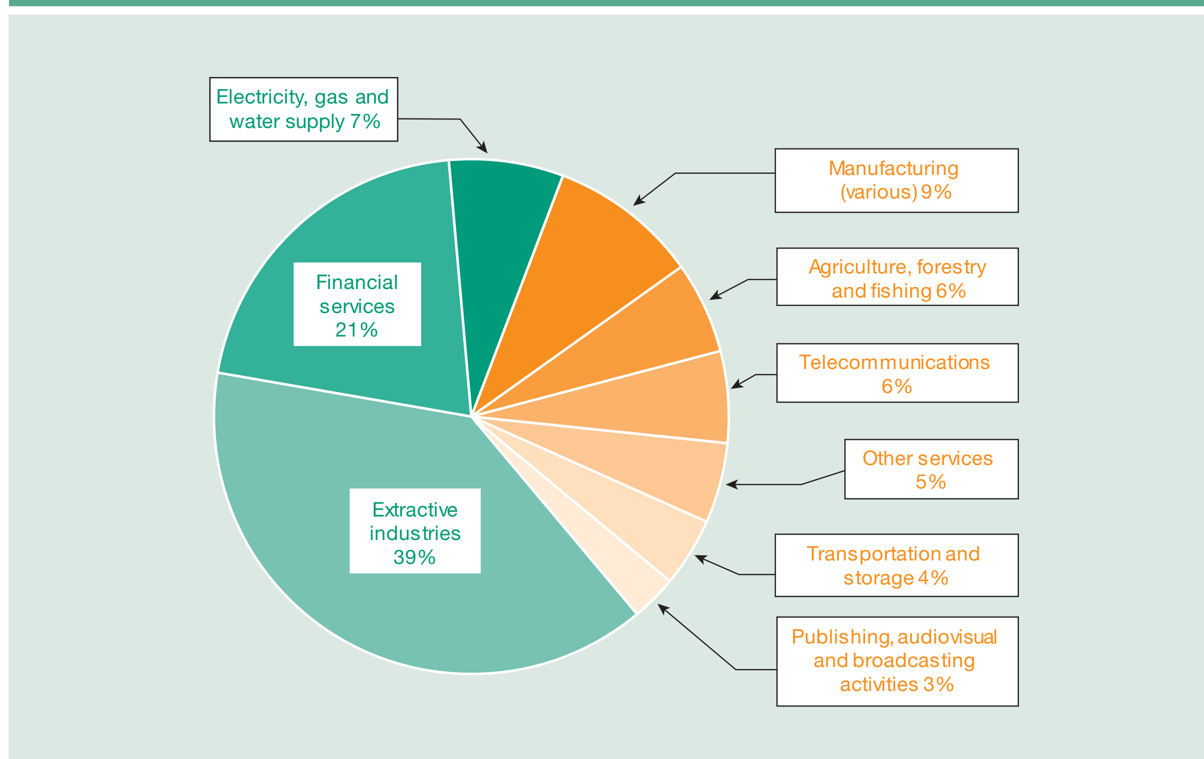
Reasons for FDI regulations in strategic industries are manifold. First, the role of FDI policies in *industrial policies* has changed. In the past, restrictive FDI policies have been applied particularly with a view to promote infant industries or for sociocultural reasons (e.g. land ownership restrictions). This relatively narrow scope has given way to a broader approach, extending nowadays to the protection of national champions, strategic enterprises and critical infrastructure.[1] Second, several countries have tightened their *national security* or *economic benefit* screening procedures for FDI, partially as a reaction to increased investment from State enterprises and sovereign wealth funds and increased FDI in natural resources (both in extractive industries and in agriculture). Third, the

Table III.2. Changes in national investment policies, 2012

Sector/industry	More favourable (%)	Less favourable (%)	Neutral/ indeter-minate (%)	Total number of measures
Total	**74**	**22**	**4**	**120**
Cross-industry	82	8	10	40
Agribusiness	60	40	0	5
Extractive industries	54	46	0	13
Manufacturing	87	13	0	16
Services (total)	70	28	2	46
Electricity, gas and water	50	50	0	10
Transport, storage and communications	85	15	0	13
Financial services	59	33	8	12
Other services	82	18	0	11

Source: UNCTAD, Investment Policy Monitor database.
Note: Because some of the measures can be classified under more than one type, overall totals differ from table III.1.

Figure III.2. Share of industries affected by restritive or regulatory measures, 2000–2012



Source: UNCTAD, Investment Policy Monitor database.

recent *economic and financial crises* may have made governments more responsive to lobbying from industry and civil society to protect the national economy from foreign competition.

3. Screening of cross-border M&As

A considerable number of cross-border M&As have been withdrawn for regulatory or political reasons, in particular during the financial crisis.

Recent years have witnessed an expansion of the role of domestic screening and monitoring mechanisms for inward FDI. While countries remain eager to attract FDI, several have become more selective in their admission procedures. An important case in point: recent policy developments with regard to cross-border M&As.

M&As can bring significant benefits to host countries in terms of transfers of capital, technology and know-how and, especially, increased potential for follow-up investments and business expansions. But M&As can also bring costs, such as a potential downgrading of local capabilities, a weakening of competition or a reduction in employment.[2] FDI policies play an important role in maximizing the benefits and minimizing the costs of cross-border M&As; for instance, through sectoral reservations, ownership regulations, size criteria, competition screening and incentives.[3]

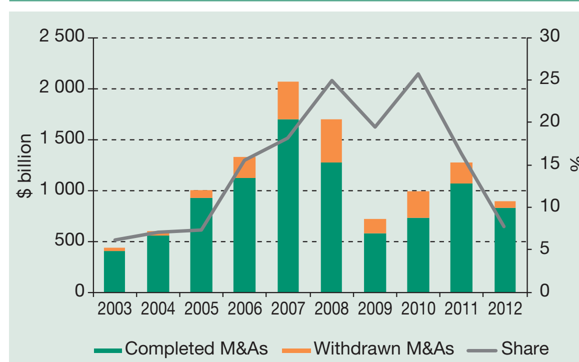
Over the past 10 years, more than 2,000 announced cross-border M&As were withdrawn. These deals represent a total gross value of $1.8 trillion, or on average almost 15 per cent of the total value of cross-border M&As per year (figure III.3).[4] The share of both the number and the value of the withdrawn deals peaked during the financial crisis.

This report analysed 211 of the largest withdrawn cross-border M&As – those with a transaction value of $500 million or more – in the period between 2008 and 2012. Within this group, announced M&As were withdrawn for a variety of reasons (figure III.4).

In most cases, plans were aborted for business considerations; for instance, because the parties could not agree on the financial conditions of the deal or because a third party outbid the potential acquirer (rival bid). Some deals were cancelled because of changes in the general economic conditions (especially in the aftermath of the financial crisis), because of legal disputes related to the planned takeover or because of difficulties in financing the acquisition.

M&As were also withdrawn because of regulatory reasons or political opposition (figure III.4). In some cases, companies did not wait for an official government decision but withdrew their bid upon receiving indications that it would not obtain approval, either for technical reasons or because of perceived general political opposition (e.g. the announced BHP Billiton–Potash Corporation M&A). Sometimes, proposed deals have been revised and then resubmitted to eventually pass the approval procedures in a subsequent round (e.g. the CNOOC–Nexen M&A). In some cases, government interventions may be influenced by a combination of regulatory and political motivations, making it difficult to assess the true motivations for the withdrawal of a deal.[5]

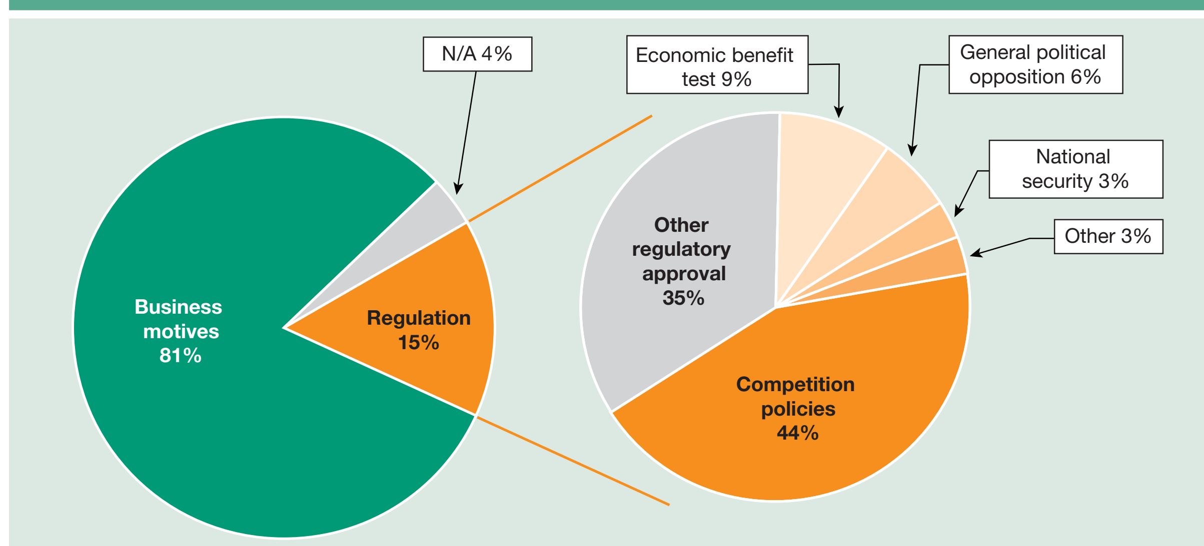
Figure III.3. Gross value of completed and withdrawn cross-border M&As and share of withdrawn M&As, 2003–2012



Source: UNCTAD, based on information from Thomson Reuters database on M&As.

Between 2008 and 2012, M&As withdrawn for regulatory reasons or political opposition had an approximate total gross value of $265 billion (figure III.5).[6] Their share among all withdrawn cross-border M&As stood at about 22 per cent in 2012, with a peak of over 30 per cent in 2010, showing the impact of the financial crisis on governments' regulatory and political stance on cross-border takeovers. Even though the value of withdrawn

Figure III.4. Reasons for withdrawn cross-border M&As, 2008–2012



Source: UNCTAD, based on information from Thomson Reuters database on M&As and various news sources.
Note: Based on number of deals with a value of $500 million or more. The seven separate M&A deals related to the withdrawn Chinalco–Rio Tinto deal are combined here into one.

deals dropped in 2012, their share of all withdrawn cross-border M&As remains relatively high.

The main industry from which M&As were withdrawn during this period was the extractive industry (figure III.6) (e.g. the Chinalco–SouthGobi Resources, BHP Billiton–Potash Corporation, and Chinalco–Rio Tinto M&As). Other key industries targeted include manufacturing, financial services and telecommunications (e.g. the Deutsche Boerse–NYSE Euronext, Singapore Exchange–ASX, and the MTN Group–Bharti Airtel M&As).

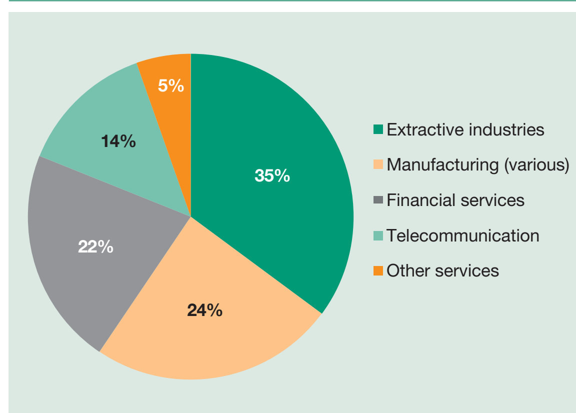
With respect to the countries of the targeted companies, Australia, the United States and Canada constitute the top three – both in number of deals withdrawn and in the value of those deals (table III.3). They are also the top three home countries of companies pursuing deals that were withdrawn because of regulatory reasons or political opposition.

Policy instruments for reviewing and rejecting M&As are manifold. Two basic categories can be distinguished – those applying to M&As irrespective of the nationality of the acquiring company and those applying only to foreign investors (table III.4). The most important example of the first category is competition policy. Competition rules may not only apply to planned M&As in the host country, but extend to M&As in third countries that affect the domestic market (e.g. the Gavilon takeover by Marubeni described in box III.5).[7] Other examples are rules that govern the transferability of shares or the issuance of "golden shares", giving the owner (often the State) voting powers disproportionate to the value of the shares, which can be used to block a hostile takeover, be it domestic or foreign.[8]

Examples of the second category include, in particular, foreign ownership ceilings and domestic screening procedures related to national security considerations, industrial policy objectives or national benefit tests. Countries may also have special screening rules for *individual types of foreign investors*, such as State-owned enterprises, or for *individual investment activities* (e.g. in critical infrastructure). Screening procedures may require a *positive contribution* from the investor to the host economy in order to get the deal approved, or they may require merely that the proposed M&A not have a *negative impact* in the host country.

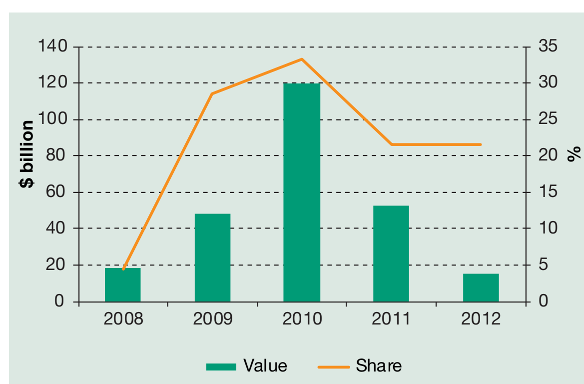
In addition to disapproving M&As, host countries may impose certain conditions before allowing them. This approach is often used in competition policies but may also play a role in other areas; for instance, in the framework of an economic benefits test (box III.5).

Figure III.6. Sectoral distribution of withdrawn cross-border M&As for regulatory reasons or political opposition, 2008–2012



Source: UNCTAD, based on information from Thomson Reuters database on M&As.
Note: Based on number of deals with a value of $500 million or more.

Figure III.5. Gross value of cross-border M&As withdrawn for regulatory reasons or political opposition and their share in the total value of withdrawn cross-border M&As, 2008–2012



Source: UNCTAD, based on information from Thomson Reuters database on M&As.
Note: Based on deals with a value of $500 million or more. In 2010 BHP Billiton withdrew its agreement to merge its Western Australian iron ore assets with the Western Australian iron ore assets of Rio Tinto to form a joint venture in a transaction valued at $58 billion.

Table III.3. Top 10 target and home countries of cross-border M&As withdrawn for regulatory reasons or political opposition, by value, 2008–2012

Rank	Target country			Home country		
	Country/economy	Total value ($ billion)	Number of deals	Country/economy	Total value ($ billion)	Number of deals
1	Australia	87.8	8	Australia	112.9	5
2	United States	54.5	7	United States	47.1	7
3	Canada	43.8	4	China	23.6	5[a]
4	Hungary	15.8	1	Austria	15.8	1
5	South Africa	11.4	1	India	11.4	1
6	India	8.8	1	Germany	10.2	1
7	United Kingdom	6.7	1	South Africa	8.8	1
8	Taiwan Province of China	5.6	3	Singapore	8.3	1
9	Hong Kong, China	4.1	3	France	6.1	1
10	Switzerland	4.0	2	Hong Kong, China	2.2	1

Source: UNCTAD, based on information from Thomson Reuters database on M&As.
Note: Based on deals with a value of $500 million or more.
[a] Combines the seven separate M&A deals related to the withdrawn Chinalco–Rio Tinto deal into one.

There are also *informal* instruments with which a government can hinder unwelcome foreign takeovers. Governments may put political pressure on potential foreign acquirers to prevent an M&A, for instance by indicating that the company will face an unfavourable domestic environment if the deal goes through, or may block an unwelcome foreign takeover by finding a "friendly" domestic buyer (a "white knight"). Another tactic is delay, for instance by establishing new or tightening existing regulatory requirements for the tender or by providing financing only to domestic bidders. Governments may also choose to support the merger of two domestic companies into a new entity that is "too big to be taken over" by foreign firms.[9] By using these informal instruments, governments enter a grey zone where it is difficult to challenge government actions in the courts.

Finally, there are recent examples of "post M&A" government policies aimed at reversing a foreign acquisition. In some cases, host governments nationalized companies after their acquisition by foreign investors; in other cases, governments purchased the foreigners' shares or introduced policies that negatively affected the operating conditions of foreign-owned companies.

Table III.4. Policy instruments affecting cross-border M&As

Applying only to foreign investors	Applying to both foreign and domestic investors
Formal	**Formal**
1. Ownership ceilings	1. Screening competition authority
2. FDI screening - National security - Economic benefit - Other screening (e.g. critical infrastructure)	2. Rules on transferability of shares (e.g. "poison pill", mandatory takeover) 3. "Golden share" options
Informal	
1. Delaying takeover procedures foreign acquisition	
2. Financial support of domestic companies	
3. Promotion of domestic mergers	
4. Political pressure	

Source: UNCTAD.

Box III.5. Examples of cross-border M&As disapproved by governments or approved only under conditions, 2008–2012

In recent years, governments reviewed a considerable number of cross-border M&As for regulatory reasons related to e.g. competition policies, economic benefit tests and national security. Some of the decisions applied to M&As that were planned in third countries, meaning that policies were applied with extraterritorial effect.

Deutsche Boerse–NYSE Euronext (2012)
Regulators in the European Union vetoed the plan by Deutsche Boerse AG and NYSE Euronext to create the world's biggest exchange, after concluding that the merger would hurt competition.[a]

Singapore Exchange–ASX (2011)
The Australian Government rejected a major foreign takeover on national interest grounds for the first time since 2001, when it blocked Royal Dutch Shell's bid for Woodside Petroleum. The Australian Treasurer said the deal would have diminished Australia's economic and regulatory sovereignty, presented material risks and supervisory issues because of ASX's dominance over clearing and settlement, and failed to boost access to capital for Australian businesses.[b]

BHP Billiton–Potash Corporation (2010)
In November 2010, the Minister of Industry rejected BHP Billiton's proposed $38.6 billion acquisition of Potash Corp. as it did not show a "net benefit" to Canada, as required under foreign investment regulations. Although BHP had 30 days to come up with a proposal that would satisfy Ottawa, the company instead chose to withdraw its takeover offer.[c]

PETRONAS–Progress (2012)
The Minister of Industry of Canada approved the acquisition of the Canadian company Progress Energy Resources Corporation by PETRONAS Carigali Canada Ltd. (owned by the national oil and gas company of Malaysia). The Ministry announced that the investment is likely to be of net benefit to Canada after PETRONAS made significant commitments in relation to its governance and commercial orientation as well as to employment and capital investments that demonstrated a long-term commitment to the development of the Canadian economy.[d]

Marubeni–Gavilon (2012)
The Ministry of Commerce of China approved the acquisition of the United States grain supplier Gavilon Group LLC by the Marubeni Corporation of Japan, after imposing significant conditions in the Chinese soyabean market, including that Marubeni and Gavilon continue selling soya to China as separate companies, with different teams and with firewalls between them blocking the exchange of market intelligence.[e]

Rhodes–Del Monte (2011)
The Competition Commission of South Africa approved the acquisition by Rhodes Food Group of the business of its competitor Del Monte Fruits with behavioural conditions that addressed employment issues. Otherwise, the merged entity would have had a negative effect on employment as about 1,000 seasonal employees could have lost their jobs during the next canning season.[f]

Alliant Techsystems–Macdonald Dettwiler (2008)
MacDonald Dettwiler and Associates, a Canadian aerospace, information services and products company, tried to sell its Information Systems and Geospatial Services operations to Alliant Techsystems (United States). The Government of Canada rejected the sale on national security grounds related to the company's Radarsat-2 satellite.[g]

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

4. Risk of investment protectionism

As government regulation, screening and monitoring grow, so does the risk that such measures can hide protectionist aims.

As countries make more use of industrial policies, tighten screening and monitoring procedures, closely scrutinize cross-border M&As and become more restrictive with regard to the degree of FDI involvement in strategic industries, the risk that some of these measures are taken for protectionist purposes grows.[10] With the emergence and rapid expansion of international production networks, protectionist policies can backfire on all actors, domestic and foreign, in such value chains (see also chapter IV).

In the absence of a commonly recognized definition of "investment protectionism", it is difficult to clearly identify measures of a protectionist nature among

investment regulations or restrictions.[11] Countries may have good reasons for restraining foreign investment. Restrictive or selective FDI policies have been recognized as potentially important elements of a development strategy and often are used for specific public policy purposes. National security considerations may also justify FDI restrictions. The problem is that what may be a legitimate reason to restrict investment for one country may not be justifiable in the view of others.

Efforts should be undertaken at the international level to clarify the meaning of "investment protectionism", with a view to establishing a set of criteria for identifying protectionist measures against foreign investment. Fact-finding endeavours could build upon UNCTAD's *Investment Policy Monitor* publications, which regularly report on developments in national and international investment policies, and the biannual UNCTAD-OECD reports on investment measures by G-20 countries.

At the national level, technical assistance can help promote quality regulation rather than overregulation. With regard to FDI policies, this means that a country's specific public policy needs should be the main guidance for the design and scope of restrictions. The non-discrimination principle included in most IIAs provides an additional benchmark for assessing the legitimacy of investment restrictions. It would also be helpful to consider extending the G-20's commitment to refrain from protectionism – and perhaps also expanding the coverage of monitoring to the whole world.

UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) can serve as a point of reference. The IPFSD – which consists of a set of Core Principles for investment policymaking, guidelines for national investment policies and options for the design of IIAs – calls for an open and welcoming investment climate, while recognizing the need of governments to regulate investment for the common good (*WIR12*).

B. INTERNATIONAL INVESTMENT POLICIES

1. Trends in the conclusion of IIAs

a. *Continued decline in treaty-making*

Although the IIA universe continues to expand and numerous negotiations are under way, the annual treaty tally has dropped to an all-time low.

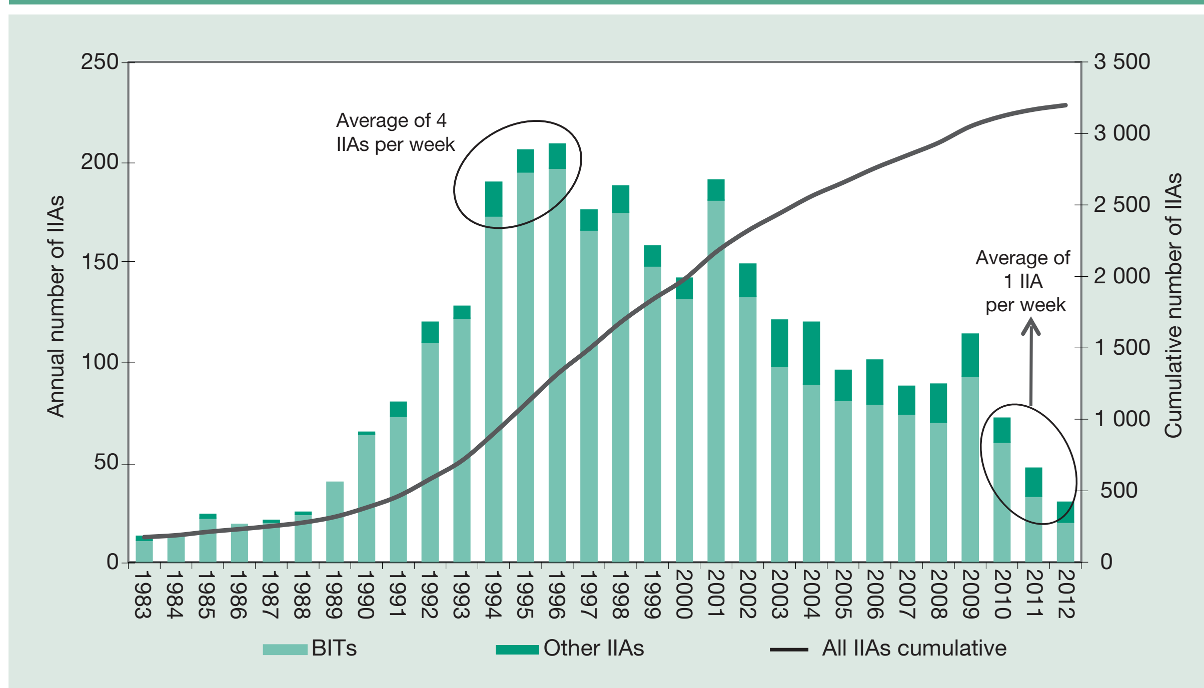
Last year saw the conclusion of 30 IIAs (20 BITs and 10 "other IIAs"[12]), bringing the total to 3,196 (2,857 BITs and 339 "other IIAs") by year-end (see annex table III.1 for a list of each country's total number of BITs and "other IIAs"). BIT-making bottomed out in 2012, with only 20 BITs signed – the lowest annual number in a quarter century.

This slowdown is revealed distinctly in multi-year period comparisons (figure III.7). From 2010 to 2012, on average one IIA was signed per week. This was a quarter of the frequency rate during the peak period in the 1990s, when an average of four treaties were concluded per week.

Of the 10 "other IIAs" concluded in 2012, eight were regional agreements. Whereas BITs largely resemble each other, "other IIAs" differ substantially. The agreements concluded in 2012 can be grouped into three broad categories, as identified in *WIR 2010* (chapter III.B):

- *IIAs with BIT-equivalent provisions.* The Australia–Malaysia Free Trade Agreement (FTA) and the China–Japan–Republic of Korea investment agreement fall in the category of IIAs that contain obligations commonly found in BITs, including substantive standards of investment protection and provisions for investor–State dispute settlement (ISDS).

Figure III.7. Trends in IIAs, 1983–2012



Source: UNCTAD.

- *IIAs with limited investment provisions.* The EU agreements with Peru and Colombia, Iraq, and the Central American States contain limited investment provisions (e.g. pre-establishment national treatment based on a positive-list approach, free movement of capital relating to direct investments). The Chile–Hong Kong (China) FTA also belongs in this category (e.g. national treatment for the establishment of companies, services and service suppliers, including in the financial sector, according to each party's schedule).

- *IIAs with investment cooperation provisions and/or a future negotiating mandate.* The Gulf Cooperation Council (GCC) Framework Agreements with Peru and the United States, the EU–Viet Nam Framework Agreement and the Pacific Alliance Framework Agreement (Chile, Colombia, Mexico and Peru) fall in the third category. These agreements contain general provisions on cooperation in investment matters and/or a mandate for future negotiations on investment.

b. Factoring in sustainable development

New IIAs illustrate the growing tendency of policymakers to craft treaties in line with sustainable development objectives.

A perusal of the content of the 17 IIAs concluded in 2012 for which texts are available shows that they increasingly include sustainable-development-oriented features.[13] Of these IIAs, 12 (including 8 BITs) refer to the protection of health and safety, labour rights, environment or sustainable development in their preamble; 10 (including 6 BITs) have general exceptions – e.g. for the protection of human, animal or plant life or health, or the conservation of exhaustible natural resources;[14] and 7 (including 4 BITs) contain clauses that explicitly recognize that parties should not relax health, safety or environmental standards to attract investment. References to CSR occur less frequently but can be found in the "trade and sustainable development" chapter of the EU–Colombia–Peru FTA and in the preamble of

the China–Japan–Republic of Korea investment agreement (see annex table III.2 for details).

These sustainable development features are supplemented by treaty elements that aim more broadly to preserve regulatory space for public policies in general or to minimize exposure to investment litigation in particular. The analysed agreements include provisions that (i) focus the treaty scope narrowly (e.g. by excluding certain assets from the definition of investment), (ii) clarify obligations (by crafting detailed clauses on fair and equitable treatment or indirect expropriation); (iii) set forth exceptions to the transfer-of-funds obligation or carve-outs for prudential measures; or (iv) carefully regulate access to ISDS (clauses that, e.g. limit treaty provisions that are subject to ISDS, exclude certain policy areas from ISDS, set out a special mechanism for taxation and prudential measures, or restrict the allotted time period within which claims can be submitted). Some agreements leave out umbrella clauses or omit ISDS altogether.

All of the 17 IIAs signed in 2012 for which texts were available included one or more provisions along these lines. Many of these provisions correspond to policy options featured in UNCTAD's Investment Policy Framework for Sustainable Development or IPFSD, set out in chapter IV of *WIR12*.

2. Trends in the negotiation of IIAs

a. Regionalism on the rise

More than 110 countries involved in 22 negotiations.

The importance of regionalism, evident from the fact that 8 of the 10 "other IIAs" concluded in 2012 were regional ones, is also manifest in current negotiations. By 2013 at least 110 countries were involved in 22 negotiations.[15] Regional and inter-regional investment treaty-making involving more than two parties can take different forms – notably, negotiations within a regional grouping, negotiations between a regional bloc and a third country, or negotiations between like-minded countries. Some of the regional investment policy developments are described below.

Asia

On 22 November 2012, ASEAN officially launched negotiations with Australia, China, India, Japan, New Zealand and the Republic of Korea on a Regional Comprehensive Economic Partnership Agreement (RCEP). The RCEP seeks to create a liberal, facilitative and competitive investment environment in the region. Negotiations on investment under the RCEP will cover the four pillars of promotion, protection, facilitation and liberalization, based on its Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership.[16] The RCEP agreement will be open for accession by any ASEAN FTA partner that did not participate in the RCEP negotiations and any other partner country after the conclusion of the RCEP negotiations.

On 20 December 2012, ASEAN and India concluded negotiations on trade in services and on investment. The ASEAN–India Trade in Services and Investment Agreements were negotiated as two stand-alone treaties pursuant to the 2003 Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India. The agreements are expected to complement the already signed FTA in goods.[17]

Latin America

In 2012, Chile, Colombia, Mexico and Peru signed a framework agreement that established the Pacific Alliance as a deep integration area – an initiative launched in 2011.[18] In line with the mandate established therein, negotiations continue for the free movement of goods, services, capital and people and the promotion of investment on the basis of the existing trade and investment frameworks between the parties. The investment negotiations emphasize objectives to attract sustainable investment and address novel elements such as responsible investment and CSR.

Africa

Negotiations towards the creation of a free trade area between the Southern African Development Community, the East African Community and the Common Market for Eastern and Southern Africa (COMESA) picked up momentum in 2012 with the establishment of the Tripartite Trade Negotiation

Forum, the body responsible for technical negotiations and guided by the road map adopted for the negotiations. Investment talks are scheduled as part of the second phase of negotiations, envisaged to commence in the latter half of 2014.[19]

Europe

In Europe, regional treaty-making activity is dominated by the European Union (EU), which negotiates as a bloc with individual countries or other regions.[20] Most of the recently launched negotiations encompass investment protection and liberalization. This is in line with the shift of competence over FDI from Member States to the EU after the entry into force in December 2009 of the Lisbon Treaty (*WIR10*, *WIR11*). Since new EU-wide investment treaties will eventually replace BITs between the EU Member States and third parties, these negotiations will contribute to a consolidation of the IIA regime (see section 2.2).

(i) Recently launched negotiations[21]

On 1 March 2013, the EU and Morocco launched negotiations for a Deep and Comprehensive Free Trade Agreement (DCFTA). Morocco is the first Mediterranean country to negotiate a DCFTA with the EU that includes investment. Negotiations with Egypt, Jordan and Tunisia are expected to follow.[22]

On 6 March 2013, FTA negotiations between the EU and Thailand were officially launched. In addition to investment liberalization, negotiations will also cover tariff reduction, non-tariff barriers and other issues, such as services, procurement, intellectual property, regulatory issues, competition and sustainable development.[23]

On 12 March 2013, the European Commission requested Member States' approval to start negotiations towards a Transatlantic Trade and Investment Partnership (TTIP) with the United States.[24] Besides investment, the TTIP is expected to include reciprocal market opening in goods and services and to foster the compatibility of regulatory regimes. With respect to investment, the EU–United States High-Level Working Group on Jobs and Growth has recommended that the future treaty include investment liberalization and protection provisions based on the highest levels of liberalization and protection standards that both sides have negotiated to date.[25] It also recommended "that the two sides explore opportunities to address these important issues, taking into account work done in the Sustainable Development Chapter of EU trade agreements and the Environment and Labor Chapters of U.S. trade agreements".[26]

On 25 March 2013, the EU and Japan officially launched negotiations for an FTA.[27] Both sides aim to conclude an agreement covering the progressive and reciprocal liberalization of trade in goods, services and investment, as well as rules on trade-related issues.[28]

(ii) Ongoing negotiations[29]

The EU is negotiating a Comprehensive Economic and Trade Agreement (CETA) with Canada. The CETA will likely be the first EU agreement to include a substantive investment protection chapter (adopting the post-Lisbon approach).[30]

Following the conclusion of free trade negotiations between the EU and Singapore in December 2012, the two sides are pursuing talks on a stand-alone investment agreement – again, based on the new EU competence under the Lisbon Treaty.[31] The FTA between the EU and India, under negotiation since 2007, is expected to include a substantive investment protection chapter (also following the post-Lisbon approach).[32]

EU negotiations with Armenia, Georgia and the Republic of Moldova are under way and address establishment-related issues, among other elements. In addition, negotiations to strengthen investment-related provisions in existing partnership and cooperation agreements are under way with Azerbaijan, Kazakhstan and China.[33]

Interregional negotiations

In terms of interregional negotiations – i.e. those conducted between numbers of individual countries from two or more geographical regions – discussions on the Trans-Pacific Partnership Agreement (TPP) continued, with the 17th negotiation round concluded in May 2013.[34] As of May 2013, 11 countries were participating in the negotiations – namely Australia, Brunei Darussalam, Canada, Chile, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Viet Nam.

Japan officially declared its intention to join the TPP negotiations on 13 March 2013, and Thailand has also expressed its interest in joining. The agreement is expected to include a fully fledged investment chapter containing typical standards of investment liberalization and protection.

In North Africa and the Middle East, Arab countries are expected to continue discussions and negotiations on a revised Unified Agreement for the Investment of Arab Capital in the Arab States. A draft text was adopted early in 2013, ensuring free movement of capital and providing national treatment and most-favoured-nation (MFN) status to investments.

Progress in 2013 is also expected in the interregional negotiations between the EU and MERCOSUR (the Mercado Común del Sur), which were first launched in 2000. Those negotiations had stalled for several years, but were relaunched in May 2010 at the EU–LAC Summit in Madrid.[35]

In the context of the World Trade Organization (WTO), a new, informal group of WTO Members, spurred by the WTO Doha Round impasse, is discussing a Trade in Services Agreement. Twenty-two WTO Members, also known as the "Real Good Friends of Services",[36] are participating in the talks.[37] The proposed agreement builds on the WTO General Agreement on Trade in Services (GATS) and targets liberalization commitments beyond those currently prevailing under the GATS.[38] The scheduling of market access obligations is envisaged to follow the format generally used by WTO Members under the GATS, based on a "positive-list approach".[39] In contrast, national treatment commitments are intended to apply across all service sectors, combined with "standstill" and "ratchet" obligations, which may be subject to reservations. Although the new trade in services agreement will address all four modes of trade in services, particular attention is said to be given to mode 3 (commercial presence, akin to investment). Accordingly, some stakeholders explicitly refer to the investment dimension of the current discussions.[40] Negotiating Members hope to eventually multilateralize the results of the negotiations, if a critical mass of WTO Members can be convinced to participate.

As governments continue concluding BITs and "other IIAs" with the support of business and the private sector, other stakeholders are voicing different opinions about the costs and benefits of IIAs, and the optimal future orientation of such agreements (*WIR11*, chapter III). The past 12 months have witnessed numerous expressions of opposition to ongoing IIA negotiations around the globe.

Examples include lawyers based in Australia, New Zealand and the United States urging TPP negotiators to abandon plans to include ISDS;[41] the Citizens Trade Campaign, representing 400 labour, consumer and environmental groups, petitioning the United States Congress about multiple perceived rights-infringing aspects of the TPP and other 21st century agreements;[42] 13 Thai groups, representing environmental and consumer interests, urging to rethink Thailand's position on joining the TPP negotiations;[43] more than 80 civil society organizations from nine countries issuing a statement opposing "excessive corporate rights" in the CETA;[44] a coalition of Indian and European non-government organizations[45] and European parliamentarians[46] opposing the investment chapter of the EU–India FTA; the Hupacasath First Nation challenging in Canadian courts the recently signed Canada–China BIT, alleging that the government had failed to fulfil its constitutional obligation to consult First Nations on this agreement and claiming that it would adversely impact First Nations' rights.[47]

b. Systemic issues arising from regionalism

Although regionalism provides an opportunity to rationalize the IIA regime, the current approach risks adding a layer of complexity.

The current IIA regime is known for its complexity and incoherence, gaps and overlaps. Rising regionalism in international investment policymaking presents a rare opportunity to rationalize the regime and create a more coherent, manageable and development-oriented set of investment policies. In reality, however, regionalism is moving in the opposite direction, effectively leading to a multiplication of treaty layers, making the network of international investment obligations even more complex and prone to overlap and inconsistency.

An analysis of 11 regional IIAs signed between 2006 and 2012 reveals that most treaties do not provide for the phasing out of older BITs. Instead, most treaty provisions governing the relationship between regional agreements and other (investment) treaties allow for the continuing existence of the BITs in parallel with the regional treaty (table III.5).

Regional IIAs use different language to regulate the relationship between prior BITs and the new treaty. Some expressly confirm parties' rights and obligations under BITs, which effectively means that the pre-existing BITs remain in force. This is done, for example, by referring to an annexed list of BITs (e.g. the Consolidated European Free Trade Agreement, or CEFTA) or to all BITs that exist between any parties that are signatories to the regional agreement (e.g. China–Japan–Republic of Korea investment agreement). Some IIAs include a more general provision reaffirming obligations under *any* agreements to which "a Party" is party (e.g. the ASEAN Common Investment Area, as well as agreements between ASEAN and China, and ASEAN and the Republic of Korea).

Another group of regional IIAs includes clauses reaffirming obligations under agreements to which "the Parties" are party (e.g. the ASEAN–Australia–New Zealand FTA, CAFTA, and COMESA). This ambiguous language leaves open the question of whether prior BITs remain in force and will co-exist with the regional IIAs.[48]

A regional agreement can also provide for the replacement of a number of prior IIAs, as is the case with the Central America–Mexico FTA, [49] or they can simply remain silent on this issue. In the latter scenario, the rules of the Vienna Convention on the Law of Treaties[50] on successive treaties that relate to the same subject matter could help to resolve the issue.

The parallel existence of such prior BITs and the more recent regional agreements with investment provisions has systemic implications and poses a number of legal and policy questions. For example, parallelism raises questions about how to deal with possible inconsistencies between the treaties. While some IIAs include specific "conflict rules", stating which treaty prevails in the case of an inconsistency,[51] others do not. In the absence of such a conflict rule, the general rules of international law enshrined in the Vienna Convention on the Law of Treaties (notably, the "lex posterior" rule) apply. Next, parallelism may pose a challenge in the context of ISDS. Parallel IIAs may create situations in which a single government measure could be challenged by the same foreign investor twice, under two formally different legal instruments.

Parallelism is also at the heart of systemic problems of overlap, inconsistency and the concomitant lack of transparency and predictability arising from a multi-faceted, multi-layered IIA regime. It adds yet another layer of obligations and further complicates

Table III.5. Relationship between regional and bilateral IIAs (illustrative)

Regional Agreement	Affected bilateral treaties	Relationship	Relevant article
ASEAN Comprehensive Investment Agreement (2009)	26	Parallel	Article 44
COMESA Common Investment Area (CCIA) (2007)	24	Parallel[a]	Article 32
SADC Protocol on Finance and Investment (2006)	16	Silent	N.A.
Consolidated Central European Free Trade Agreement (CEFTA) (2006)	11	Parallel	Article 30
ASEAN–China Investment Agreement (2009)	10	Parallel	Article 23
Eurasian Economic Community investment agreement (2008)	9	Silent	N.A.
ASEAN–Republic of Korea Investment Agreement (2009)	8	Parallel	Article 1.4
Dominican Republic–Central America–United States FTA (CAFTA) (2004)	4	Parallel[a]	Article 1.3
Central America–Mexico FTA (2011)	4	Replace	Article 21.7
China–Japan–Republic of Korea investment agreement (2012)	3	Parallel	Article 25
ASEAN–Australia–New Zealand FTA (2009)	2	Parallel[a]	Article 2 (of chapter 18)

Source: UNCTAD.
Note: All except CEFTA include substantive and procedural investment protection provisions as commonly found in BITs. (CEFTA contains some BIT-like substantive obligations but no ISDS mechanism.)
[a] The language of the relevant provision leaves room for doubt as to whether it results in the parallel application of prior BITs and the regional IIA.

countries' ability to navigate the complex spaghetti bowl of treaties and pursue a coherent, focused IIA strategy.

Current regional negotiations present an opportunity to consolidate the IIA regime.

Although parallelism appears to be the prevalent approach, current regional IIA negotiations nevertheless present a window of opportunity to consolidate the existing network of BITs. Nine current regional negotiations that have BIT-type provisions on the agenda may potentially overlap with close to 270 BITs, which constitute nearly 10 per cent of the global BIT network (table III.6). The extent to which parties opt to replace *several* existing BITs with an investment chapter in *one* regional agreement could help consolidate the IIA network.

Such an approach is already envisaged in the EU context, where Regulation 1219/2012, adopted in December 2012, sets out a transitional arrangement for BITs between EU Member States and third countries. Article 3 of the Regulation stipulates that "without prejudice to other obligations of the Member States under Union law, bilateral investment agreements notified pursuant to article 2 of this Regulation may be maintained in force, or enter into force, in accordance with the [Treaty on the Functioning of the European Union] and this Regulation, *until a bilateral investment agreement between the Union and the same third country enters into force*." (Italics added.)

3. IIA regime in transition

a. Options to improve the IIA regime

Interpretation, revision, replacement, termination – they all offer opportunities to improve the IIA regime.

Many countries have accumulated a stock of older BITs that were concluded in the 1990s, before the rise of ISDS cases prompted a more cautious approach. The risks exposed by this growing number of disputes, together with countries' desire to harness the sustainable development contribution of foreign investment, has led to the emergence of "new generation" IIAs (*WIR12*). The desire to move towards a more sustainable regime has precipitated a debate about possible ways to reform the IIA regime.

Countries have several avenues for taking preemptive or corrective action, depending on the depth of change they wish to achieve:

Interpretation. As drafters and masters of their treaties, States retain interpretive authority over them. While it is the task of arbitral tribunals to rule on ISDS claims and interpret and apply IIAs to this end, the contracting States retain the power to *clarify* the meaning of treaty provisions through authoritative interpretations – stopping short, however, of attaching a *new* or *different* meaning to treaty provisions that would amount to their amendment.[52] The interpretative statement issued

Table III.6. Regional initiatives under negotiation and existing BITs between the negotiating parties (illustrative)

Regional initiative	Existing BITs between negotiating parties
Inter-Arab investment draft agreement	96
Regional Comprehensive Economic Partnership Agreement (RCEP) between ASEAN and Australia, China, India, Japan, New Zealand and the Republic of Korea	68
Comprehensive Economic and Trade Agreement (CETA)	23
Trans-Pacific Partnership Agreement (TPP)	21
EU–India FTA	20
EU–Morocco Deep and Comprehensive Free Trade Area (DCFTA)	12
EU–Singapore FTA	12
EU–Thailand FTA	8
EU–United States Transatlantic Trade and Investment Partnership (TTIP)	8

Source: UNCTAD.
Note: These nine regional negotiations cover investment protection issues as currently addressed in BITs.

by the NAFTA Free Trade Commission (clarifying among other things the “minimum standard of treatment”) is an example of this approach.[53]

Revision. Revision can be pursued through amendments that are used to modify or suppress existing provisions in a treaty or to add new ones. Amendments are employed when the envisaged changes do not affect the overall design and philosophy of the treaty and, usually, are limited in number and length. Amendments require the consent of all contracting parties, often take the form of a protocol to the treaty and typically require domestic ratification. An example is the amendment of 21 BITs by the Czech Republic, following its accession to the EU in May 2004, which was aimed at ensuring consistency between those BITs and EU law with regard to exceptions to the free transfer-of-payments provision.

Replacement. Replacement can be done in two ways. First, a BIT might be replaced with a new one as a result of a renegotiation (i.e. conclusion of a new treaty between the same two parties).[54] Second, one or several BITs can be replaced through the conclusion of a new plurilateral/regional agreement. The latter case leads to the consolidation of the IIA network if *one* new treaty replaces several old ones, entailing a reduction in the overall number of existing treaties. One of the few examples of this second approach is the Central America–Mexico FTA, which provides for the replacement of a number of FTAs; i.e. the FTAs between Mexico and Costa Rica (1994); Mexico and El Salvador, Guatemala and Honduras (2000); and Mexico and Nicaragua (1997) (see section B.2.1).

Termination. A treaty can be terminated unilaterally or by mutual consent. The Vienna Convention allows parties to terminate their agreement by mutual consent at any time.[55] Rules for unilateral treaty termination are typically set out in the BIT itself.[56] Treaty termination may result from a renegotiation (replacing the old BIT with a new one). It can also be done with the intent to relieve respective States of their treaty commitments (eliminating the BIT). Furthermore, a *notice* of termination can be an attempt to bring the other contracting party back to the negotiation table. Countries that have terminated their BITs include the Bolivarian Republic of Venezuela (denouncing its BIT with the Netherlands in 2008), Ecuador (denouncing nine of its BITs in 2008),[57] the Plurinational State of Bolivia (denouncing its BIT with the United States in 2011) and South Africa (denouncing one BIT in 2012). Countries wishing to unilaterally terminate their IIAs – for whatever reason – need to have a clear understanding of the relevant treaty provisions (box III.6), as well as the implications of such actions.

Depending on their IIA strategy (see section E.1. of the IPFSD) and the degree of change they wish to achieve, countries may wish to carefully consider options appropriate to reach their particular policy goals and accordingly adapt tools to implement them. To the extent that contracting parties embark on changes by mutual consent, the range of options is vast and straightforward. The situation becomes more complex, however, if only one party to an IIA wishes to amend, renegotiate or terminate the treaty.

b. Treaty expirations

By the end of 2013, more than 1,300 BITs will have reached their “anytime termination stage”.

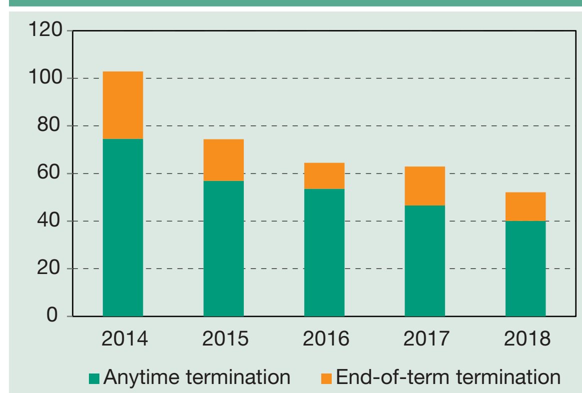
BIT-making activity peaked in the 1990s. Fifteen years on, the inclination to enter into BITs has bottomed out. This has brought the IIA regime to a juncture that provides a window of opportunity to effect systemic improvement.[58] As agreements reach their expiry date, a treaty partner can opt for automatic prolongation of the treaty or notify its wish to revoke a treaty.[59] The latter option gives treaty partners an opportunity to revisit their agreements, with a view to addressing inconsistencies and overlaps in the multi-faceted and multi-layered IIA regime. Moreover, it presents the opportunity to strengthen its development dimension.

In September 2012, South Africa informed the Belgo–Luxembourg Economic Union, through a notice of termination, that it would not renew the existing BIT, which was set to expire in March 2013. South Africa further stated its intent to revoke its BITs with other European partners, as most of these treaties were reaching their time-bound window for

termination which, if not used, would trigger the automatic extension of these agreements for 10 years or more.[60]

The significant number of expired or soon-to-expire BITs creates distinct opportunities for updating and improving the IIA regime. Between 2014 and 2018, at least 350 BITs will reach the end of their initial duration. In 2014 alone, the initial fixed term of 103 BITs will expire (figure III.9). After reaching the end of the initial fixed term, most BITs can be unilaterally terminated at any time by giving notice ("anytime termination"); the minority of BITs – if not terminated at the end of the initial term – are extended for subsequent fixed terms and can be unilaterally terminated only at the end of each subsequent term ("end-of-term termination") (see box III.6).

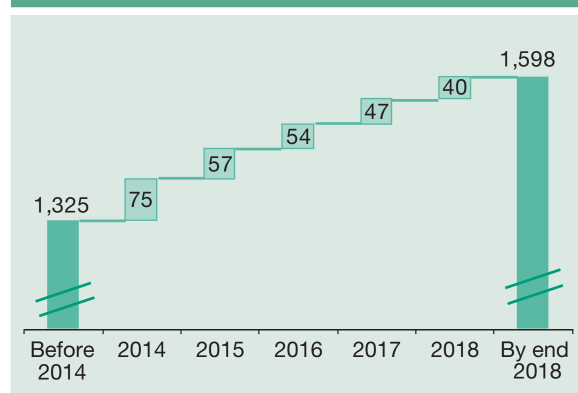
Figure III.8. BITs reaching the end of their initial term, 2014–2018



Source: UNCTAD.
Methodology: Data for BITs in force; derived from an examination of BITs for which texts were available, extrapolated to BITs for which texts were unavailable. Extrapolation parameters were obtained on the basis of a representative sample of more than 300 BITs.

The great majority of BITs set the initial treaty term at 10 years or 15 years, and about 80 per cent of all BITs provide for the "anytime termination" approach after the end of the initial term. Given that a large proportion of the existing BITs were signed in the 1990s and that most of them have reached the end of their initial period, the overall number of BITs that can be terminated by a party at any time is estimated to exceed 1,300 by the end of 2013. This number will continue to grow as BITs with the "anytime termination" option reach their expiry dates (figures III.8 and III.9).

Figure III.9. Cumulative number of BITs that can be terminated or renegotiated at any time



Source: UNCTAD.
Methodology: Data for BITs before 2014 with an "anytime termination" option; based on an examination of a representative sample of more than 300 BITs, extrapolated to the universe of BITs in force after accounting for the initial fixed term of treaty duration.

Using treaty expirations to instigate change in the IIA regime is not a straightforward endeavour. First, there is a need to understand how BIT rules on treaty termination work, so as to identify when opportunities arise and what procedural steps are required (see box III.6).

A second challenge originates from the "survival clause", contained in most BITs, which prevents unilateral termination of the treaty with immediate effect. It prolongs the exposure of the host State to international responsibility by extending the treaty's application for a further period, typically 10 or 15 years.[61]

Third, renegotiation efforts aimed at reducing or rebalancing treaty obligations can be rendered futile by the MFN obligation. If the scope of the MFN clause in the new treaty is not limited, it can result in the unanticipated incorporation of stronger investor rights from IIAs with third countries. Hence, in case of amendments and/or renegotiations that reduce investors's rights, IIA negotiators may wish to formulate MFN provisions that preclude the importation of substantive IIA provisions from other IIAs.[62]

In addition, countries need to analyse the pros and cons of treaty termination and its implications for the overall investment climate and existing investment.

Box III.6. Treaty termination and prolongation clauses

BITs usually specify that they shall remain in force for an initial fixed period, most typically 10 or 15 years. Very few treaties do not set forth such an initial fixed term, providing for indefinite duration from the outset.

BITs that establish an initial term of application typically contain a mechanism for their prolongation. Two approaches are prevalent. The first states that, after the end of the initial fixed term and unless one party opts to terminate, the treaty shall continue to be in force indefinitely. However, each party retains the right to terminate the agreement at any time by giving written notice. The second approach provides that the treaty shall continue to be in force for additional fixed terms (usually equal in length to the initial term, sometimes shorter), in which case the treaty can be terminated only at the end of each fixed period.

The majority of BITs thus fall in one of the two categories: (1) those that can be terminated at any time after the end of an initial fixed term, and (2) those that can be terminated only at the end of each fixed term. These two options may be referred to as "anytime termination" and "end-of-term termination" (see box table III.6.1).

Box table III.6.1. Types of BITs termination clauses

Anytime termination			End-of-term termination
Duration: Initial fixed term; automatic renewal for an indefinite period	**Duration:** Initial fixed term; automatic renewal for further fixed terms	**Duration:** No initial fixed term; indefinite duration from the start	**Duration:** Initial fixed term; automatic renewal for further fixed terms
Termination: (1) At the end of the initial fixed term (2) At any time after the end of the initial fixed term	**Termination:** (1) At the end of the initial fixed term (2) At any time after the end of the initial fixed term	**Termination:** At any time	**Termination:** (1) At the end of the initial fixed term (2) At the end of each subsequent fixed term
Example: Hungary–Thailand BIT (1991)	**Example:** Iceland–Mexico BIT (2005)	**Example:** Armenia–Canada BIT (1997)	**Example:** Azerbaijan–Belgium/Luxembourg BIT (2004)

The "anytime termination" model provides the most flexibility for review as the parties are not tied to a particular date by which they must notify the other party of their wish to terminate the BIT. The "end-of-period" model, in contrast, provides opportunities to terminate the treaty only once every few years. Failure to notify the intention to terminate within a specified notification period (usually either 6 or 12 months prior to the expiry date) will lock the parties into another multi-year period during which the treaty cannot be unilaterally terminated.

Source: UNCTAD.

4. Investor–State arbitration: options for reform

a. ISDS cases continue to grow

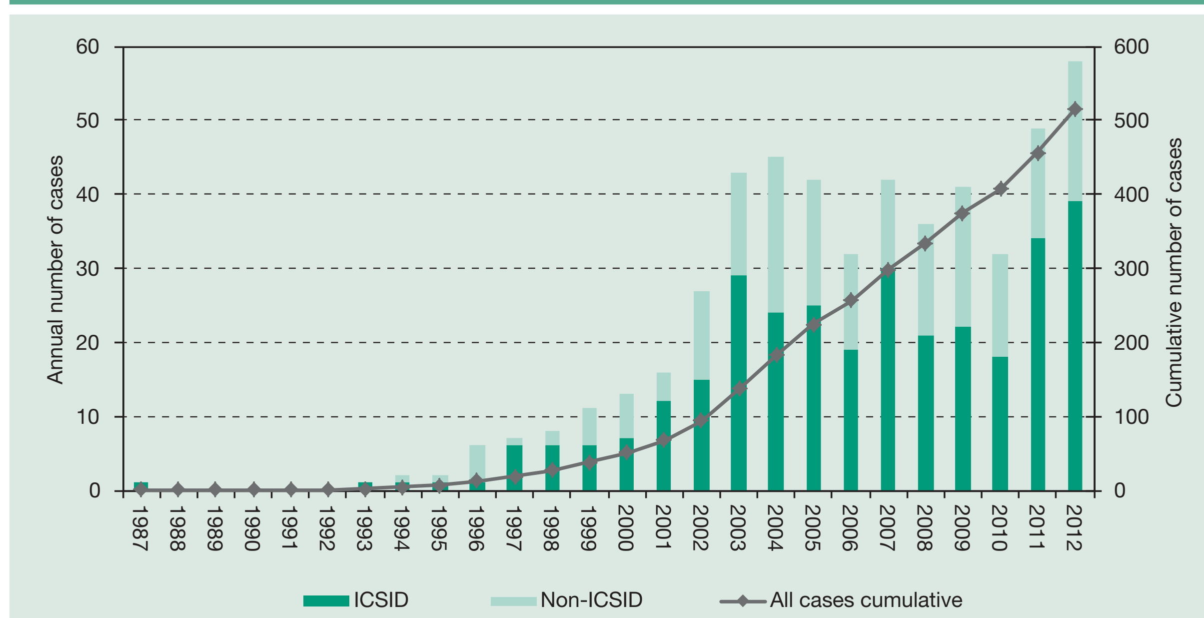
A record number of new ISDS cases were initiated in 2012.

In 2012, 58 new international investor–State claims were initiated.[63] This constitutes the highest number of known ISDS claims ever filed in one year and confirms foreign investors' increased inclination to resort to investor–State arbitration (figure III.10). In 66 per cent of the new cases, respondents were developing or transition economies.

In 2012, foreign investors challenged a broad range of government measures, including changes to domestic regulatory frameworks (with respect to gas, nuclear energy, the marketing of gold, and currency regulations), as well as measures relating to revocation of licences (in the mining, telecommunications and tourism sectors). Investors also took action on the grounds of alleged breaches of investment contracts; alleged irregularities in public tenders; withdrawals of previously granted subsidies (in the solar energy sector); and direct expropriations of investments.

By the end of 2012, the total number of known cases (concluded, pending or discontinued[64]) reached 514, and the total number of countries that have responded to one or more ISDS claims increased to 95. The majority of cases continued

Figure III.10. Known ISDS cases, 1987–2012



Source: UNCTAD.

to accrue under the ICSID Convention and the ICSID Additional Facility Rules (314 cases) and the UNCITRAL Rules (131). Other arbitral venues have been used only rarely.

At least 42 arbitral decisions were issued in 2012, including decisions on objections to a tribunal's jurisdiction, on the merits of the dispute, on compensation and on applications for annulment of an arbitral award.

In 12 of the 17 public decisions addressing the merits of the dispute last year, investors' claims were accepted, at least in part.

Of all cases concluded by the end of 2012, 31 per cent ended in favour of the investor and another 27 per cent were settled.

By the end of 2012, the overall number of concluded cases reached 244. Of these, approximately 42 per cent were decided in favour of the State and 31 per cent in favour of the investor. Approximately 27 per cent were settled.[65]

Last year saw some notable developments, including:

- the highest monetary award in the history of ISDS ($1.77 billion) in *Occidental v. Ecuador*,[66] a case that arose out of that country's unilateral termination of an oil contract; and
- the first treaty-based ISDS proceeding in which an arbitral tribunal affirmed its jurisdiction over a counterclaim that had been lodged by a respondent State against the investor.[67]

b. Mapping five paths for reform

The ISDS mechanism, designed to ensure fairness and neutrality, has in practice raised concerns about its systemic deficiencies.

In light of the increasing number of ISDS cases, the debate about the pros and cons of the ISDS mechanism has gained momentum, especially in those countries where ISDS is on the agenda of IIA negotiations or those that have faced controversial investor claims.

The ISDS mechanism was designed to depoliticize investment disputes and create a forum that would offer investors a fair hearing before an independent, neutral and qualified tribunal. It was seen as a mechanism for rendering final and enforceable decisions through a swift, cheap and flexible process, over which disputing parties would

have considerable control.[68] Given that investor complaints relate to the conduct of sovereign States, taking these disputes out of the domestic sphere of the State concerned provides aggrieved investors with an important guarantee that their claims will be adjudicated in an independent and impartial manner.

However, the actual functioning of ISDS under investment treaties has led to concerns about systemic deficiencies in the regime. These have been well documented in the literature and need only be summarized here:[69]

- *Legitimacy.* It is questionable whether three individuals, appointed on an *ad hoc* basis, can be entrusted with assessing the validity of States' acts, particularly when they involve public policy issues. The pressures on public finances[70] and potential disincentives for public-interest regulation may pose obstacles to countries' sustainable development paths.
- *Transparency.*[71] Even though the transparency of the system has improved since the early 2000s, ISDS proceedings can still be kept fully confidential – if both disputing parties so wish – even in cases where the dispute involves matters of public interest.[72]
- *"Nationality planning"*. Investors may gain access to ISDS procedures using corporate structuring, i.e. by channelling an investment through a company established in an intermediary country with the sole purpose of benefitting from an IIA concluded by that country with the host State.
- *Consistency of arbitral decisions.* Recurring episodes of inconsistent findings by arbitral tribunals have resulted in divergent legal interpretations of identical or similar treaty provisions as well as differences in the assessment of the merits of cases involving the same facts. Inconsistent interpretations have led to uncertainty about the meaning of key treaty obligations and lack of predictability as to how they will be read in future cases.[73]
- *Erroneous decisions.* Substantive mistakes of arbitral tribunals, if they arise, cannot be corrected effectively through existing review mechanisms. In particular, ICSID annulment committees, besides having limited review powers,[74] are individually created for specific disputes and can also disagree among themselves.
- *Arbitrators' independence and impartiality*. An increasing number of challenges to arbitrators may indicate that disputing parties perceive them as biased or predisposed. Particular concerns have arisen from a perceived tendency of each disputing party to appoint individuals sympathetic to their case. Arbitrators' interest in being re-appointed in future cases and their frequent "changing of hats" (serving as arbitrators in some cases and counsel in others) amplify these concerns.[75]
- *Financial stakes.* The high cost of arbitrations can be a concern for both investors (especially small and medium-size enterprises), and States. From the State perspective, even if a government wins the case, the tribunal may refrain from ordering claimant investors to pay the respondents' costs, leaving the average $8 million spent on lawyers and arbitrators as a significant burden on public finances and preventing the use of those funds for other goals.[76]

These challenges have prompted a debate about the challenges and opportunities of ISDS. This discourse has been developing through relevant literature, academic/practitioner conferences and the advocacy work of civil society organizations. It has also been carried forward under the auspices of UNCTAD's Investment Commission and Expert Meetings, its multi-stakeholder World Investment Forum[77] and a series of informal conversations it has organized,[78] as well as the OECD's Freedom-of-Investment Roundtables.[79]

Five broad paths for reform have emerged from these discussions:

1. Promoting alternative dispute resolution
2. Tailoring the existing system through individual IIAs
3. Limiting investors' access to ISDS
4. Introducing an appeals facility
5. Creating a standing international investment court

(i). Promotion of alternative dispute resolution methods

Reform options range from tailored modifications by individual States to systemic change that requires dialogue and cooperation between countries.

This approach advocates for increasing resort to so-called alternative methods of dispute resolution (ADR) and dispute prevention policies (DPPs), both of which have formed part of UNCTAD's technical assistance and advisory services on IIAs. ADR can be either enshrined in IIAs or implemented at the domestic level, without specific references in the IIA.

Compared with arbitration, non-binding ADR methods, such as conciliation and mediation,[80] place less emphasis on legal rights and obligations. They involve a neutral third party whose main objective is not the strict application of the law but finding a solution that would be recognized as fair by the disputing parties. ADR methods can help to save time and money, find a mutually acceptable solution, prevent escalation of the dispute and preserve a workable relationship between the disputing parties. However, there is no guarantee that an ADR procedure will lead to resolution of the dispute; an unsuccessful procedure would simply increase the costs involved. Also, depending on the nature of a State act challenged by an investor (e.g. a law of general application), ADR may not always be acceptable to the government.

An investment ombudsman can help defuse disputes in the early stages.

ADR could go hand in hand with the strengthening of dispute prevention and management policies at the national level. Such policies aim to create effective channels of communication and improve institutional arrangements between investors and respective agencies (e.g. investment aftercare services) and between different ministries dealing with investment issues. An investment ombudsman office or a specifically assigned agency that takes the lead should a conflict with an investor arise, can help resolve investment disputes early on, as well as assess the prospects of, and, if necessary, prepare for international arbitration.[81]

In terms of implementation, this approach is relatively straightforward, and much has already been implemented by some countries. Importantly, given that most ADR and DPP efforts are implemented at the national level, individual countries can also proceed without need for their treaty partners to agree. However, similar to some of the other options mentioned below, ADR and DPPs do not solve key ISDS-related challenges. The most they can do is to reduce the number of full-fledged legal disputes, which would render this reform path a complementary rather than stand-alone avenue for ISDS reform.

(ii). Tailoring the existing system through individual IIAs

This option implies that the main features of the existing system would be preserved and that individual countries would apply "tailored modifications" by modifying selected aspects of the ISDS system in their new IIAs. A number of countries have already embarked on this course of action.[82] Procedural innovations, many of which also appear in UNCTAD's IPFSD, have included:[83]

- *Setting time limits for bringing claims*; e.g. three years from the events giving rise to the claim, in order to limit State exposure and prevent the resurrection of "old" claims;[84]
- *Increasing the contracting parties' role in interpreting the treaty* in order to avoid legal interpretations that go beyond their original intentions; e.g. through providing for binding joint party interpretations, requiring tribunals to refer certain issues for determination by treaty parties and facilitating interventions by the non-disputing contracting parties;[85]
- *Establishing a mechanism for consolidation of related claims*, which can help to deal with the problem of related proceedings, contribute to the uniform application of the law, thereby increasing the coherence and consistency of awards, and help to reduce the cost of proceedings;[86]
- *Providing for more transparency in ISDS*; e.g. granting public access to documents and hearings, and allowing for the participation of interested non-disputing parties such as civil society organizations;[87]

- *Including a mechanism for an early discharge of frivolous* (unmeritorious) *claims* in order to avoid waste of resources on full-length proceedings.[88]

To these, add changes in the wording of IIAs' substantive provisions – introduced by a number of countries – that seek to clarify the agreements' content and reach, thereby enhancing the certainty of the legal norms and reducing the margin of discretion of arbitrators.[89]

Tailored modifications can be made to suit individual countries' concerns, but they also risk neglecting systemic deficiencies.

The approach whereby countries provide focused modifications through their IIAs allows for individually tailored solutions and numerous variations. For example, in their IIAs, specific countries may choose to address those issues and concerns that appear most relevant to them. At the same time, this option cannot address all ISDS-related concerns.

What is more, this approach would require comprehensive training and capacity-building to enhance awareness and understanding of ISDS-related issues.[90] Mechanisms that facilitate high-quality legal assistance to developing countries at an affordable price can also play a role (box III.7).

Implementation of this "tailored modifications" option is fairly straightforward given that only two treaty parties (or several – in case of a plurilateral treaty) need to agree. However, the approach is limited in effectiveness: unless the new treaty is a renegotiation of an old one, the "modifications" are applied only to newly concluded IIAs while some 3,000 "old" ones remain intact. Moreover, one of the key advantages of this approach, namely, that countries can choose *whether* and *which* issues to address, is also one of its key disadvantages, as it turns this reform option into a piecemeal approach that stops short of offering a comprehensive, integrated way forward.

(iii) Limiting investors' access to ISDS

Limiting investors' access to ISDS can help to slow down the proliferation of ISDS proceedings, reduce States' financial liabilities and save resources.

This option narrows the range of situations in which investors may resort to ISDS. This could be done in three ways: (i) by reducing the subject-matter scope for ISDS claims, (ii) by restricting the range of investors who qualify to benefit from the treaty, and (iii) by introducing

Box III.7. Addressing ISDS-related challenges: initiatives from Latin America

On 22 April 2013 during a ministerial-level meeting held in Ecuador, seven Latin American countries (the Plurinational State of Bolivia, Cuba, the Dominican Republic, Ecuador, Nicaragua, Saint Vincent and the Grenadines, and the Bolivarian Republic of Venezuela) adopted a declaration on "Latin American States affected by transnational interests".[a] In the declaration ministers agreed to establish an institutional framework to deal with challenges posed by transnational companies, especially legal claims brought against governments under BITs. The declaration also supports the creation of a regional arbitration centre to settle investment disputes and an international observatory for cooperation on international investment litigation. To that effect, the Dominican Republic, Ecuador and the Bolivarian Republic of Venezuela have agreed to produce a proposal to create such an observatory by July 2013.

This follows various earlier initiatives, undertaken by groups of countries in the region, that were aimed at helping countries find an adequate response to the lack of capacity and resources on one hand, and the overall legitimacy of the ISDS system on the other. As early as 2009, UNCTAD, together with the Academia de Centroamerica, the Organization of American States and the Inter-American Development Bank, was invited to pursue the possibility of establishing an Advisory Facility on International Investment Law and ISDS. This resulted in a series of meetings that addressed technical issues, including what type of services such a facility should offer (e.g. capacity-building for IIA negotiations and implementation, management or prevention of ISDS cases, provision of legal opinions, and legal representation in ISDS cases), what its membership limits could be (open to all countries and organizations or only a limited number of countries) and how it should be financed.

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

the requirement to exhaust local remedies before resorting to international arbitration. A far-reaching version of this approach would be to abandon ISDS as a means of dispute resolution altogether and return to State–State arbitration proceedings, as some recent treaties have done.[91]

Some countries have adopted policies of the first kind; e.g. by excluding certain types of claims from the scope of arbitral review.[92] Historically, this approach was used to limit the jurisdiction of arbitral tribunals in a more pronounced way, such as allowing ISDS only with respect to expropriation disputes.[93]

To restrict the range of covered investors, one approach is to include additional requirements in the definition of "investor" and/or to use denial-of-benefits provisions.[94] Among other things, this approach can address concerns arising from "nationality planning" and "treaty shopping" by investors and ensure that they have a genuine link to the putative home State.

Requiring investors to exhaust local remedies, or alternatively, to demonstrate the manifest ineffectiveness or bias of domestic courts, would make ISDS an exceptional remedy of last resort. Although in general international law, the duty to exhaust local remedies is a mandatory prerequisite for gaining access to international judicial forums,[95] most IIAs dispense with this duty.[96] Instead, they allow foreign investors to resort directly to international arbitration without first going through the domestic judicial system. Some see this as an important positive feature and argue that reinstating the requirement to exhaust domestic remedies could undermine the effectiveness of ISDS.

These options for limiting investor access to ISDS can help to slow down the proliferation of ISDS proceedings, reduce States' financial liabilities arising from ISDS awards and save resources. Additional benefits may be derived from these options if they are combined with assistance to strengthen the rule of law and domestic legal and judicial systems. To some extent, however, this approach would be a return to the earlier system, in which investors could lodge claims only in the domestic courts of the host State, negotiate arbitration clauses in specific investor–State contracts or apply for diplomatic protection by their home State.

In terms of implementation – like the options described earlier – this alternative does not require coordinated action by a large number of countries and can be put in practice by parties to individual treaties. Implementation is straightforward for future IIAs; past treaties would require amendments, renegotiation or unilateral termination.[97] Similar to the "tailored modification" option, however, this alternative results in a piecemeal approach towards reform.

(iv) Introducing an appeals facility[98]

Consistent and balanced opinions from an authoritative appeals body would enhance the credibility of the ISDS system.

An appeals facility implies a standing body with a competence to undertake a substantive review of awards rendered by arbitral tribunals. It has been proposed as a means to improve the consistency of case law, correct erroneous decisions of first-level tribunals and enhance the predictability of the law.[99] This option has been contemplated by some countries.[100] If the facility is constituted of permanent members appointed by States from a pool of the most reputable jurists, it has the potential to become an authoritative body capable of delivering consistent – and balanced – opinions, which could rectify some of the legitimacy concerns about the current ISDS regime.[101]

Authoritative pronouncements on points of law by an appeals facility would guide both the disputing parties (when assessing the strength of their respective cases) and arbitrators adjudicating disputes. Even if today's system of first-level tribunals remains intact, concerns would be alleviated through the effective supervision at the appellate level. In sum, an appeals facility would add order and direction to the existing decentralized, non-hierarchical and ad hoc regime.

At the same time, absolute consistency and certainty would not be achievable in a legal system that consists of about 3,000 legal texts; different outcomes may still be warranted by the language of specific applicable treaties. Also, the introduction of an appellate stage would further add to the time and cost of the proceedings, although that could

be controlled by putting in place tight timelines, as has been done for the WTO Appellate Body.[102]

In terms of implementation, for the appeals option to be meaningful, it needs to be supported by a significant number of countries. In addition to an in-principle agreement, a number of important choices would need to be made: Would the facility be limited to the ICSID system or be expanded to other arbitration rules? Who would elect its members and how? How would it be financed?[103] In sum, this reform option is likely to face significant, although not insurmountable, practical challenges.

(v) Creating a standing international investment court

A standing international investment court would be an institutional public good – but can it serve a fragmented universe of thousands of agreements?

This option implies the replacement of the current system of *ad hoc* arbitration tribunals with a standing international investment court. The latter would consist of judges appointed or elected by States on a permanent basis, e.g. for a fixed term. It could also have an appeals chamber.

This approach rests on the theory that a private model of adjudication (i.e. arbitration) is inappropriate for matters that deal with public law.[104] The latter requires objective guarantees of independence and impartiality of judges, which can be provided only by a security of tenure – to insulate the judge from outside interests such as an interest in repeat appointments and in maintaining the arbitration industry. Only a court with tenured judges, the argument goes, would establish a fair system widely regarded to be free of perceived bias.[105]

A standing investment court would be an institutional public good, serving the interests of investors, States and other stakeholders. The court would address most of the problems outlined above: it would go a long way to ensure the legitimacy and transparency of the system, and facilitate consistency and accuracy of decisions, and independence and impartiality of adjudicators.[106]

However, this solution would also be the most difficult to implement as it would require a complete overhaul of the current regime through the coordinated action of a large number of States. Yet, the consensus would not need to be universal. A standing investment court may well start as a plurilateral initiative, with an opt-in mechanism for those States that wish to join.

Finally, it is questionable whether a new court would be fit for a fragmented regime that consists of a huge number of mostly bilateral IIAs. It has been argued that this option would work best in a system with a unified body of applicable law.[107] Nonetheless, even if the current diversity of IIAs is preserved, a standing investment court would likely be much more consistent and coherent in its approach to the interpretation and application of treaty norms, compared with numerous ad hoc tribunals.

Given the numerous challenges arising from the current ISDS regime, it is timely for States to assess the current system, weigh options for reform and then decide upon the most appropriate route.

Among the five options outlined here, some imply individual actions by governments and others require joint action by a significant number of countries. Most of the options would benefit from being accompanied by comprehensive training and capacity-building to enhance awareness and understanding of ISDS-related issues.[108]

Although the collective-action options would go further in addressing the problems, they would face more difficulties in implementation and require agreement between a larger number of States. Collective efforts at the multilateral level can help develop a consensus on the preferred course of reform and ways to put it into action.

An important point to bear in mind is that ISDS is a system of *application* of the law. Therefore, improvements to the ISDS system should go hand in hand with progressive development of substantive international investment law.[109]

The national policy trends outlined in this chapter give mixed signals to foreign investors. Most countries continue to attract FDI, but ongoing macro economic, systemic and legal reforms, together with the effects of political elections in several countries, also created some regulatory uncertainty. Together with ongoing weakness and

instability in the global economy, this uncertainty has constrained foreign investors' expansion plans. Overall, the world economy is in a transition phase, adjusting previous liberalization policies towards a more balanced approach that gives more weight to sustainable development and other public policy objectives. This is also reflected by policy developments at the international level, where new-generation IIAs and opportunities for reform of the ISDS system are gaining ground.

Notes

1 See also UNCTAD (2011: 105–106).
2 See Lall (2002).
3 See UNCTAD (2000).
4 Data do not include pending deals that may be withdrawn later or withdrawn deals for which no value is available. In some cases, a business or regulatory/political motivation to withdraw a cross-border M&A may affect more than one deal, as recorded in the Thomson Reuters database on M&As.
5 See Dinc and Erel (2012) and Harlé, Ombergt and Cool (2012).
6 Although in some cases regulatory or political motivations for withdrawn M&As have been recorded, in many other deals are aborted for these reasons before they can be recorded as an announced M&A. For this reason, it is safe to assume that in reality more deals would fall in this category and thus that the impact of regulatory reasons and political opposition is in fact bigger (see also Dinc and Erel, 2012 and Heinemann, 2012).
7 The reason is the so-called "effects doctrine" in competition law, allowing for jurisdiction over foreign conduct, as long as the economic effects of the anticompetitive conduct are experienced on the domestic market.
8 See Dinc and Erel (2012: 7–10) and Heinemann (2012: 851).
9 See Dinc and Erel (2012: 7–10).
10 The share of regulations and restrictions in governments' new FDI measures has increased from 6 per cent in 2000 to 25 per cent in 2012 (see figure III.1).
11 See UNCTAD (2012: 101).
12 "Other IIAs" refer to economic agreements, other than BITs, that include investment-related provisions (for example, framework agreements on economic cooperation), investment chapters in economic partnership agreements and FTAs.
13 The analysis is based on the review of 16 IIAs signed in 2012 for which text was available namely, the Albania–Azerbaijan BIT, Australia–Malaysia FTA, Bangladesh–Turkey BIT, Cameroon–Turkey BIT, Canada–China BIT, China–Japan–Republic of Korea Trilateral investment agreement, EU–Central America Association Agreement, EU–Colombia–Peru FTA, EU–Iraq Partnership and Cooperation Agreement (PCA), Former Yugoslav Republic of Macedonia–Kazakhstan BIT, Gabon–Turkey BIT, Iraq–Japan BIT, Japan–Kuwait BIT, Nicaragua–Russian Federation BIT and Pakistan–Turkey BIT. The analysis does not include framework agreements.
14 In two of these, the exceptions are included in a chapter that is not entirely dedicated to investment but applies to it. See the EU–Iraq Partnership and Cooperation Agreement (Article 203) and the EU–Colombia–Peru FTA (Article 167).
15 This includes the 27 EU Member States counted individually.
16 The Guiding Principles were adopted by the economic ministers in Siem Reap, Cambodia in August 2012 and endorsed by the ASEAN leaders at the 21st ASEAN Summit, http://www.asean.org/news/asean-secretariat-news/item/asean-and-fta-partners-launch-the-world-s-biggest-regional-free-trade-deal.
17 Vision Statement, ASEAN–India Summit, New Delhi, India, 20 December 2012, http://www.asean.org/news/asean-statement-communiques/item/vision-statement-asean-india-commemorative-summit. Because the two agreements were awaiting signature at the end of 2012, they are not reported as IIAs concluded in 2012.
18 "Mandatarios suscriben Acuerdo Marco de la Alianza del Pacífico", Presidency of the Republic of Peru Antofagasta, 6 June 2012, http://www.presidencia.gob.pe/mandatarios-suscriben-acuerdo-marco-de-la-alianza-del-pacifico.
19 The first phase of the negotiations, scheduled to conclude in June 2014, will focus on merchandise trade liberalization, infrastructure development and industrial development.
20 This section highlights negotiations involving the EU that were launched in 2013, as well as negotiations that were started earlier and that cover investment protection and liberalization based on the new EU mandate. Negotiations that were started earlier and that do not directly address investment protection (e.g. such as those carried out in the EPA context) are not included in the review.
21 This section covers negotiations that began in 2013. For a comprehensive overview of EU FTAs and other negotiations, see http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf.
22 These negotiations are taking place after the European Commission, in December 2012, received a mandate to upgrade association agreements with its Mediterranean partner countries to include investment protection. See http://trade.ec.europa.eu/doclib/press/index.cfm?id=888.
23 http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/thailand.
24 http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/united-states.
25 "Final Report of the High Level Working Group on Jobs and Growth", 11 February 2013, http://trade.ec.europa.eu/doclib/docs/2013/february/tradoc_150519.pdf.
26 This follows the April 2012 "Statement on Shared Principles for International Investment," which set out a number of principles for investment policymaking, including the need for sustainable-development-friendly elements, (see http://europa.eu/rapid/press-release_IP-12-356_en.htm and *WIR 2012*, chapter III.B) .
27 http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/japan.
28 http://trade.ec.europa.eu/doclib/press/index.cfm?id=881.
29 This section refers to the latest developments in negotiations that were launched before 2013.
30 http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/canada.
31 http://trade.ec.europa.eu/doclib/press/index.cfm?id=855.
32 http://ec.europa.eu/trade/creating-opportunities/bilateral-relations/countries/india.
33 At the EU–China Summit on 14 February 2012, the leaders agreed that "a rich in substance EU–China investment agreement would promote and facilitate investment in both directions" and that "[n]egotiations towards this agreement would include all issues of interest to either side, without prejudice to the final outcome". See http://europa.eu/rapid/press-release_MEMO-12-103_en.htm.
34 Press release, United States Trade Representative, 13 March 2013, http://www.ustr.gov/about-us/press-office/press-releases/2013/march/tpp-negotiations-higher-gear.
35 During a joint EU-MERCOSUR Ministerial Meeting (26 January 2013), the parties stressed the importance of ensuring progress in the next stage of the negotiation and agreed to start their respective internal preparatory work for the exchange of offers, http://trade.ec.europa.eu/doclib/docs/2013/january/

tradoc_150458.pdf. Note that these negotiations currently focus on establishment and do not cover BITs-type protection issues. See http://eeas.europa.eu/mercosur/index_en.htm.

36 The 22 WTO Members in the Real Good Friends group are Australia, Canada, Chile, Colombia, Costa Rica, the EU, Hong Kong (China), Iceland, Israel, Japan, Mexico, New Zealand, Norway, Pakistan, Paraguay, Peru, the Republic of Korea, Singapore, Switzerland, Taiwan Province of China, Turkey, and the United States.

37 Press release, European Commission, 15 February 2013, http://europa.eu/rapid/press-release_MEMO-13-107_en.htm.

38 None of the Real Good Friends will ever match the levels scheduled by Moldova, Kyrgyzstan and some others.

39 Strictly speaking, the GATS does not prescribe any particular scheduling format, whether bottom-up or top-down.

40 News alert, Crowell & Morning, 15 October 2012, http://www.crowell.com/NewsEvents/AlertsNewsletters/all/1379161; Global Services Coalition, Statement on Plurilateral Services Agreement, 19 September 2012, http://www.keidanren.or.jp/en/policy/2012/067.pdf.

41 http://tpplegal.wordpress.com/open-letter.

42 http://www.citizenstrade.org/ctc/p-content/uploads/2013/03/CivilSocietyLetteronFastTrackandTPP_030413.pdf.

43 http://www.bilaterals.org/spip.php?page=print&id_article=22300.

44 http://tradejustice.ca/pdfs/Transatlantic%20Statement%20on%20Investor%20Rights%20in%20CETA.pdf.

45 http://www.globaleverantwortung.at/images/doku/aggv_2809 2010_finaljointletter_eu_india_fta_forsign.doc.

46 http://www.dewereldmorgen.be/sites/default/files/attachments/2011/01/18/mep_open_letter_final.pdf.

47 http://canadians.org/blog/?p=18925.

48 This lack of clarity arises from the fact that the treaty's reference to "the Parties" could be understood as covering either *all* or *any* of the parties to the regional agreement. The latter interpretation would also include BITs, hence resulting in parallel application; the former interpretation would only include agreements which all of the regional treaty parties have signed, hence excluding bilateral agreements between some – but not all – of the regional agreement's contracting parties.

49 The Central America–Mexico FTA (2011) replaces the FTAs between Mexico and Costa Rica (1994), Mexico and El Salvador, Guatemala and Honduras (2000), and Mexico and Nicaragua (1997).

50 Vienna Convention on the Law of Treaties (1969), http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf.

51 The COMESA investment agreement, for example, states in Article 32.3: "In the event of inconsistency between this Agreement and such other agreements between Member States mentioned in paragraph 2 of this Article, this agreement shall prevail to the extent of the inconsistency, except as otherwise provided in this Agreement." Article 2.3 of the ASEAN–Australia–New Zealand FTA enshrines a "soft" approach to inconsistent obligations whereby "In the event of any inconsistency between this Agreement and any other agreement to which two or more Parties are party, such Parties shall immediately consult with a view to finding a mutually satisfactory solution."

52 On various interpretative tools that can be used by States, see UNCTAD, "Interpretation of IIAs: What States Can Do", *IIA Issues Note*, No.3, December 2011.

53 "Notes of Interpretation of Certain NAFTA Chapter 11 Provisions", NAFTA Free Trade Commission, 31 July 2001. Available at http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp.

54 As opposed to amendments, renegotiations are used when the parties wish to make extensive modifications to the treaty.

55 Article 54(b) of the Vienna Convention on the Law of Treaties.

56 If not, and if needed, in addition to the rules set out in the treaty, the rules of the Vienna Convention on the Law of Treaties apply.

57 These were BITs with Cuba, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Romania and Uruguay. Subsequently, on 9 March 2013, Ecuador announced its intent to terminate all remaining IIAs and that the legislative assembly would work on the requisite measures to that effect from 15 May 2013 onward. See Declaration by the President of Ecuador Rafael Correa, ENLACE Nro 312 desde Piquiucho - Carchi, published 10 March 2013. Available at http://www.youtube.com/watch?v=CkC5i4gW15E (at 2:37:00).

58 This section is limited to BITs and does not apply to "other IIAs" as the latter raise a different set of issues. Importantly, an investment chapter in a broad economic agreement such as an FTA cannot be terminated separately, without terminating the whole treaty.

59 In accordance with general international law, a treaty may also be terminated by consent of the contracting parties at any time, regardless of whether the treaty has reached the end of its initial fixed term (Article 54(b) of the Vienna Convention on the Law of Treaties).

60 Publication by a spokesman of South Africa's Department of Trade and Industry. Available at http://www.bdlive.co.za/opinion/letters/2012/10/01/letter-critical-issues-ignored.

61 It is an open question whether the survival clause becomes operative only in cases of *unilateral* treaty termination or also applies in situations where the treaty is terminated by mutual consent by the contracting parties. This may depend on the wording of the specific clause and other interpretative factors.

62 This will not automatically solve the issue of those older treaties that were not renegotiated; but it will gradually form a new basis on which negotiators can build a more balanced network.

63 For more details, see UNCTAD, "Latest Developments in Investor-State Dispute Settlement", *IIA Issues Note*, No. 1, March 2013.

64 A case may be discontinued for reasons such as failure to pay the required cost advances to the relevant arbitral institution.

65 A number of arbitral proceedings have been discontinued for reasons other than settlement (e.g. due to the failure to pay the required cost advances to the relevant arbitral institution). The status of some other proceedings is unknown. Such cases have not been counted as "concluded".

66 *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012.

67 *Antoine Goetz & Others and S.A. Affinage des Metaux v. Republic of Burundi*, ICSID Case No. ARB/01/2, Award, 21 June 2012, paras. 267–287.

68 For a discussion of the key features of ISDS, see also, "Investor-State Dispute Settlement – a Sequel", UNCTAD Series on Issues in IIAs (forthcoming).

69 See Michael Waibel et al. (eds.), *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International, 2010); D. Gaukrodger and K. Gordon, "Investor–State Dispute Settlement: A Scoping Paper for the Investment Policy Community", OECD Working Papers on International Investment, No. 2012/3; P. Eberhardt and C. Olivet, *Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom* (Corporate Europe Observatory and Transnational Institute, 2012), available at http://corporateeurope.org/sites/default/files/publications/profiting-from-injustice.pdf.

70 Host countries have faced ISDS claims of up to $114 billion (the aggregate amount of compensation sought by the three claimants constituting the majority shareholders of the former Yukos Oil Company in the ongoing arbitration proceedings against the Russian Federation) and awards of up to $1.77 billion (*Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, 5 October 2012).

71 UNCTAD, *Transparency – A Sequel*, Series on Issues in IIAs II. (United Nations, New York and Geneva, 2012).

[72] It is indicative that of the 85 cases under the UNCITRAL Arbitration Rules administered by the Permanent Court of Arbitration (PCA), only 18 were public (as of end-2012). *Source*: Permanent Court of Arbitration International Bureau.

[73] Sometimes, divergent outcomes can be explained by differences in wording of a specific IIA applicable in a case; however, often they represent differences in the views of individual arbitrators.

[74] It is notable that even having identified "manifest errors of law" in an arbitral award, an ICSID annulment committee may find itself unable to annul the award or correct the mistake. See *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision of the ad hoc Committee on the application for annulment, 25 September 2007. Article 52(1) of the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention) enumerates the following grounds for annulment: (a) improper constitution of the arbitral Tribunal; (b) manifest excess of power by the arbitral Tribunal; (c) corruption of a member of the arbitral Tribunal; (d) serious departure from a fundamental rule of procedure; or (e) absence of a statement of reasons in the arbitral award.

[75] For further details, see Gaukrodger and Gordon (2012: 43–51).

[76] Lawyers' fees (which may reach $1,000 per hour for partners in large law firms) represent the biggest expenditure: on average, they have been estimated to account for about 82 per cent of the total costs of a case. D. Gaukrodger and K. Gordon, p. 19.

[77] http://unctad-worldinvestmentforum.org.

[78] During 2010 and 2011, UNCTAD organized seven "Fireside" talks – informal discussions among small groups of experts about possible improvements to the ISDS system.

[79] See e.g. OECD, "Government perspectives on investor-state dispute settlement: a progress report", Freedom of Investment Roundtable, 14 December 2012. Available at www.oecd.org/daf/inv/investment-policy/foi.htm.

[80] Mediation is an informal and flexible procedure: a mediator's role can vary from shaping a productive process of interaction between the parties to effectively proposing and arranging a workable settlement to the dispute. It is often referred to as "assisted negotiations". Conciliation procedures follow formal rules. At the end of the procedure, conciliators usually draw up terms of an agreement that, in their view, represent a just compromise to a dispute (non-binding to the parties involved). Because of its higher level of formality, some call conciliation a "non-binding arbitration".

[81] See further UNCTAD, *Investor–State Disputes: Prevention and Alternatives to Arbitration* (United Nations, New York and Geneva, 2010); UNCTAD, *How to Prevent and Manage Investor-State Disputes: Lessons from Peru*, Best Practice in Investment for Development Series (United Nations, New York and Geneva, 2011).

[82] In particular, Canada, Colombia, Mexico, the United States and some others. Reportedly, the European Union is also considering this approach. See N. Bernasconi-Osterwalder, "Analysis of the European Commission's Draft Text on Investor–State Dispute Settlement for EU Agreements", *Investment Treaty News*, 19 July 2012. Available at http://www.iisd.org/itn/2012/07/19/analysis-of-the-european-commissions-draft-text-on-investor-state-dispute-settlement-for-eu-agreements.

[83] Policy options for individual ISDS elements are further analysed in UNCTAD, *Investor–State Dispute Settlement: A Sequel* (forthcoming).

[84] See e.g. NAFTA Articles 1116(2) and 1117(2); see also Article 15(11) of the China–Japan–Republic of Korea investment agreement.

[85] See UNCTAD, *Interpretation of IIAs: What States Can Do*, IIA Issues Note, No.3, December 2011. Two issues merit attention with respect to such authoritative interpretations. First, the borderline between interpretation and amendment can sometimes be blurred; second, if issued during an ongoing proceeding, a joint party interpretation may raise due-process related concerns.

[86] See e.g. NAFTA Article 1126; see also Article 26 of the Canada–China BIT.

[87] See e.g. Article 28 of the Canada–China BIT; see also NAFTA Article 1137(4) and Annex 1137.4.

[88] See e.g. Article 41(5) ICSID Arbitration Rules (2006); Article 28 United States–Uruguay BIT.

[89] UNCTAD, *World Investment Report 2010*. Available at http://unctad.org/en/Docs/wir2010_en.pdf. See also UNCTAD's Pink Series Sequels on Scope and Definition, MFN, Expropriation, FET and Transparency. Available at http://investmentpolicyhub.unctad.org/Views/Public/IndexPublications.aspx

[90] Such capacity-building activities are being carried out by among others, UNCTAD (together with different partner organizations). Latin American countries, for example, have benefited from UNCTAD's advanced regional training courses on ISDS on an annual basis since 2005.

[91] Recent examples of IIAs without ISDS provisions are the Japan–Philippines Economic Partnership Agreement (2006), the Australia–United States FTA (2004) and the Australia–Malaysia FTA (2011). In April 2011, the Australian Government issued a trade policy statement announcing that it would stop including ISDS clauses in its future IIAs as doing so imposes significant constraints on Australia's ability to regulate public policy matters: see Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity, April 2011. Available at www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.pdf.

[92] For example, claims relating to real estate (Cameroon–Turkey BIT); claims concerning financial institutions (Canada–Jordan BIT); claims relating to establishment and acquisition of investments (Japan–Mexico FTA); claims concerning specific treaty obligations such as national treatment and performance requirements (Malaysia–Pakistan Closer Economic Partnership Agreement); and claims arising out of measures to protect national security interest (India–Malaysia Closer Economic Cooperation Agreement). For further analysis, see UNCTAD, *Investor–State Dispute Settlement: Regulation and Procedures* (New York and Geneva, forthcoming).

[93] For example, Chinese BITs concluded in the 1980s and early 1990s (e.g. Albania–China, 1993; Bulgaria–China, 1989) provided investors access to international arbitration only with respect to disputes relating to the amount of compensation following an investment expropriation.

[94] Denial of benefits clauses authorize States to deny treaty protection to investors who do not have substantial business activities in their alleged home State and who are owned and/or controlled by nationals or entities of the denying State or of a State who is not a party to the treaty.

[95] Douglas, Z. (2009). *The international law of investment claims*. Cambridge: Cambridge University Press.

[96] Some IIAs require investors to pursue local remedies in the host State for a certain period of time (e.g. Belgium/Luxembourg–Botswana BIT and Argentina–Republic of Korea BIT). A small number of agreements require the investor to exhaust the host State's administrative remedies before submitting the dispute to arbitration (e.g. China–Côte d'Ivoire BIT).

[97] Termination of IIAs is complicated by "survival" clauses that provide for the continued application of treaties, typically for 10 to 15 years after their termination.

[98] In 2004, the ICSID Secretariat mooted the idea of an appeals facility, but at that time the idea failed to garner sufficient State support. See ISCID, "Possible Improvements of the Framework for ICSID Arbitration", Discussion paper, 22 October 2004, Part VI, and Annex "Possible Features of an ICSID Appeals Facility". In the eight years that have passed since, the views of many governments may have evolved.

[99] For the relevant discussion, see e.g. C. Tams, "An Appealing Option? A Debate about an ICSID Appellate Structure", *Essays in Transnational Economic Law*, No.57, 2006.

[100] Several IIAs concluded by the United States have addressed the potential establishment of a standing body to hear appeals from investor–State arbitrations. The Chile–United States FTA was the first one to establish a "socket" in the agreement into which an appellate mechanism could be inserted should one be established under a separate multilateral agreement (Article 10.19(10)). The Dominican Republic–Central America–United States FTA (CAFTA) (2004) went further, and required the establishment of a negotiating group to develop an appellate body or similar mechanism (Annex 10-F). Notwithstanding these provisions, there has been no announcement of any such negotiations and no text regarding the establishment of any appellate body.

[101] An alternative solution would be a system of preliminary rulings, whereby tribunals in ongoing proceedings would be enabled or required to refer unclear questions of law to a certain central body. This option, even though it does not grant a right of appeal, may help improve consistency in arbitral decision making. See e.g. C. Schreuer, "Preliminary Rulings in Investment Arbitration", in K. Sauvant (ed.), *Appeals Mechanism in International Investment Disputes* (OUP, 2008).

[102] At the WTO, the appeals procedure is limited to 90 days.

[103] Other relevant questions include: Would the appeal be limited to the points of law or also encompass questions of fact? Would it have the power to correct decisions or only a right of remand to the original tribunal? How to ensure the coverage of earlier-concluded IIAs by the new appeals structure?

[104] Because these cases "involve an adjudicative body having the competence to determine, in response to a claim by an individual, the legality of the use of sovereign authority, and to award a remedy for unlawful State conduct." G. Van Harten, "A Case for International Investment Court", Inaugural Conference of the Society for International Economic Law, 16 July 2008, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1153424.

[105] Ibid.

[106] A system where judges are assigned to the case, as opposed to being appointed by the disputing parties, would also save significant resources currently spent on researching arbitrator profiles.

[107] Similarly to the European Court of Human Rights, which adjudicates claims brought under the European Convention for the Protection of Human Rights and Fundamental Freedoms.

[108] Such capacity-building activities are being carried out by, among others, UNCTAD (with different partner organizations). Latin American countries, for example, have benefitted from UNCTAD's advanced regional training courses on ISDS on an annual basis since 2005: see http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20(IIA)/IIA-Technical-Cooperation.aspx.

[109] IPFSD, 2012.

Box III.1

[a] Decree No.86, China Securities Regulatory Commission, 11 October 2012.

[b] Press Notes No. 4, 5, 6, 7 and 8, Ministry of Commerce and Industry, 20 September 2012, Circular No. 41, Reserve Bank of India, 10 October 2012.

[c] Press release, Ministry of Finance, 21 December 2012.

[d] "New areas in Dubai where expats can own property", *Khaleej Times*, 22 June 2012.

[e] Foreign Investment Law (Law No, 21/ 2012), Presidential Office, 2 November 2012. See www.president-office.gov.mm/en/hluttaw/law/2012/11/23/id-1103.

[f] Resolution No. 111-F/2012, *Official Gazette*, 28 December 2012.

[g] "Government adopted a decree on privatization of the fuel and energy complex enterprises", Ukraine government portal, 19 February 2013.

Box III.2

[a] "Simplification of direct investment foreign exchange management to promote trade and investment facilitation", State Administration of Foreign Exchange, 21 November 2012.

[b] Press release, Ministry of Economy, Industry and Commerce, 23 October 2012.

[c] "Emergency Economic Measures for the Revitalization of the Japanese Economy", Cabinet Office, 11 January 2013.

[d] "President Asif Ali Zardari signs Special Economic Zones Bill 2012", Board of Investment, 10 September 2012.

[e] "Cabinet Approves Bill of National Investment for 2013", Ministry of Cabinet Affairs, 3 February 2013.

Box III.3

[a] Resolución Conjunta 620/2012 y 365/2012, Official Gazette, 23 October 2012.

[b] Regulation No. 14/8 / PBI/2012, Bank Indonesia, 13 July 2012.

[c] "Kazakh Law Sets State Control of New Oil Pipelines", Reuters 14 June 2012.

[d] Executive Order No.79-S-2012, Official Gazette, 16 July 2012.

Box III.4

[a] New Land Code (Law No. 2013-1), 14 January 2013.

[b] "Government nationalizes Electropaz, Elfeo and ensures job security and salary workers", Official press release, 29 December 2012.

[c] "Morales Dispone Nacionalización del Paquete Accionario de Sabsa", Official press release, 18 February 2013.

[d] Statement by the Prime Minister of Canada on foreign investment, 7 December 2012.

[e] Act T/9400/7 amending the Fundamental Law, 18 December 2012.

[f] Law 56 of 2012, Official Gazette No. 111, 14 May 2012.

Box III.5

[a] Bloomberg, "Deutsche Boerse-NYSE Takeover Vetoed by European Commission", 1 February 2012. Available at www.bloomberg.com/news/2012-02-01/european-commission-blocks-proposed-deutsche-boerse-nyse-euronext-merger.html (accessed 30 April 2013).

[b] Reuters, "Singapore Exchange ends ASX bid after Australia rebuff", 8 April 2011. Available at www.reuters.com/article/2011/04/08/us-asx-sgx-idUSTRE7370LT20110408 (accessed 30 April 2013).

[c] The Economic Times, "BHP Billiton abandons bid for fertiliser-maker Potash", 15 November 2010. Available at http://articles.economictimes.indiatimes.com/2010-11-15/news/27607057_1_potash-corp-marius-kloppers-saskatchewan (accessed 30 April 2013).

[d] Press release, Ministry of Industry, Canada, 7 December 2012. Available at http://news.gc.ca/web/article-eng.do?nid=711509 (accessed 30 April 2013).

[e] Financial Times, "China clears Marubeni-Gavilon deal", 23 April 2013. Available at www.ft.com/cms/s/0/032f2e7c-ac33-11e2-9e7f-00144feabdc0.html#axzz2Rw2yv1Ly (accessed 30 April 2013).

[f] Competition NEWS, "The Rhodes-Del Monte merger", March 2011. Available at www.compcom.co.za/assets/Uploads/AttachedFiles/MyDocuments/Comp-Comm-Newsletter-38-March-2011.pdf (accessed 6 May 2013).

[g] CBCNews, "Govt. confirms decision to block sale of MDA space division", 9 May 2008. Available at http://www.cbc.ca/news/technology/story/2008/05/09/alliant-sale.html (accessed 30 April 2013).

Box III.7

[a] http://cancilleria.gob.ec/wp-content/uploads/2013/04/22abr_declaracion_transnacionales_eng.pdf.

GLOBAL VALUE CHAINS: INVESTMENT AND TRADE FOR DEVELOPMENT

CHAPTER IV

INTRODUCTION

Global trade and FDI have grown exponentially over the last decade as firms expanded international production networks, trading inputs and outputs between affiliates and partners in GVCs.

About 60 per cent of global trade, which today amounts to more than $20 trillion, consists of trade in *intermediate* goods and services that are incorporated at various stages in the production process of goods and services for final consumption. The fragmentation of production processes and the international dispersion of tasks and activities within them have led to the emergence of borderless production systems – which may be sequential chains or complex networks and which may be global, regional or span only two countries. These systems are commonly referred to as global value chains (GVCs).

GVCs are typically coordinated by transnational corporations (TNCs), with cross-border trade of production inputs and outputs taking place within their networks of affiliates, contractual partners (in non-equity modes of international production, or NEMs; see *WIR11*) and arm's-length suppliers. The phenomenon of international production driven by TNCs engaging in efficiency-seeking FDI is not entirely new – the theme of *WIR93* was integrated international production – however, since around 2000, global trade and FDI have both grown exponentially, significantly outpacing global GDP growth, reflecting the rapid expansion of international production in TNC-coordinated networks.

GVCs lead to a significant amount of *double counting* in global trade. Raw material extracted in one country may be exported first to an affiliate in a second country for processing, then exported again to a manufacturing plant in a third country, which may then export the manufactured product to a fourth for final consumption. The value of the raw material counts only once as a GDP contribution in the original country but is counted several times in world exports.[1]

Recent advances in trade statistics aim to identify the double counting in gross trade figures and show where value is created in global production chains. Figure IV.1 shows a simplified example of *value added trade*.

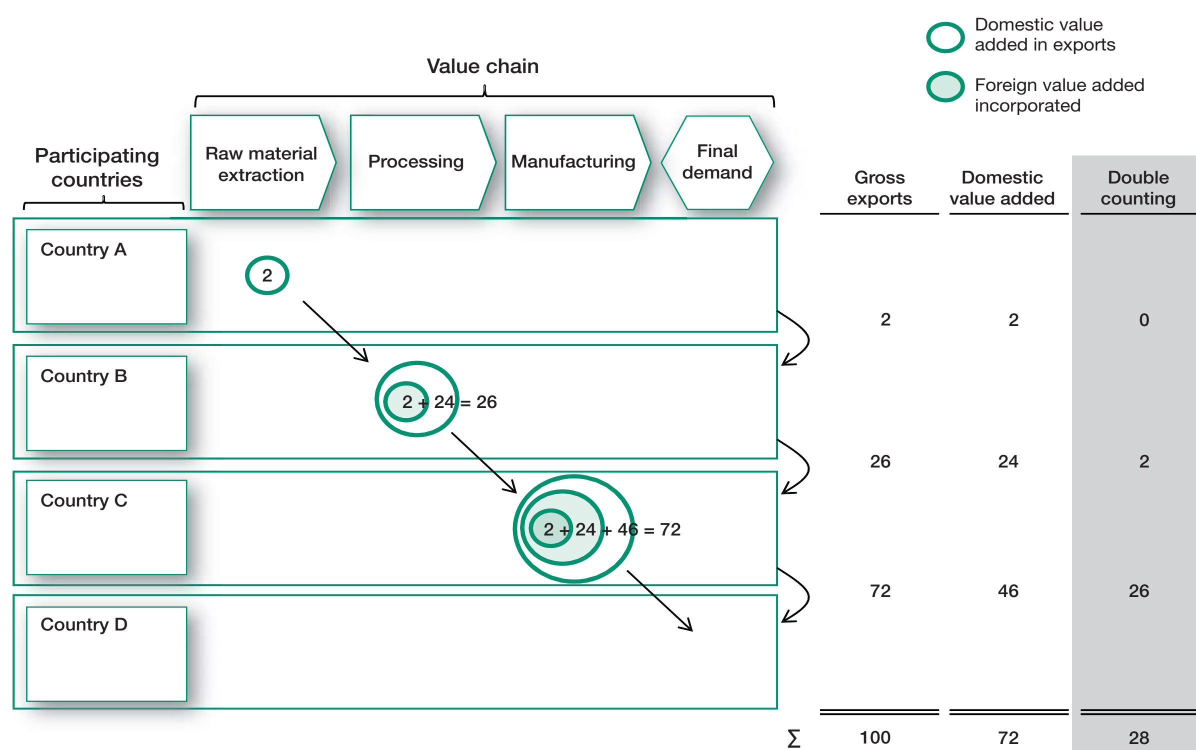
Value added trade statistics can lead to important policy insights on GVCs, trade, investment and development. For *WIR13*, in a collaborative effort with the Eora project,[2] UNCTAD built a value added trade dataset: the UNCTAD-Eora GVC Database (box IV.1).[3] The database will be used in this chapter to assess the patterns, drivers and determinants, development impact and policy implications of value added trade and investment.

GVCs are a concept taken up by different schools of economic theory, development studies and international business disciplines, with each strand of scholars adopting different definitions and boundaries of analysis. Table IV.1 illustrates a number of important contrasts. This chapter will attempt to bring together the various schools of thought, borrowing concepts from different disciplines and adding new cross-disciplinary insights.

UNCTAD's research objectives in this report are to demonstrate how GVCs constitute the nexus between investment and trade, to show the importance of GVCs in today's global economy and especially their weight in developing countries, to provide evidence for the impact of GVC participation in developing countries, and to make concrete recommendations to help policymakers maximize the benefits of GVC participation for economic growth and development while minimizing the associated risks.

To this end, in the remainder of this chapter, Section A describes GVC patterns at the global level and in developing countries specifically, and shows how FDI and TNC activities shape such patterns – based on (and building on) value added trade data. Section B borrows more from other GVC disciplines and international business theory to discuss firm-level drivers of GVC activity and locational determinants, which are important for policymakers in understanding the factors influencing country-level GVC participation. Section C describes the development impacts of GVC participation, including the GDP contribution of GVCs (direct

Figure IV.1. Value added trade: how it works



Source: UNCTAD.

and indirect through business linkages), the employment generation and working conditions in GVCs, the potential for technology dissemination and skill building through GVCs, and the social and environmental impacts of GVCs, as well as the potential contribution of GVCs to upgrading and long-term industrial development. Finally, Section D discusses policy implications, proposing a "GVC policy framework" focusing on the role of GVCs in development strategy, on the synergies between trade and investment policies, on trade and investment promotion, and on mainstreaming sustainable development and inclusive growth in GVC policies.

A. GVCs and patterns of value added trade and investment

1. Value added trade patterns in the global economy

GVCs cause "double counting" in global gross trade figures. This is a growing phenomenon as most countries increasingly participate in GVCs. Only the domestic value added in exports contributes to countries' GDP.

At the global level, the average foreign value added in exports is approximately 28 per cent (figure IV.2). That means, roughly, that about $5 trillion of the $19 trillion in 2010 world exports of goods and services has been contributed by foreign countries for further exports and is thus "double counted" in global trade figures.[4] The remaining $14 trillion is the actual value added contribution of trade to the global economy (or about one fifth of global GDP).

These figures differ significantly by country and by industry, with important policy implications:

- At the *country* level, foreign value added in exports measures the extent to which the GDP contribution of trade is absorbed by other countries upstream in the value chain, or the extent to which a country's exports are

Box IV.1. International efforts to map GVCs and the UNCTAD-Eora GVC Database

The growing importance of GVCs has led to the realization that the way international trade has traditionally been accounted for may no longer be sufficient. A growing body of work aims to net out the "double-counting" effect of GVCs on global trade, determine value added in trade, and map how value added moves between countries along GVCs before final consumption of end-products. Value added in trade can be estimated on the basis of international input-output (I-O) tables that illustrate the economic interactions between countries. To date, several initiatives have sought to compile intercountry I-O tables using different methodologies. A selection of the main initiatives appears in box table IV.1.1.

Box table IV.1.1. Selected initiatives mapping value added in trade

Project	Institution	Data sources	Countries	Industries	Years	Comments
UNCTAD-Eora GVC Database	UNCTAD/Eora	National Supply-Use and I-O tables, and I-O tables from Eurostat, IDE-JETRO and OECD	187	25–500 depending on the country	1990–2010	"Meta" database drawing together many sources and interpolating missing points to provide broad, consistent coverage, even of data-poor countries
Inter-Country-Input-Output model (ICIO)	OECD/WTO	National I-O tables	40	18	2005, 2008, 2009	Based on national I-O tables harmonized by the OECD
Asian International I-O tables	Institute of Developing Economies (IDE-JETRO)	National accounts and firm surveys	10	76	1975,1980, 1985,1990, 1995,2000, 2005	United States-Asia tables also bilateral tables, including China-Japan
Global Trade Analysis Project (GTAP)	Purdue University	Contributions from individual researchers and organizations	129	57	2004, 2007	Unofficial dataset; includes data on areas such as energy volumes, land use, carbon dioxide emissions and international migration
World Input-Output Database (WIOD)	Consortium of 11 institutions, EU funded	National Supply-Use tables	40	35	1995–2009	Based on official National Accounts statistics; uses end-use classification to allocate flows across partner countries

The UNCTAD-Eora GVC Database uses I-O tables to estimate the import-content ratio in exportable products and value added trade. Its value added trade data are derived from the Eora global multi-region input-output (MRIO) table. The Eora MRIO brings together a variety of primary data sources including national I-O tables and main aggregates data from national statistical offices; I-O compendia from Eurostat, IDE (Institute of Developing Economies)–JETRO (Japan External Trade Organization) and OECD; national account data (the UN National Accounts Main Aggregates Database; and the UN National Accounts Official Data); and trade data (the UN Comtrade international trade database and the UN ServiceTrade international trade database). Eora combines these primary data sources into a balanced global MRIO, using interpolation and estimation in some places to provide a contiguous, continuous dataset for the period 1990-2010. The Eora MRIO thus builds on some of the other efforts in the international community. Accompanying every data point in the results provided on the Eora website (www.worldmrio.com) is an estimate of that data point's standard deviation, reflecting the extent to which it was contested, interpolated, or estimated, during the process of assembling the global MRIO from constituent primary data sources. For more details on the Eora database, see the Technical note on the UNCTAD-Eora GVC Database in the database launch report "GVCs and Development", available at http://unctad.org/en/PublicationsLibrary/diae2013d1_en.pdf (pp. 26-30).

The joint OECD-WTO project (see box table) is recognized as a comprehensive effort to set a common standard for the estimation of value added in trade. Placing significant emphasis on methodology, it necessarily sacrifices some coverage (of countries, industries and time series) for statistical rigor. In contrast, the primary objective of the UNCTAD-Eora GVC Database is extended coverage, to provide a *developing-country perspective*. This explains the choice of the MRIO approach, the key innovation of which is the use of algorithms that allow the use of different data sources and types while minimizing accounting discrepancies, enabling the inclusion of data-poor countries.

Source: UNCTAD.

Table IV.1. Perspectives on GVCs

	International Business "Firm perspective"	Economics "Country perspective"
Defining concepts	• GVCs are defined by *fragmented* supply chains, with internationally dispersed tasks and activities *coordinated* by a lead firm (a TNC).	• GVCs explain how exports may incorporate imported inputs; i.e. how exports include foreign and domestically produced *value added.*
Scope	• GVCs are present predominantly in industries characterized by such supply chains, with typical examples including electronics, automotive and textiles (although the scope is widening to agriculture and food and offshore services, among others).	• GVCs and value added trade, by design and by the necessities of statistical calculation, encompass *all trade*; i.e. all exports and imports are part of a value chain.
Role of investment and trade	• Investment and trade are complementary but alternative modes of international operation for firms; i.e. a firm can access foreign markets or resources by establishing an affiliate or through trade.	• Investment is needed to build export capacity (i.e., it creates the factors of production required to generate value added exports); both investment and value added in exports are GDP contributors.

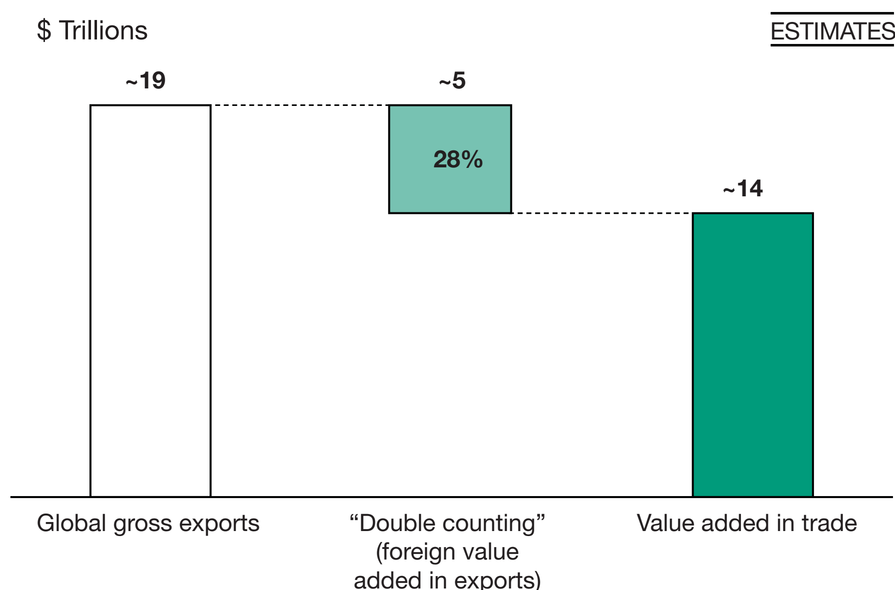
Source: UNCTAD.

dependent on imported content. It is also an indication of the level of vertical specialization of economies: the extent to which economic activities in a country focus on particular tasks and activities in GVCs.

- At the *industry* level, the average foreign value added is a proxy for the extent to which industry value chains are segmented or "fine-sliced" into distinct tasks and activities that generate trade, compounding the double-counting effect. This is important for policymakers in designing, for example, industrial development, trade and investment promotion policies.

Developed countries, as a whole, at 31 per cent have a higher share of foreign value added in exports than the global average (figure IV.3); i.e. the import dependence of exports in those countries appears higher. However, this picture is distorted by the weight in global figures of internal trade within

Figure IV.2. Value added in global trade, 2010



Source: UNCTAD-Eora GVC Database, UNCTAD estimates.

Box IV.2. Understanding value added trade data and indicators

A country's exports can be divided into domestically produced value added and imported (foreign) value added that is incorporated into exported goods and services. Furthermore, exports can go to a foreign market either for final consumption or as intermediate inputs to be exported again to third countries (or back to the original country). The analysis of GVCs takes into account both foreign value added in exports (the *upstream* perspective) and exported value added incorporated in third-country exports (the *downstream* perspective). The most common indicators, which will also be used in this report, are as follows:

1. **Foreign value added** (foreign value added as a share of exports) indicates what part of a country's gross exports consists of inputs that have been produced in other countries. It is the share of the country's exports that is not adding to its GDP.[a]
2. **Domestic value added** is the part of exports created in-country, i.e. the part of exports that contributes to GDP. The sum of foreign and domestic value added equates to gross exports. Domestic value added can be put in relation to other variables:
    a. As a share of GDP, it measures the extent to which trade contributes to the GDP of a country.
    b. As a share of global value added trade (the "slice of the value added trade pie"), it can be compared with a country's share in global gross exports or its share in global GDP.
3. **GVC participation**[b] indicates the share of a country's exports that is part of a multi-stage trade process, by adding to the foreign value added *used* in a country's own exports also the value added *supplied* to other countries' exports. Although the degree to which exports are used by other countries for further export generation may appear less relevant for policymakers, because it does not change the domestic value added contribution of trade, the participation rate is nonetheless a useful indicator of the extent to which a country's exports are integrated in international production networks. It is thus helpful in exploring the trade-investment nexus.

The GVC participation rate corrects the limitation of the foreign and domestic value added indicators in which countries at the beginning of the value chain (e.g. exporters of raw materials) have a low foreign value added content of exports by definition. It gives a more complete picture of the involvement of countries in GVCs, both upstream and downstream.

A country's GVC participation, measured as a share of exports, effectively assesses the *reliance* of exports on GVCs. In this sense, it is also an indicator of how much hypothetical "damage" to GVCs (and global GDP) would occur if a country's exports are blocked or, alternatively, it represents the *vulnerability* of the GVC to shocks in the respective country.

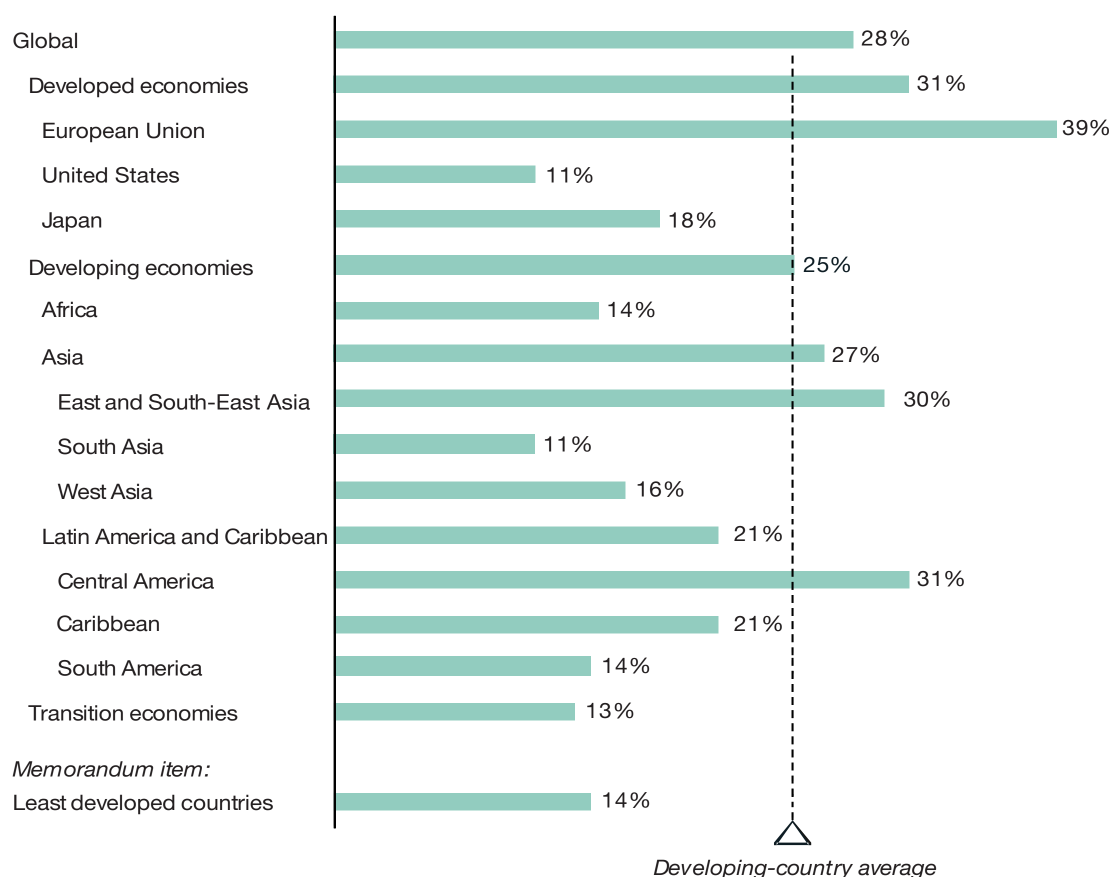
GVC indicators can also be used to assess the extent to which *industries* rely on internationally integrated production networks. Data on value added trade by industry can provide useful indications on comparative advantages and competitiveness of countries, and hence form a basis for development strategies and policies. A number of complex methods have been devised in the literature to measure GVC length.[c] This report will use a simplification device by looking at the degree of double counting in industries, which, conceptually, can serve as a rough proxy for the length of GVCs.

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

the highly integrated EU economy, which accounts for some 70 per cent of EU-originated exports. Japan and the United States show significantly lower shares of such "double counting".

Thus, while developing countries (25 per cent) have a lower share of foreign value added than the world average (28 per cent), their foreign value added share is significantly higher than in the United States and Japan – or than in the EU, if only external trade is taken into account. Among developing economies, the highest shares of foreign value added in trade are found in East and South-East Asia and in Central America (including Mexico), where processing industries account for a significant part of exports. Foreign value added in exports is much lower in Africa, West Asia, South America and in the transition economies, where natural resources and commodities exports with little foreign inputs tend to play an important role. The lowest share of foreign value added in exports is found in South Asia, mainly due to the weight of services exports, which also use relatively fewer foreign inputs.

Figure IV.3. Share of foreign value added in exports, by region, 2010



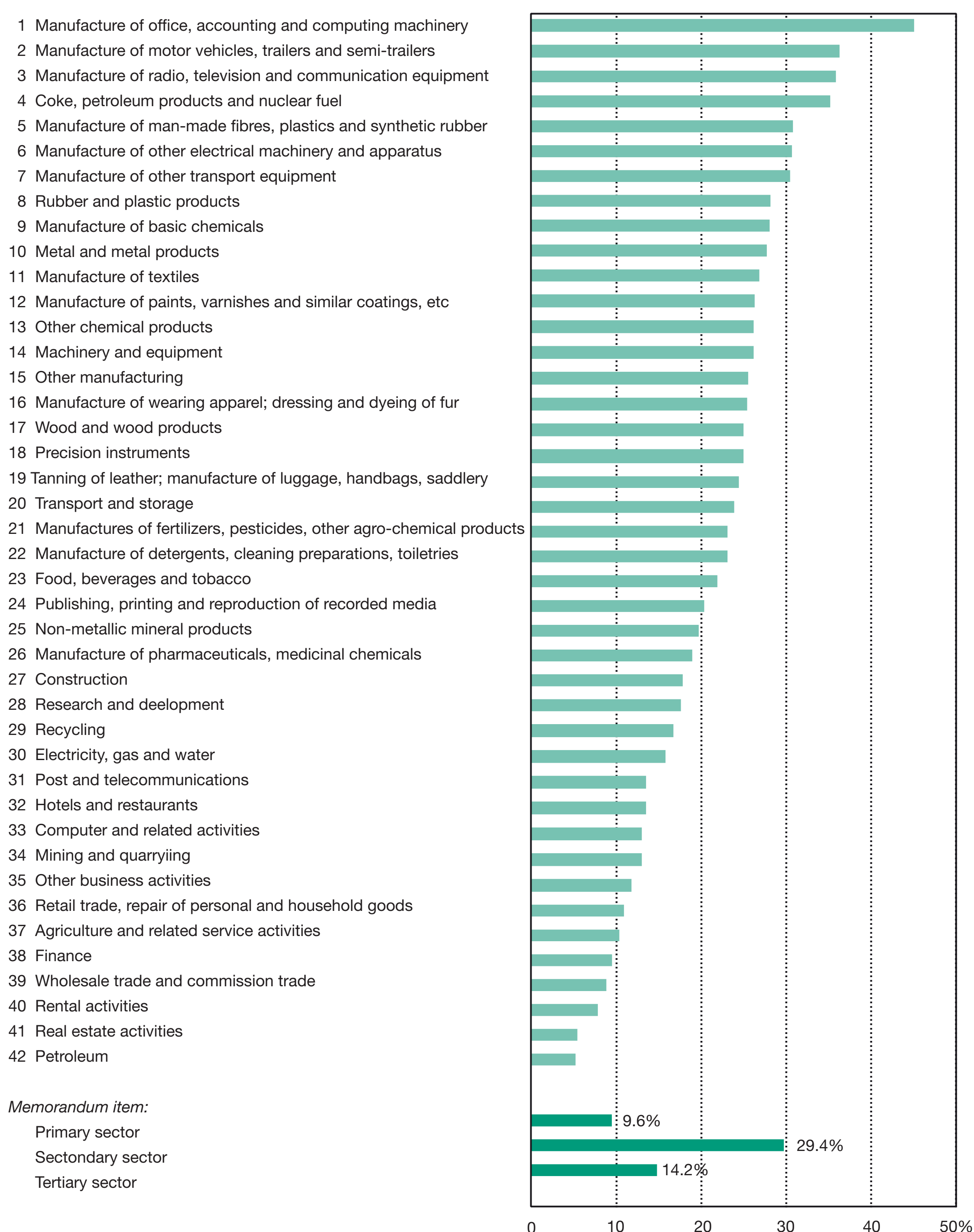
Source: UNCTAD-Eora GVC Database.

The average foreign value added share of exports and the degree of double counting in global exports of an industry provide a rough indication of the extent to which industries rely on internationally integrated production networks, as it proxies the extent to which intermediate goods and services cross borders until final consumption of the industry's output.

Traditionally, a select number of manufacturing industries have been at the forefront of value chain segmentation ("fine-slicing" of value chains) and of associated trends such as outsourcing and offshoring. The electronics and automotive industries, where products can be broken down into discrete components that can be separately produced, easily transported and assembled in low-cost locations, have led the way in shaping GVCs and consequently rank highest by share of foreign value added in trade (figure IV.4). A number of industries that incorporate and process outputs from extractive industries and traded commodities (e.g. petroleum products, plastics, basic chemicals) follow closely behind. The extractive industries themselves naturally rank much lower as they require little imported content of exports apart from some services. Foreign value added in exports is thus not a fully fledged indicator of the GVC complexity of industries; extractive industries are clearly a fundamental "starting point" of many GVCs, not because of their use of foreign value added, but because they constitute value added inputs in many other industries' exports. Similarly, services industries – e.g. business services, finance, utilities – also rank low in terms of imported content of exports as they use fewer intermediate inputs and their involvement in GVCs typically occurs through value added incorporated in exported manufactured goods.

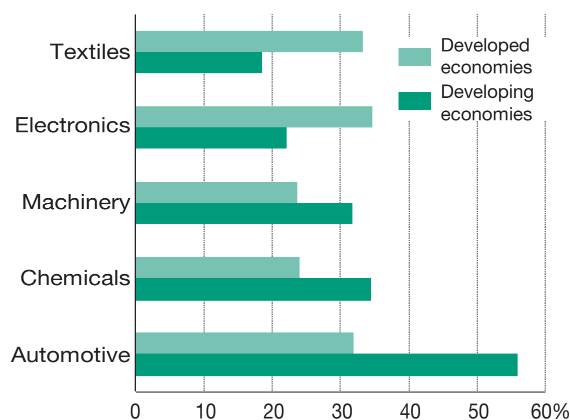
Clearly, GVCs do not equate with industries. A value chain for a given product may incorporate value added produced by many different industries (e.g. manufactured products incorporate value added

Figure IV.4. Share of foreign value added in exports, selected industries, 2010



Source: UNCTAD-Eora GVC Database.
Note: Illustrative list of industries selected based on significance in GVCs, at various levels of industry classification.

Figure IV.5. Share of foreign value added in exports, developed and developing economies, selected industries, 2010



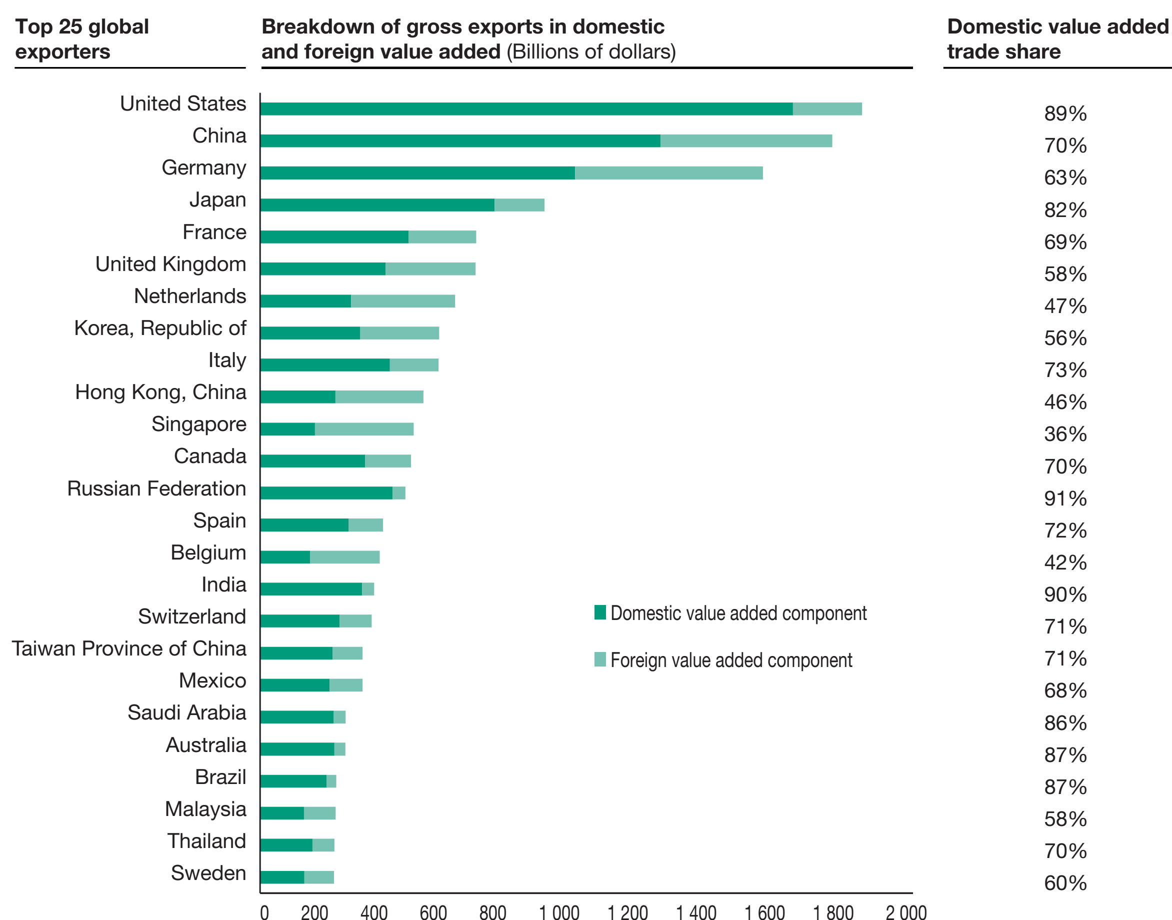
Source: UNCTAD-Eora GVC Database.

from services industries). The global average shares by industry of foreign value added ignore the fact that each industry may be part of and contribute to many different value chains.

Global industry averages also disguise significant differences by country or region (figure IV.5). Foreign value added shares in the textile industry are much higher in developed than in developing countries, confirming that the latter provide much of the semi-finished inputs used by developed-country exporters. Electronics is another industry in which developed countries import a greater share of the value added in their exports. In contrast, in machinery, chemicals and the automotive industry, developing countries tend to use more foreign inputs for the production of their exports.

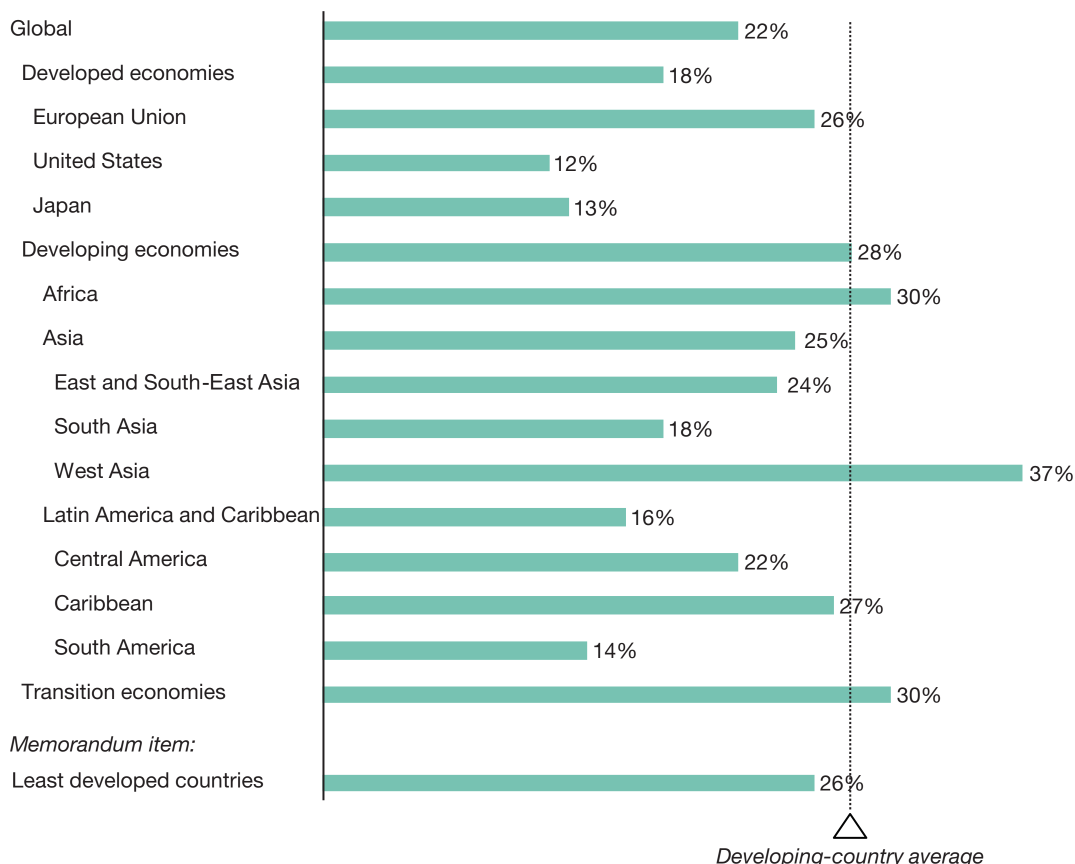
Because exports incorporate foreign produced value added, the share of domestic value added in exports by country can be quite different (figure IV.6).

Figure IV.6. Domestic value added trade shares of the top 25 exporting economies, 2010



Source: UNCTAD-Eora GVC Database.

Figure IV.7. Domestic value added in trade as a share of GDP, by region, 2010



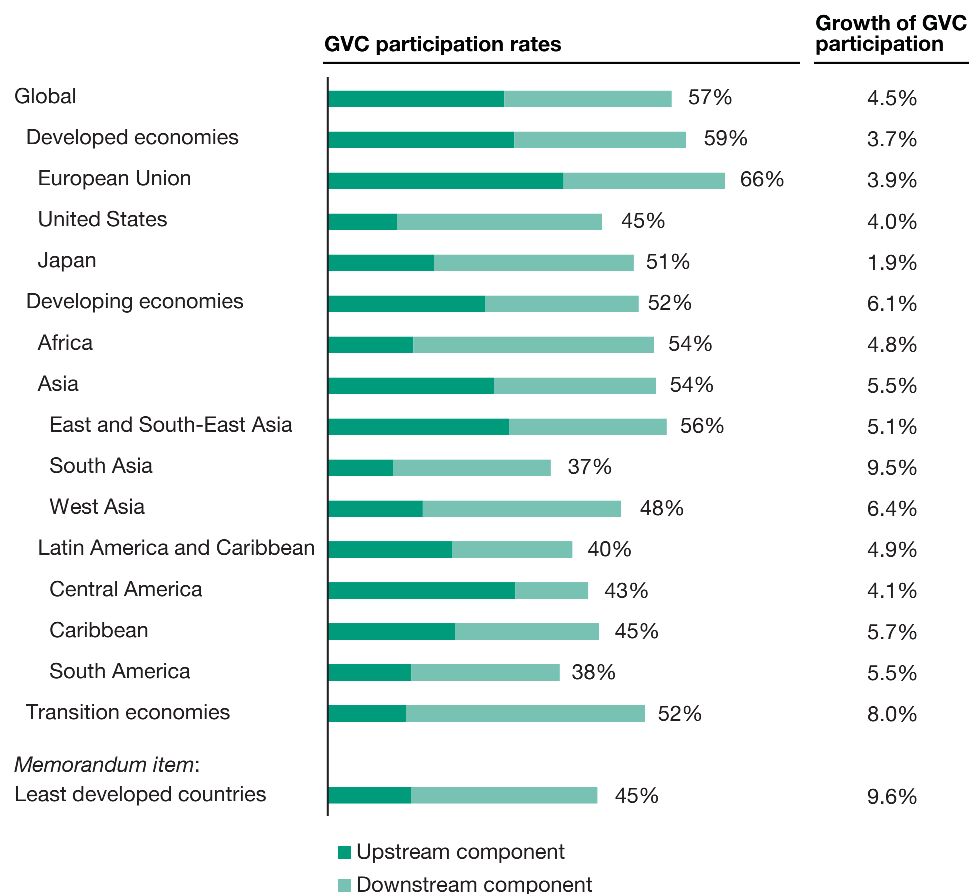
Source: UNCTAD-Eora GVC Database.

Factors that influence the share of domestic value added in exports include:

- *Size of the economy*. Large economies, such as the United States or Japan, tend to have significant internal value chains and to rely less on foreign inputs. There are important exceptions, including China, Germany and the United Kingdom.
- *Composition of exports and position in GVCs*. Countries that have significant shares of natural resources, oil or other commodities in their exports, such as the Russian Federation and Saudi Arabia, tend to have higher shares of domestic value added trade, as such exports are at the "beginning" of GVCs and require few foreign inputs. Countries that have significant services exports such as India also tend to capture relatively more value (although India's exports of natural resources are important as well). In contrast, countries that have significant shares of exports in highly segmented industries (see figure IV.4) may need to import more to generate exports.
- *Economic structure and export model*. Countries with significant shares of entrepôt trade, such as Hong Kong (China), Singapore or the Netherlands, will have higher shares of foreign value added. The same applies for countries with important processing trade sectors.

The combination of these three factors explains most countries' domestic value added shares (net of policy factors which will be explored later). For example, China, on the one hand, is a large economy with an increasingly important internal supply chain. On the other hand, it has a significant share of processing trade and is an important exporter of electronics, the industry with the most complex GVC linkages. As a result, its domestic

Figure IV.8. GVC participation, 2010, and GVC participation growth rates, 2005–2010



Source: UNCTAD-Eora GVC Database.
Note: GVC participation indicates the share of a country's exports that is part of a multi-stage trade process; it is the foreign value added used in a country's exports (upstream perspective) plus the value added supplied to other countries' exports (downstream perspective), divided by total exports. GVC participation growth here is the annual growth of the sum of the upstream and downstream component values (CAGR).

value added share balances at about the global average of 72 per cent.

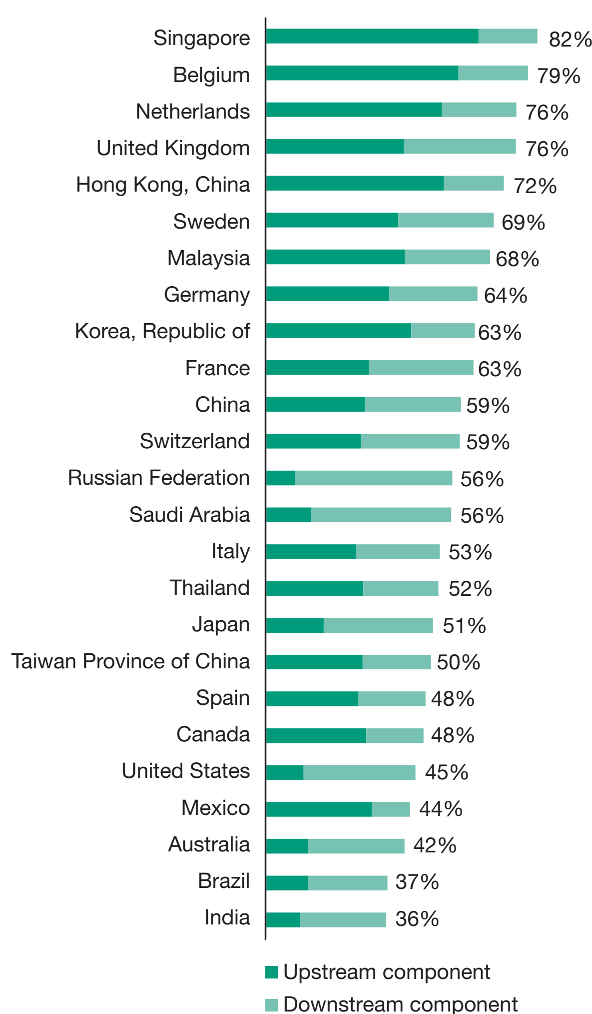
Domestic value added created from trade – the actual contribution of trade to GDP after discounting imported value added – can be significant relative to the size of local economies. While the contribution of trade to global GDP is about one fifth, this share is higher in developing and transition economies (figure IV.7). It is particularly high in Africa, West Asia and the transition economies owing to the relative importance of exports of natural resources there and, in part, to the relatively small size of the local "non-tradables" economy. The contribution of trade to GDP is high also in East and South-East Asia; on this measure, that region rivals the highly integrated European market. This high share not only reflects the export competitiveness of these Asian economies but also their higher share of domestic value added in trade compared with Europe.

The value and share of developing-country exports that depend on GVCs, because of either upstream links (foreign value added in exports) or downstream links (exports that are incorporated in other products and re-exported) is quite significant (figure IV.8). East and South-East Asia remains the region with the highest level of GVC participation, reflecting its primacy as the most important region for export-oriented manufacturing and processing activities. Central America (including Mexico) also has a high participation rate, but whereas it ranked equal with South-East Asia in terms of foreign value added in exports, it has a lower downstream participation rate, reflecting the fact that it exports relatively more

to the United States domestic market rather than for onward exports.

Commodity-exporting regions have a significantly higher GVC participation rate than their foreign value added share would suggest, indicating that much of their exports are processed and their value added incorporated in third-country exports – i.e. they operate at the starting point of GVCs. South Asia remains the lowest ranked region in terms of GVC participation, partly because of exports of natural resources, and because much of the services exports from the region satisfy final demand in importing countries and are not used to produce further exports.

Figure IV.9. GVC participation rate of the top 25 exporting economies, 2010



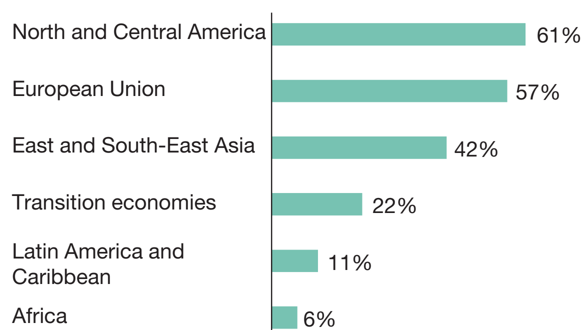
Source: UNCTAD-Eora GVC Database.

However, South Asia is the region with the highest GVC participation growth rate, albeit from a low base. Transition economies also show faster than average growth. Nearly all developing regions outpace the developed world in GVC growth. It should be noted that much of the growth in GVC participation in developing countries, on this measure, must be attributed to downstream use in GVCs of natural resources and raw materials. Although downstream use is the more positive component of participation, in the sense that it contributes to GDP, the lack of parallel growth of the upstream component confirms that many poorer developing countries are still behind in accessing more fragmented GVCs.

As noted above, GVC participation – or the role that individual countries play in international production networks – is driven by many different factors, from size of the economy to industrial structure and level of industrialization, composition of exports and positioning in value chains, policy elements, and others. As a result, countries with very different characteristics may be very similar in the ranking of GVC participation (figure IV.9).

The GVC participation of many countries relates substantially to GVC interactions within their respective regions. Instead of a global reach, most value chains have a distinctive regional character, as shown in figure IV.10. North and Central American value chain links are especially strong, as are intra-European Union ones. The largest extraregional bilateral GVC flows are between Germany and the United States, China and Germany, and Japan and the United States, in that order.

Figure IV.10. Share of intra-regional GVC flows in total GVC participation, selected regions, 2010



Source: UNCTAD-Eora GVC Database.

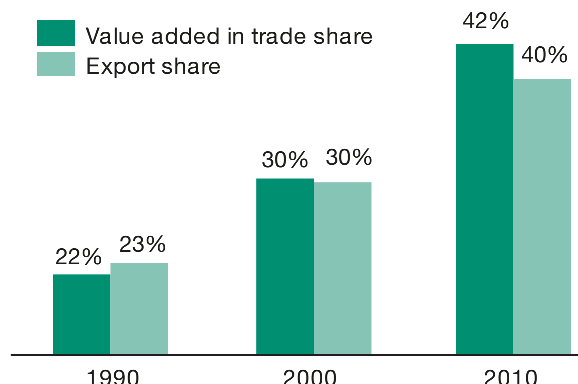
2. Value added trade patterns in the developing world

Developing countries, including the poorest, are increasingly participating in GVCs and gaining domestic value added, although many are starting from a very low base.

The share of global value added trade captured by developing economies is increasing rapidly. It grew from about 20 per cent in 1990, to 30 per cent in 2000, to over 40 per cent in 2010. As a group, developing and transition economies are capturing an increasing share of the global value added trade pie (figure IV.11). As global trade grows, developed economies appear to rely increasingly on imported content for their exports, allowing developing countries to add disproportionately to their domestic value added in exports.

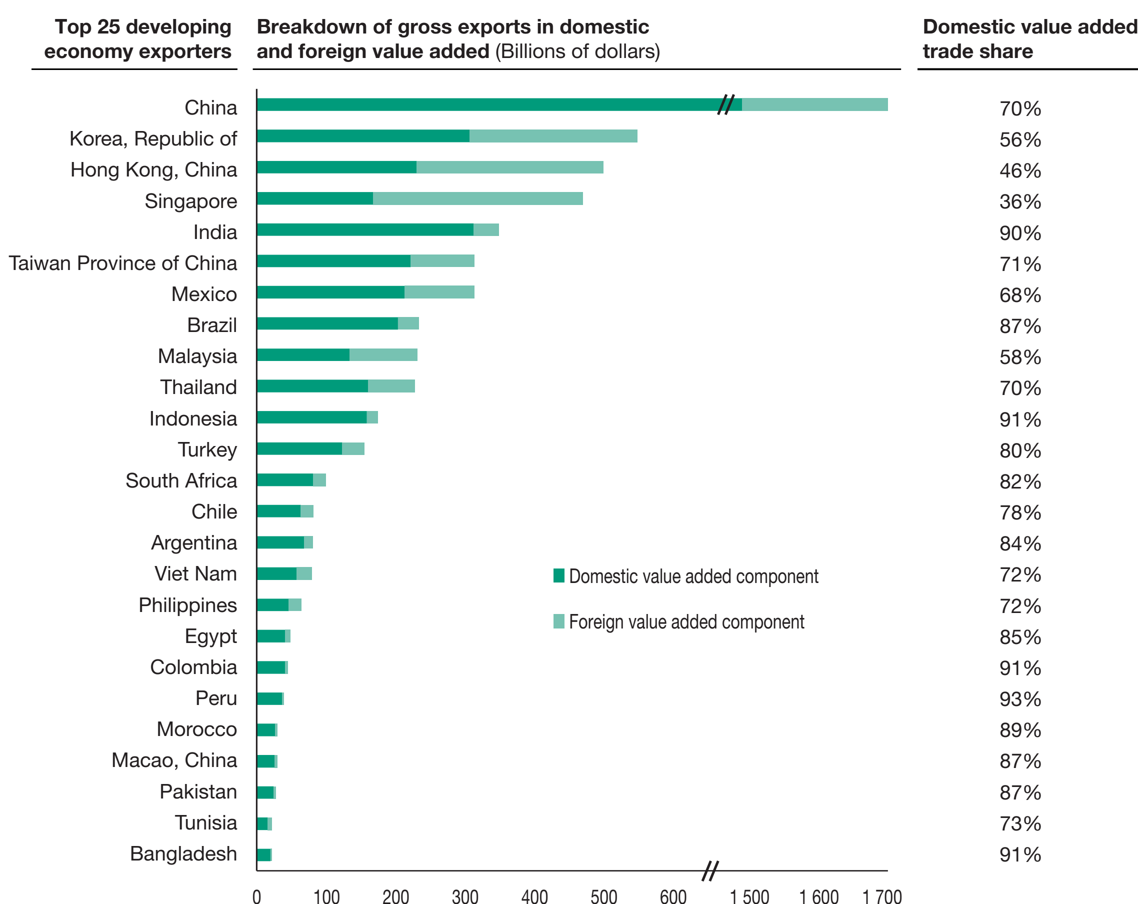
Looking at the domestic value added trade shares for the top 25 developing-economy exporters, excluding predominantly oil-exporting countries (figure IV.12), shows that exporters of natural resources and raw materials that use little foreign value added in exports (such as Chile or Indonesia) obtain a relatively large share of domestic value

Figure IV.11. Share of developing countries in global value added trade and in gross exports, 1990–2010



Source: UNCTAD-Eora GVC Database.

Figure IV.12. Domestic value added trade shares of the top 25 developing economy exporters, 2010

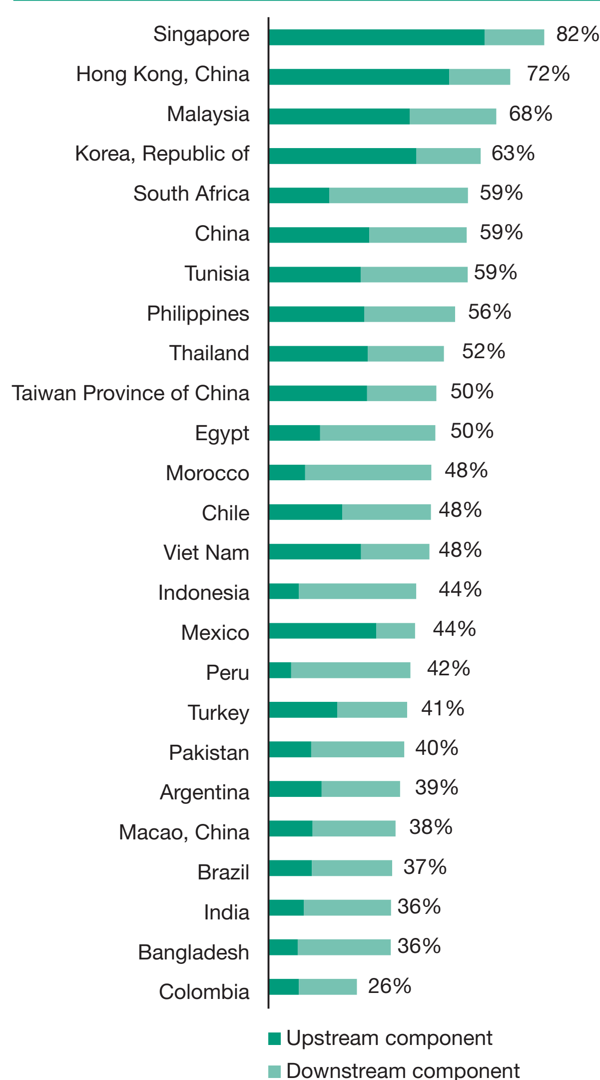


Source: UNCTAD-Eora GVC Database.
Note: Top 25 excludes predominantly oil-exporting countries.

added, as do services exporters such as India. Relatively open developing economies with strong export performances and very high GVC participation (such as the Republic of Korea; Hong Kong, China; Singapore; Malaysia) get a lower value added contribution from trade than their export shares would suggest, although the absolute contribution of value added trade to GDP in these countries is high.

Among the top 25 exporting developing economies there are significant differences in the degree to which their exports are integrated in – or depend on – GVC participation (figure IV.13). The main East and South-East Asian exporters rank highest in GVC participation because they both import a substantial part of their exports (foreign value added) and a significant part of their exports are intermediate goods that are used in third countries' exports. These countries' exports are thus integrated in GVCs both upstream and downstream; in other words, they operate in "the middle" of GVCs. The commodity-exporting group of countries also rates relatively high in GVC participation, but largely because of outsized downstream usage of their export products in third countries' exports.

Figure IV.13. GVC participation rate of the top 25 developing economy exporters, 2010



Source: UNCTAD-Eora GVC Database.
Note: Top 25 excludes predominantly oil-exporting countries.

Some of the larger emerging markets, such as India, Brazil, Argentina and Turkey, have relatively low GVC participation rates. These countries may have lower upstream participation levels, both because of the nature of their exports (natural resources and services exports tend to have less need for imported content or foreign value added) and because larger economies display a greater degree of self-sufficiency in production for exports. They may also have lower downstream participation levels because of a focus on exports of so-called final-demand goods and services, i.e. those not used as intermediates in exports to third countries.

3. FDI and the role of TNCs in shaping GVCs

TNCs are involved in 80 per cent of global trade. They shape value added trade patterns through intra-firm, NEM and arm's-length transactions.

Investment and trade are inextricably intertwined. Much of trade in natural resources is driven by large cross-border investments in extractive industries by globally operating TNCs. Market-seeking foreign direct investment (FDI) by TNCs also generates trade, often shifting arm's-length trade to intra-firm trade. Efficiency-seeking FDI, through which firms seek to locate discrete parts of their production processes in low-cost locations, is particularly associated with GVCs; it increases the amount of trade taking place within the international production networks of TNCs and contributes to the "double counting" in global trade flows discussed in this report.

FDI generally precedes increases in exports. FDI is thus an increasingly important driver of trade flows worldwide. This is confirmed by evidence at the firm level. Only a very small fraction of the universe of

firms in most economies engages in international trade, and trading activity tends to be highly concentrated. In the EU, the top 10 per cent of exporting firms typically accounts for 70 to 80 per cent of export volumes, while this figure rises to 96 per cent of total exports for the United States, where about 2,200 firms (the top 1 per cent of exporters, most of which are TNC parent companies or foreign affiliates) account for more than 80 per cent of total trade. The international production networks shaped by TNC parent companies and affiliates account for a large share of most countries' trade.[5]

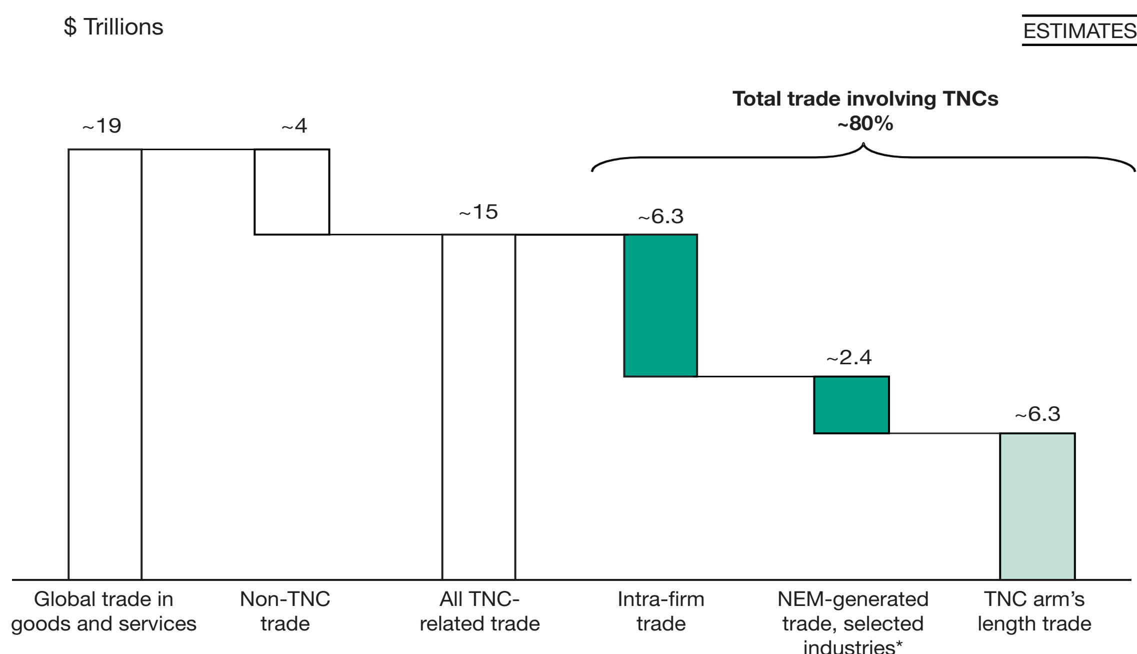
On the basis of these macro-indicators of international production and firm-level evidence, UNCTAD estimates that about 80 per cent of global trade (in terms of gross exports) is linked to the international production networks of TNCs, either as intra-firm trade, through NEMs (which include, among others, contract manufacturing, licensing, and franchising), or through arm's-length transactions involving at least one TNC (figure IV.14 and box IV.3).

The international production networks of TNCs, within which most trade takes place, are heavily geared towards providing those value added inputs required to generate trade. For example, GVCs make extensive use of services: while the share of services in gross exports worldwide is only about 20 per cent, almost half (46 per cent) of value added in exports is contributed by service-sector activities, as most manufacturing exports require services for their production. This provides a parallel with global FDI stock, two thirds of which is allocated to services activities (figure IV.15).[6] This picture is essentially the same for developed and developing countries.

The involvement of TNCs in generating value added trade is strongly implied by the statistical relationship between FDI stock in countries and their GVC participation rates (figure IV.16). The correlation is strongly positive and increasingly so over time, especially in the poorest countries, indicating that FDI may be an important avenue for developing countries to gain access to GVCs and increase their participation.

Ranking countries by the ratio of FDI stock over GDP and grouping them in quartiles (figure IV.17) shows that the group of countries with the most FDI relative to the size of their economies tend to have three characteristics:

Figure IV.14. Global gross trade (exports of goods and services), by type of TNC involvement, 2010



Source: UNCTAD estimates (see box IV.3).
Note: * Including contract manufacturing in electronics, automotive components, pharmaceuticals, garments, footwear, toys; and IT services and business process outsourcing (see *WIR11*). TNC arm's length trade may include other NEM trade.

Box IV.3. Estimating trade within the international production networks of TNCs

The estimates for trade taking place with the international production networks of TNCs shown in figure IV.14 are based on evidence about investment-trade links of individual countries and regions:[a]

- In the United States, in 2010, affiliates of foreign TNCs accounted for 20 per cent of exports and 28 per cent of imports of goods, while TNCs based in the United States accounted for 45 per cent of exports and 39 per cent of imports. Thus some two thirds of both exports and imports of goods can be considered to be within the international production networks of TNCs.
- In Europe, also in 2010, French TNCs accounted for some 31 per cent of goods exports and 24 per cent of imports, while foreign affiliates in France accounted for 34 per cent and 38 per cent, respectively. Thus some 64 per cent of total French exports and 62 per cent of total French imports of goods in 2009 can be considered to be within the international production networks of TNCs. Similar scattered evidence exists for other EU countries.
- In Japan, TNCs based there accounted for 85 per cent of exports of goods and services, while foreign affiliates contributed a further 8 per cent. Thus 93 per cent of total Japanese exports of goods and services are linked to TNCs.
- In China, foreign affiliates accounted for some 50 per cent of exports and 48 per cent of imports in 2012. Adding the trade activities of Chinese TNCs – although they are perhaps not as large as the share of their French or United States counterparts given the lower (but growing) share of Chinese outward FDI – would lead to estimates of trade within international production networks in excess of the United States share.
- In developing countries as a group, it is likely that the share of trade within the production networks of TNCs is higher, for two reasons: (i) the productivity curve of firms is steeper than in developed countries, meaning that trade is likely to be even more concentrated in a small number of large exporters and importers with above-average productivity, i.e. predominantly TNCs and their affiliates; (ii) the share of extractive industries in their exports (at about 25 per cent) is significantly higher than the world average (about 17 per cent) and the extraction and trade of natural resources generally involves TNCs.

A significant share of this trade is intra-firm trade, the international flows of goods and services between parent companies and their affiliates or among these affiliates, as opposed to arm's-length trade between unrelated parties (inter-firm trade). For example, the share of exports by United States affiliates abroad directed to other affiliated firms, including parent firms, remained high at about 60 per cent over the past decade. Similarly, nearly half of the exports of goods by foreign affiliates located in the United States are shipped to the foreign parent group and as much as 70 per cent of their imports arrive from the foreign parent group. Japanese TNCs export 40 per cent of their goods and services to their own affiliates abroad. Although further evidence on intra-firm trade is patchy, the general consensus is that intra-firm trade accounts on average for about 30 per cent of a country's exports, with large variations across countries.

These explanations focus for the most part on merchandise trade. There is evidence that TNC involvement in services trade, with a growing share of intra-firm trade in services (e.g. corporate functions, financial services), is even higher. Where it does not occur in the form of intra-firm trade, services trade often takes place in NEM relationships (information technology and business process outsourcing, call centres, etc.). NEMs as a whole (including contract manufacturing activities) are estimated to be worth over $2 trillion (see *WIR11*).

Arm's-length trade by TNCs (exports to and imports from unrelated parties in data from the OECD's Activity of Multinational Enterprises database) is estimated to be worth about $6 trillion, the residual. Non-TNC-related trade includes all transactions between firms that have only domestic operations, anonymous transactions on commodity exchanges, etc.

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

- Higher foreign value added in their exports (foreign affiliates of TNCs producing for exports tend to use value added produced by other parts of the TNC production network);
- Higher GVC participation (foreign affiliates of TNCs not only use foreign inputs in their production, but also supply to other parts of the TNC network for further exports); and

- A higher relative share in global value trade compared with their share in global exports.

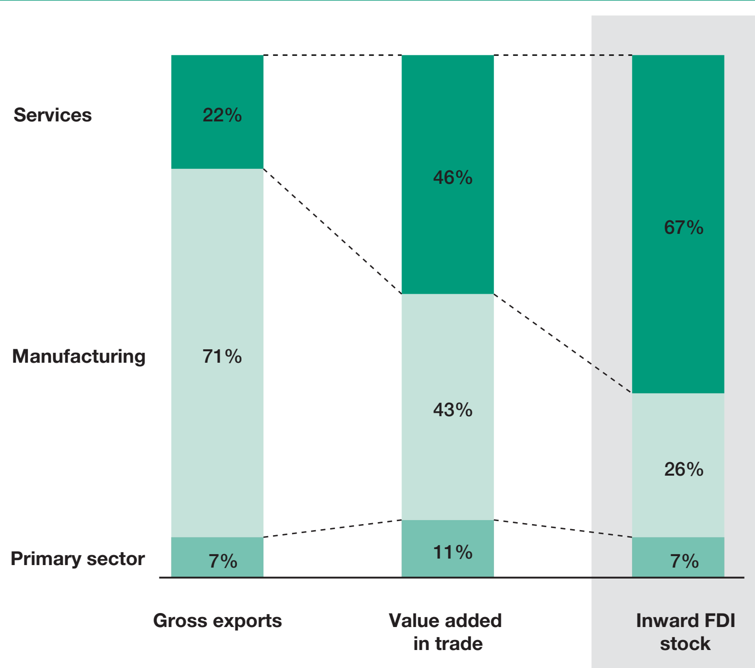
While the link between FDI and TNC activities, on the one hand, and value added trade patterns, on the other, can thus be established *at the macro level*, determining how TNCs and their networks of affiliates and contractual partners shape value added trade patterns through *firm-level evidence* remains challenging. Information on TNC ownership structures and financial figures is fragmented, and transactions between co-affiliates within the same group are typically not reported. For a given country-industry combination, by matching TNC network structures with industry value added inputs and outputs, it is possible to derive intra-firm sourcing and supply propensities (see box IV.4 for methodological details and data sources).

The Thai automotive industry provides a clear example of the pivotal role of TNCs in shaping patterns of value added trade and domestic value creation (table IV.2). It is one of the fastest growing industries in Thailand, accounting for about $34 billion in gross output. Some 80 per cent of production is exported. The domestic value added share is about 25 per cent of the export value. Of that 25 per cent of domestic value added, only 60 per cent is produced by firms in the automotive industry, and 40 per cent is contributed by firms in supplier industries, including services (further detail on such local linkages in section C).

More than half of the gross output of the industry is produced by a relatively small group of foreign affiliates of TNCs: 52 foreign affiliates, part of 35 business groups or TNC networks – corresponding to 4 per cent of the total number of companies registered (some 1,300) – produce 56 per cent of total output. To a large extent, these foreign affiliates also drive the upstream and downstream linkages of the industry in Thailand.

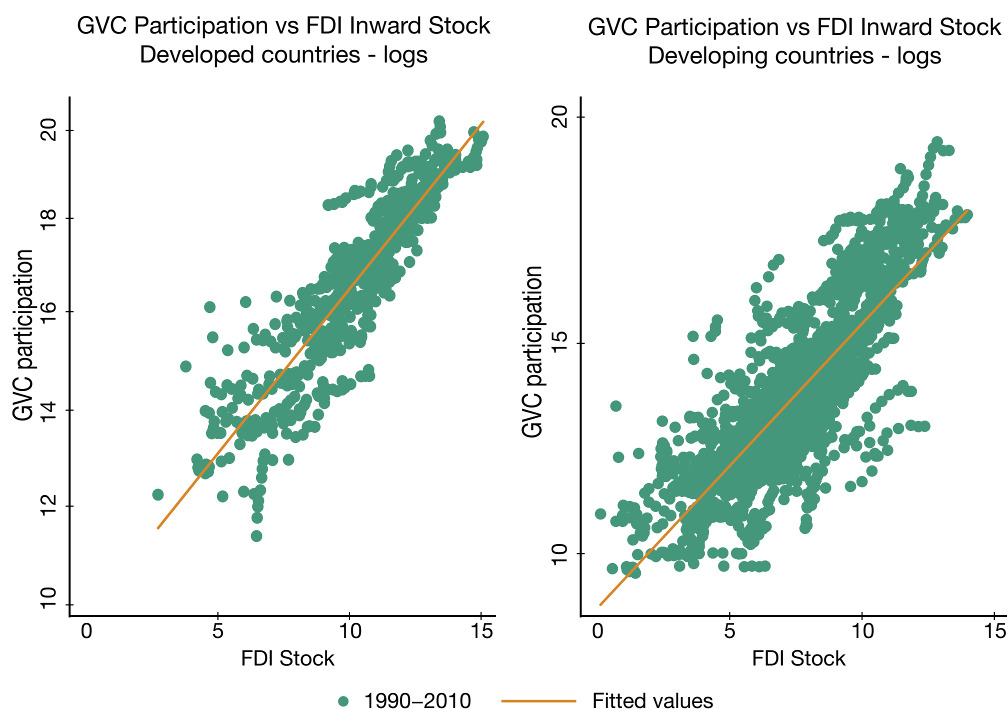
The total TNC network of the 52 foreign affiliates in Thailand comprises some 6,000 co-affiliates located in 61 countries around the world (the sum of affiliates of all 35 business groups). About 27 per cent of the foreign value added used by individual affiliates in Thailand (of the 75 per cent of foreign value added in exports) is sourced intra-firm from within their own TNC networks or business groups. On the downstream side, an estimated 65 per cent of foreign affiliate exports is absorbed by firms within their own network. Downstream linkages are more concentrated, with potential intra-firm export connections limited to some 850 co-affiliates.

Figure IV.15. Sector composition of global gross exports, value added trade, and FDI stock, 2010



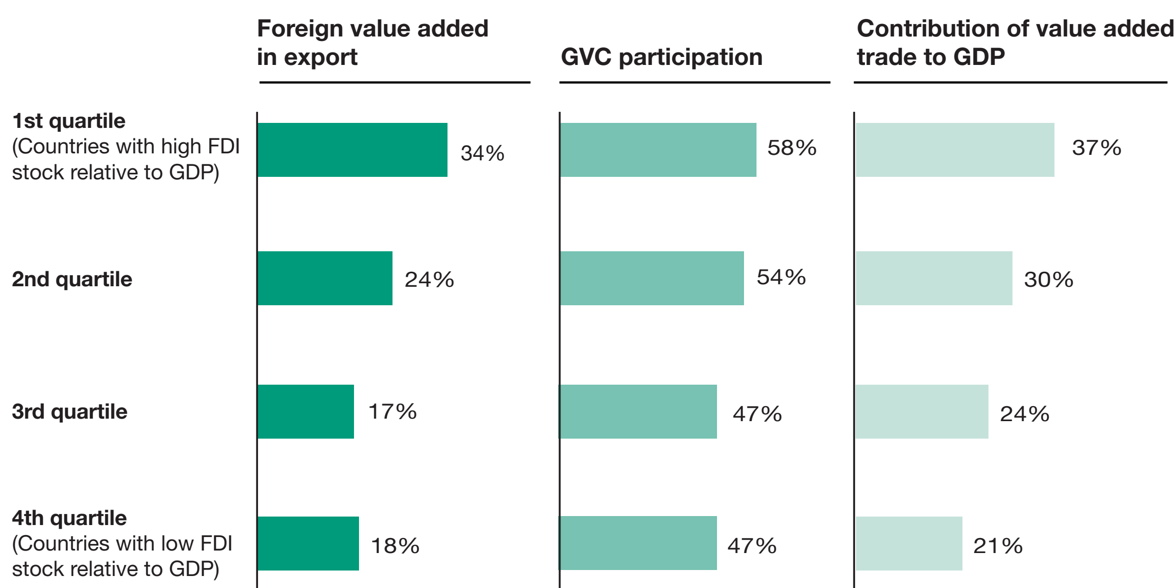
Source: UNCTAD-Eora GVC Database, UNCTAD FDI Database.

Figure IV.16. Correlation between levels of inward FDI stock and GVC participation



Source: UNCTAD-Eora GVC Database, UNCTAD FDI Database, UNCTAD analysis.
Note: Data for 187 countries over 20 years. The regression of the annual GVC participation growth on the annual FDI inward (stock) growth yields a positive and significant correlation (at the 5 per cent level) both for developed and developing countries (R^2 = 0.77 and 0.44, respectively). The correlation remains significant considering the two time periods 1990 - 2000 and 2001 - 2010 separately. Regressions use lagged (one year) inward FDI (stock) growth rates and include year fixed effects to account for unobserved heterogeneity.

Figure IV.17. Key value added trade indicators, by quartile of inward FDI stock relative to GDP, 2010



Source: UNCTAD-Eora GVC Database, UNCTAD FDI Database, UNCTAD analysis.
Note: Data for 180 countries, ranked by inward FDI stock relative to GDP and grouped in quartiles; data reported are median values for each quartile.

Table IV.2. Role of TNCs in shaping value added trade in the Thai automotive industry

Indicators	Values	Example affiliates and co-affiliates
Automotive industry production in Thailand		
Gross output	~$34 billion	
Export share in gross output	78%	
Domestic value added share in exports	25%	
Share of domestic value added contributed by industries other than automotive in Thailand	40%	
Number of foreign affiliates of TNCs	52	• Mitsubishi: Tri Petch Isuzu Sales Co. Ltd. • Honda: Thai Honda Manufacturing Co. Ltd. • BMW Manufacturing Co. Ltd.
Number of business groups (TNC networks) to which these foreign affiliates belong	35	
Foreign affiliates as share of total number of firms	4%	
Upstream: foreign value added used by the automotive industry in Thailand (imports)		
Foreign value added share in exports	75%	• Mitsubishi: NHK Manufacturing, Malaysia (electronic components) • Honda: Kyusyu TS Co.,Ltd., Japan (plastics) • BMW: SGL Carbon Fibers Limited, UK (chemicals)
Number of potential intra-firm supplier links	~6,000	
Number of countries in which these intra-firm suppliers are based	61	
Estimated share of foreign value added sourced intra-firm (intra-firm import propensity)	27%	
Downstream: exports from the automotive industry in Thailand		
Number of potential intra-firm client links	850	• Mitsubishi: Guangzhou Intex Auto Parts Co., China (automotive parts) • Honda Trading de México, SA, Mexico (wholesale) • BMW Brilliance Automotive Ltd., China (wholesale)
Number of countries in which these intra-firm clients are based	57	
Estimated share of intra-firm exports (intra-firm export propensity)	65%	

Source: UNCTAD analysis, based on the UNCTAD-Eora GVC Database and the Business Group Database.

Box IV.4. Assessing value added trade patterns at the firm level

Determining how TNCs and their networks of foreign affiliates and contractual partners shape patterns of value added trade is challenging, as information on TNC ownership structures and financial data is fragmented, and transactions between affiliates within the same group are typically not reported. In order to fill this gap, UNCTAD has linked the UNCTAD-Eora GVC Database with firm-level ownership and financial data from a business group database[a] (based on the Orbis ownership database), which allows the mapping of some 50,000 international business groups with nearly 500,000 affiliates worldwide. The database contains key information on TNC activity by country and industry (as classified by the six-digit NAICS standard system), e.g. the number of foreign affiliates, revenues, value added, and number of employees.

Linking value added trade data and business group connections yields an index of the propensity for foreign affiliates to source foreign value added from co-affiliates within their own business group networks, and to provide value added inputs to other parts of their networks. These propensity indices (upstream and downstream) can be used to estimate the relevance of intra-firm trade linkages in TNC-governed GVCs (in the absence of data on actual shipments between affiliates in TNC networks), for a given industry in a given economy.

The methodology includes the following steps:
1. Retrieve sources of production inputs and destinations for production outputs from value added trade data.
2. Match patterns of inputs and outputs (patterns of value added trade) with business group ownership structures. Any overlap between value added trade flows and the web of co-affiliates is considered a potential intra-firm trade connection. (If trade flows do not find a correspondence in the network, these connections are considered to be arm's-length.)
3. Assign weights to the resulting potential trade-ownership linkages based on a production function derived from national I-O tables.
4. Estimate upstream and downstream intra-firm trade propensities at business group level. (The sum of the weights assigned to all intra-firm trade linkages.)
5. Project propensities at the industry level, by applying to the propensities for individual affiliates weights based on (i) cost of goods sold for the upstream side and (ii) revenues for the downstream side.

/...

Box IV.4. Assessing value added trade patterns at the firm level (concluded)

The methodology has a number of limitations. The first is the underlying assumption that any ownership connection in business groups that matches with a value added trade link translates into an intra-firm trade link; i.e. all inputs sourced from a country in which a co-affiliate is present (and carries out the matching economic activity) are assumed to be sourced from that co-affiliate. This assumption is validated by earlier studies that found that 80 per cent of company transactions with countries in which an affiliate is present are intra-firm transactions.[b] The second limitation relates to the assumption that all firms in the industry share the same production function. As a consequence, the method cannot discriminate the foreign input share between foreign affiliate and domestic firms. Foreign affiliates can be assumed to have higher foreign value added than domestic firms.

Despite these limitations, and the fact that the current method can treat only one industry/country combination at a time, this approach – one of the first systematic (not based on case studies) analyses of the role of TNCs in GVCs – can provide insights into how TNC group structures shape patterns of value added trade.

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

B. GVC governance and locational determinants

TNC's decisions on where to locate and with whom to partner are decisions on where to invest and from where to trade. These decisions drive patterns of value added in GVCs.

In the period immediately after the Second World War, an international political economy grounded in concepts of national independence, self-sufficiency and import substitution led to international trade essentially being conducted between autonomous enterprises, with TNC activity mostly in the form of "multi-domestic", host-country-oriented affiliates. This began to change in the late 1960s and 1970s, with the initial footfalls of offshore production by Japanese, European and United States manufacturing TNCs in South-East Asia, pursuing cost-cutting strategies in the wake of recession and competitive pressures in their home (and later global) markets. Subsequent decades have inexorably built on the dynamic of these incipient GVCs, with technological progress (e.g. modern information and communication technology, international quality standards), political factors (e.g. liberalization and privatization policies, China's emergence as a global manufacturing base) and investor strategies (e.g. fine-slicing of operations and offshoring of every segment or subsegment of their value chains, a greater use of cross-border non-equity modes) jointly – and interconnectedly – leading to the *trade-investment nexus* of today.

As seen in the previous section, trade within the ambit of TNCs in this nexus includes, first, cross-border intra-company trade; second, trade governed by contracts between TNCs and their NEM partners; and finally, cross-border inter-company arm's-length transactions in which TNCs are either supplied with inputs by independent companies or, in turn, supply them (or serve final consumer markets). TNCs simultaneously make decisions on whether to conduct operations internally or externally (i.e. outsource them to other firms either through contracts or markets) *and* determine if they should be located in their home country or geographically dispersed.

Because such decisions directly impact on investment, production, and value added creation and retention in host countries, this section looks, first, at how TNCs manage their GVCs, including trade flows and, second, at which factors are key locational determinants at each segment or stage within a GVC. TNCs' orchestration and coordination of their GVCs, can significantly affect the strategies of national governments and local firms. For instance, inasmuch as TNCs relocate *segments* of their value chains (or activities within them) to new host countries, countries keen to attract FDI or other forms of TNC participation must formulate their investment promotion policies in line with segment-specific determinants in order to focus their resources more effectively.

Box IV.5. GVC governance: systems, processes and tools

A significant part of TNCs' capabilities or assets in today's GVCs are related to *how* they *manage, control and coordinate* their global networks. Consequently, TNCs design their corporate structures, management processes, functional services and associated procedures and tools to govern GVCs with a number of aims in mind:

- First, the transmission of goals and requirements related to products, processes and activities — along with relevant technologies, skills, technical specifications, etc. – to affiliates, contract partners and independent firms (for arm's-length transactions);
- Second, to maintain and enhance, as much as possible, their power balance over these same firms; and
- Third, to maximize their appropriation of the total value added in the GVC.

In order to manage GVCs and meet their overall aims, TNCs have evolved and reconfigured their corporate services and support processes. They have become full-fledged international infrastructures for the management of far-flung activities, encompassing affiliates, NEMs and arm's-length transaction networks. This infrastructure is adapted by each and every TNC, as appropriate. Differences in industry drivers and dynamics, as well as TNC strategic responses to these, lead to a variety of GVC patterns – so their governance also necessarily varies considerably.

Which particular corporate service or process is outsourced depends on whether it is "core" (i.e. crucial for competitive advantage) or not, the value of doing so (e.g. can external institutions better train a TNC's NEM partners, or indeed its own affiliates), the costs, the availability of suitable NEM partners and other locational determinants. In terms of "core" infrastructure, usually the vision, control and supervisory functions are retained at the TNC headquarters (although they can, in principle, be positioned in different global locations), while supply chain management and support functions can be separated into core and non-core elements, depending on the circumstances of the TNC and its GVC. For instance, distribution and logistics are increasingly seen by TNCs as non-core and outsourced, often to globally integrated logistics TNCs that specialize in offering such services. DHL (Germany), for example, is such a logistics TNC and provides support to major TNCs in different global locations with logistical and supply chain solutions.

Supply chain management strategy is at the heart of TNC's coordination of their GVCs. Of course, the structures of supply chain strategies vary on the basis of contextual factors e.g. demand variation, product life-cycles and managerial objectives.[a] Whether elements of supply chain management are located in the home country, set up in critical international locations for global management purposes, designed to favour a strategy of regional value chains or fully farmed out to partner firms at the host country level depends on the specifics of a GVC. For instance, IBM (United States) has moved from a structure defined by regional divisions in the 1960s and 1970s (with product sales in 150 countries), through a globally integrated firm in the 1980s and 1990s, to one in which "supply chain management analytics" within a network structure are at the heart of how it operates today. Along the way, it has integrated over 30 supply chains into one and focuses particular attention on areas such as risk management, visibility, cost containment and sustainability. This process, supported by ICT-based services has improved coordination, reduced costs and boosted profitability.[b]

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

1. GVC governance: the orchestration of fragmented and internationally dispersed operations

TNCs manage GVCs through complex webs of supplier relationships and various governance modes. Different governance modes have different development implications.

TNCs are increasingly able to fine-slice activities and operations in their value chains, and place them in the most cost-effective location, domestically and globally (*WIR11*). This situation presents companies with a potentially highly fragmented organizational architecture or GVC configuration. It might include multiple operations, activities and tasks; numerous affiliates (FDI), contractual partner firms (NEMs) and arm's-length transactions, each of these modes on their own or in combination; and, finally, a geographical dispersion of GVC segments, activities and modes of governance. Ultimately, effective GVC governance requires absolute attention to communication, information flows and logistics across the global TNC network.

Such expansive GVCs, in which TNCs must simultaneously manage complex, fragmented, geographically dispersed production processes and flows in trade and investment, have to be

organized, orchestrated and coordinated in line with companies' strategic objectives (see box IV.5). GVCs can be large and complex, and they extend far beyond manufacturing. For instance, even the relatively simple GVC of Starbuck's (United States), based on one service (the sale of coffee), requires the management of a value chain that spans all continents; directly employs 150,000 people; sources coffee from thousands of traders, agents and contract farmers across the developing world; manufactures coffee in over 30 plants, mostly in alliance with partner firms, usually close to final market; distributes the coffee to retail outlets through over 50 major central and regional warehouses and distribution centres; and operates some 17,000 retail stores in over 50 countries across the globe.[7] This GVC has to be efficient and profitable, while following strict product/service standards for quality. It is supported by a large array of services, including those connected to supply chain management and human resources management/development, both within the firm itself and in relation to suppliers and other partners. The trade flows involved are immense, including the movement of agricultural goods, manufactured produce, and technical and managerial services.

The decision on whether a company opts for FDI, NEMs or arm's-length transactions (or a combination of these), as governance modes in its GVC is dictated by elements such as transaction costs, power relations and the risks inherent in externalization (*WIR11*). Scholars focusing on *global value chain analysis* as an organizing conceptual framework, argue that the *complexity of this knowledge*, whether it can be easily *codified for transmission* and the *capabilities of suppliers or partner firms* have implications for the particular governance mode chosen to manage a GVC (or part of one). This, in turn, requires TNCs to develop and utilize capabilities most appropriate to the mode, i.e. FDI, arm's-length transactions or NEMs.[8]

(i) Foreign Direct Investment (FDI)

In the case of FDI, a TNC has to be able to effectively coordinate and integrate affiliate activities. In GVCs where knowledge flows are complex, but not easy to codify (they may be tacit or not easily separable because of the co-specialization of assets), and if the capabilities of potential partners or arm's-length suppliers are low, then internalization of operations through FDI is the governance mode most likely to prevail. Managing these activities within a company is itself complex and involves considerable costs, and TNCs have developed complex strategic corporate support infrastructures to manage their operations, i.e. "HQ functions" such as human resources, accounting and operations management. These further enhance a company's ability to organize, coordinate and manage globally dispersed affiliates operating in a range of segments along its GVC. In the GVC literature, this mode is commonly referred to as "hierarchy" and is applied in the case of cross-border vertical integration along different sectors of a value chain.[9]

(ii) Arm's-length transactions

TNCs' reliance on *arm's-length* transactions internationally requires a capacity to source from or service a fully independent company at a distance. This mode of governance is most suitable for standardized products for which it is possible to exchange information on a good or service – prices, specifications (maybe based on international standards), quality assurance – between buyers and suppliers in a simple way. This market mode of GVC governance is a significant feature in some GVCs and requires relatively simple coordination capabilities, namely the ability to source (procurement) and service at a distance, as well as procedures for monitoring compliance.

(iii) Non-equity modes (NEMs)

TNCs use NEMs for governance in GVCs when the complexity of the buyer-seller relationship leads to increased coordination costs and transactional interdependence. The use of NEMs within TNC GVC networks is today highly developed (*WIR11*), but the mechanisms for coordinating them vary. This variety can be captured by treating these mechanisms as subcategories of NEMs (or NEM modes of governance). In the GVC literature there are three principal types of NEM: captive, modular and relational. A particular NEM supplier is not tied to any one of these modes; depending on its capabilities, it could potentially operate in each of them simultaneously with different TNCs.

In the case of *captive NEMs*, a TNC responds to the limited capabilities of potential suppliers or partners by providing clear, codified instructions for tasks

to be carried out and providing, where necessary, support for the suppliers so that they can develop their competences. This facilitates the building up of a supplier base (often in the form of key suppliers) in order to deliver inputs into a lead TNC's GVC, but given the high power imbalance the suppliers are effectively captive to the lead company. TNCs nevertheless recognize that the development of local capabilities is crucial for their long-term goals. Thus TNCs such as IKEA assist their global network of suppliers through their trading sales offices, which act as the primary interface with local firms, including monitoring them through regular and frequent on-site visits. These offices provide technological support to local suppliers in order to help them improve their operational and innovative capabilities.[10] The low level of independence enjoyed by captive NEMs makes them comparable to tightly controlled affiliates in vertically integrated FDI operations, so the control mechanisms are similar; i.e. the organization and coordination of suppliers and partners, including managing knowledge transfers and monitoring quality.

Modular NEMs have emerged as a strategy to minimize the costs of orchestrating GVCs and to increase the ease of choosing and switching between suppliers. This form of governance is seen extensively in the electronics industry. The combination of highly competent first-tier suppliers and the standardization of product specifications means that the TNC can source customized products without having to engage in complex transactions with suppliers. The NEM partner works with the TNC to provide a customized product, but it will supply many other companies and can be substituted by other suppliers without undue difficulty.

Relational NEMs result from a mutual dependence between TNCs and partner firms. They arise when collaborations between TNCs and other firms rely on the communication of tacit knowledge and

Table IV.3. Types of GVC governance: lead-firm perspective

Governance types	Key characteristics of TNC-supplier relationship	Typical examples	Explicit TNC coordination
FDI (ownership)	• Complex transactions • Information on product or process specifications proprietary, or not easy to codify and transmit • Lead firm may require full managerial control for risk management	• Products with high intellectual property content, high quality risks, high brand value	High
NEMs:			
- Captive	• Relatively simple transactions • Lead firm tends to have significant buying power • Lead firm exercises significant control over production	• Tiered supplier structures in the automotive industry	Medium-high
- Relational	• Complex transactions • Information on product or process specifications not easy to codify and transmit • Working in partnership	• Relationships between suppliers and buyers of retailers or major apparel brands	Medium
- Modular	• Complex transactions • Information on product specifications easily transmitted • Lead firm prefers coordination partner/ supplier management firm	• Turnkey supplier relationships in electronics industries	Medium-low
Trade (market)	• Relatively simple transactions • Information on product specifications easily transmitted • Price as central governance mechanism	• Commodities and commoditized products	Low

Source: UNCTAD, based on Gereffi, G., J. Humphrey and T. J. Sturgeon (2005) "The governance of global value chains", *Review of International Political Economy*, 12:78-104.

Table IV.4. Types of GVC governance: supplier perspective

Governance types	Key implications for suppliers	Key GVC development implications
FDI (ownership)	• Supplier is fully vertically integrated and under full managerial control	• Fastest and often only approach to gaining ownership advantages required for GVC access • Business linkages required to widen the scope of technology and knowledge transfer
NEMs:		
- Captive	• Relatively small suppliers; high degree of power asymmetry • High degree of monitoring and control by lead firm • Knowledge sharing focuses on efficiency gains	• Can generate relatively high degree of dependency on few TNCs that may have low switching costs • Knowledge transfer takes place (due to mutual benefits) but limited in scope
- Relational	• Degree of mutual dependence between partners • Frequent interactions and knowledge exchange between partners • Supplier more likely to produce differentiated products	• Degree of knowledge transfer and learning relatively high • More stable demand due to higher switching costs for lead firms
- Modular	• Lower degree of dependence on lead-firms; suppliers tend to operate in more than one GVC • Limited transaction-specific investments (e.g. generic machinery that can be used for more than one client)	• Substantial scope for linkages • Relatively high volume of information flowing across firm linkages
Trade (market)	• No formal cooperation between partners • Low switching costs for customers	• Full exposure to market forces • Learning options limited to trade channels

Source: UNCTAD, based on Gereffi, Humphrey and Sturgeon, 2005 (ibid.).

the sharing of key competences between them. The contractual arrangements that support such relational governance need to reflect the exchange of tacit knowledge and the difficulties of judging the effort put into the business by the partners. For this reason, arrangements such as joint ventures are typical of relational governance.

These modes or types of GVC governance, summarized in table IV.3, have significant implications for suppliers and host country governments as well (table IV.4).

2. Locational determinants of GVC activities

For many GVC segments, tasks and activities, there are relatively few "make or break" locational determinants that act as preconditions for countries' access to GVCs.

In addition to deciding *how* to orchestrate GVC activities, TNCs must decide *where* to locate the value added activities (or segments) comprised in a value chain. Various factors determine a TNC's choice of host country locations, including economic characteristics (e.g. market size, growth potential, infrastructure, labour availability and skills), the policy framework (e.g. rules governing investment behaviour, trade agreements and the intellectual property regime) and business facilitation policies (e.g. costs of doing business and investment incentives).

The "classical" locational determinants for investment (*WIR98*) have changed over time, as new industries, types of players and GVC modes have come to the fore, and as value chain activities have become increasingly fine-sliced. In particular, the relative importance of specific determinants differs depending on the mode of governance employed by the TNC and the segment or subsegment of the GVC in question. Locational determinants of TNC activity are increasingly specific to GVC segments and GVC modes. By way of illustration, table IV.5 provides an indicative, non-exhaustive list of the key locational determinants for different segments of a generic GVC.

Table IV.5. Key locational determinants for GVC tasks and activities, selected examples

GVC segment or stage	Economic determinants	Policy determinants and business facilitation
All stages		
	• Economic, political, social stability • Suitability of characteristics of available labour force (cost, skill level, language proficiency, education, science and technology competences) • Distance and access to market or next stage in value chain • Availability and quality of transport and logistics infrastructure (for goods exports) • Presence and capabilities of locally based firms	• Trade restrictions and promotions • Investment policy • Stable commercial law and contract enforcement regimes • General business facilitation (e.g. cost of doing business, hassle costs) • Business facilitation to support foreign affiliates (e.g. investment promotion, aftercare, provision of social amenities) • Business facilitation to support local firms (e.g. local enterprise development, schemes to upgrade quality, productivity, capabilities of local firms, start-up incentives, support for standards of working conditions and corporate social responsibility (CSR) in local firms)
Knowledge creation stage		
Innovation and R&D	• National innovation system • Suitability and characteristics of available labour force (cost, education, science and technology competences) • Presence of research clusters	• Government R&D policy • Intellectual property regime • Policies towards sale of intellectual property (IP) by local firms ("pure" in-licensing of technology) • Laws governing contract research and licensing contracts • Investment incentives • Science and technology parks
Design and branding	• Location-specific consumer preferences (for local/regional-market oriented goods and services) • Suitability and characteristics of available labour force (cost, education, marketing competences) • Design, creativity clusters	• IP regime • Policies towards sale of IP by local firms ("pure" in-licensing of brands, trademarks, etc.) • Investment incentives • Design centres and institutional support
Main operational stages		
Raw materials and agricultural inputs	• Availability of natural resources, including relevant raw materials, agricultural (land, water) • Availability and quality of utility services (electricity, water) • Low-cost labour • Presence and capabilities of locally based producers of raw material inputs	• Environmental policy • Trade restrictions and promotions, Generalized System of Preferences (GSP) and other Preferential Trade Agreements (PTAs) • Policies pertaining to foreign ownership, lease and exploitation/operations of natural resources, including land • Land tenure system, approaches to traditional rights to land, other resources • Privatization policies • Laws governing contract farming • Customs and border procedures
Manufactured goods, including parts and subassemblies	• Basic infrastructure and utility availability and costs (energy, water, telecommunications) • Industrial clusters • Suitability and characteristics of available labour force (cost, skill level)	• Trade restrictions and promotions, GSP and other PTAs • Customs and border procedures and trade facilitation • Policy supporting skills development • Laws governing contract manufacturing • Customs and border procedures • Industrial parks and export processing zones (EPZs) • Investment promotion, including one-stop shops, image-building exercises and facilitation services • Schemes to develop and upgrade capabilities of local firms

/...

Table IV.5. Key locational determinants for GVC tasks and activities, selected examples

Distribution and support services		
Distribution and logistics	• Availability and quality of transport and logistics infrastructure • Availability, quality and cost of inputs (transport, communications, energy) • Networks of locally based distribution and logistics companies in relevant industries (e.g. wholesaling, storage, distribution, etc.)	• Policies pertaining to foreign ownership, lease and operations in "strategic" industries • Infrastructure development policies • Customs and border procedures • Regional infrastructure connectivity and corridors
Services (e.g. HQ, IT, human resources, legal, auditing)	• Availability and quality of telecom infrastructure and services • Low-cost labour • Suitability and characteristics of available labour force (cost, language proficiency, education)	• Services trade restrictions and promotions • Policy supporting skills development through education, science and technology competences • Tax policy • Confidentiality and data protection laws • Laws governing services outsourcing contracts • Schemes to develop and upgrade capabilities of local firms • "Liveability" of location (especially for expatriate senior staff)

Source: UNCTAD.

Many locational determinants are relevant irrespective of the specific value segment. A stable economic, political and social environment and robust commercial law and contract regimes are important preconditions for all GVC stages. Similarly, business facilitation measures aimed at reducing "hassle" costs or supporting foreign affiliates or local firms. Trade and investment policies are, at a general level, pertinent for all value chain segments, although specific measures may have more influence over one or another segment.

For most GVC segments, however, there are some specific locational determinants which are particularly significant for TNC activity. For instance, at the knowledge creation stage (which includes innovation, research and development (R&D), design and branding), the existence of an appropriate intellectual property regime and the availability of educated, but relatively low-cost, labour are key determinants (table IV.5).

The locational determinants of the main operational segment of a GVC depend principally on the nature of the product or service created. In manufacturing, for example, the choice of location depends on the availability of relatively low-cost skilled/unskilled labour, the quality of the logistics infrastructure, distance to final markets and the availability of inputs. FDI is conditioned particularly by the strength of local competition or joint venture partners, as well as the availability of industrial parks, whereas the decision to operate through NEMs is swayed by the capabilities of locally based firms and the laws governing contract manufacturing. For raw material and agriculture, the principal determinants are the existence of natural resources, the capacity of infrastructure to support their extraction and transport and the panoply of policies governing their utilization and consumption. In services, the specific characteristics of the labour force (language skills and education, as supported by policy initiatives) are important, as is the reliability of telecommunications infrastructure.

The locational determinants of GVCs as a whole are necessarily different from those affecting individual segments, tasks or activities, whether coordinated through FDI, NEMs or at arm's length. As shown in table IV.5, although some locational determinants are important to all stages of TNCs' value chains, as well as all modes of governance, most GVC segments or activities have only a few "make or break" determinants.

Governments are thus in a position to selectively target GVCs and GVC segments in line with their endowments and development objectives. For example, in the case of services outsourcing, governments might first aim to attract call centres

Box IV.6. Locational determinants: high-tech manufacturing in Malaysia

The Malaysian Investment Development Authority (MIDA) has sought to leverage Malaysia's assets and capabilities in contract manufacturing by strengthening its locational determinants to provide the requisite created assets to become a global outsourcing hub for high-tech manufacturing value chains. A further objective is to upgrade the breadth of its participation in key manufacturing value chains, i.e. to "manage the entire process (from product conception to serial production), including logistics, warehousing, packaging, testing and certification." In working towards this goal, the MIDA has sought to identify key strengths and weaknesses, and the areas in which Malaysia needs to improve on its attractiveness as a destination for FDI and NEMs (box table IV.6.1).

The Malaysian Government recognizes that a number of areas need to be strengthened in order to have the appropriate locational determinants to attract FDI and NEM activity. Through this strategy, Malaysia aims to build further on its existing competitive position as an outsourcing destination for TNCs in the electronics, automotive, machinery manufacturing, and oil and gas industries, as well as leverage these strengths to also become a key player in the aerospace, medical, defense and photovoltaic industries.

Box table IV.6.1. High-tech manufacturing strengths and weaknesses as identified by MIDA

Strengths	Weaknesses
• Consistent quality and on-time delivery	• Inadequate R&D and design investment
• Competitive cost of high technology products	• Lack of mid-level technical expertise
• Language skills	• Fragmented industry – lack of collaboration between firms
• Trainable and educated workforce	• Lack of high-end component manufacturing companies
• Strong government support: financial and operational	
• IP protection, laws and regulations	
• Investor protection, rule of law	
• Ease of doing business	
• Developed infrastructure, transport and logistics	

Source: UNCTAD.

(considered the entry-level activity in the industry) by focusing on a number of key determinants – for instance low-cost labour with basic skills, telecommunications infrastructure and data protection laws – and then pursue a move to business process outsourcing, which requires more specific and higher skills and a concerted industrial policy effort. If as a part of this industrial policy, capable local companies emerge, then this improves the likelihood of TNCs pursuing NEM partnerships, as opposed to FDI.

National governments increasingly recognize the importance of locational determinants and how policy actions can influence the attractiveness of their country as a destination for TNC activities in specific segments of a value chain. More and more countries are now considering how to position and promote themselves as locations for GVC activities, either in a segment or part of the chain or the entire chain. Some countries initially have limited assets with which to pursue strategies to encourage TNCs to locate segments of a chain in their economy (e.g. the "cut, make and trim" value chain in the garments industry in Cambodia), while others are able to pursue a more sophisticated approach, by building on existing strengths to target desired value chains, segments and activities.

Malaysia is a case in point. The Malaysian Investment Development Authority (MIDA) has developed a sophisticated strategy that aims to leverage its existing locational strengths, in particular in contract manufacturing, to target similar segments in a more diverse range of value chains and segments. In particular, it has identified locational strengths and weaknesses in pursuing its strategy of encouraging the establishment of high-technology manufacturing value chain segments and activities in the country chain (box IV.6).

C. Development implications of GVCs

GVCs can make a contribution to development through direct GDP and employment gains and by providing opportunities for industrial upgrading, but these benefits are not automatic and there are risks involved in GVC participation.

GVCs are an expression of globalization. They spread economic activities across a broader range of countries. As such, they can accelerate the catch-up of developing countries' GDP and income levels and lead to greater convergence between economies. At the global level, that is the essential development contribution of GVCs.

At the level of individual developing economies, the experience is obviously much more heterogeneous. This section explores the role that GVCs play in the development process of countries. As firms within countries gain access to value chains, this affects their value added creation, employment generation and potential for learning and productivity growth. GVCs can also affect the social configuration of countries and the environment. Not all these effects are necessarily positive. Lead firms in GVCs – TNCs – tend to control higher value added activities (from innovation and technological activities to branding and new product development), while other firms (often operating under contractual arrangements in developing countries) engaged in routine assembly tasks or services within GVCs may earn less, have fewer opportunities to grow and be more vulnerable to business cycles. A summary of the main areas of development impact of GVCs appears in table IV.6.

The potential impact of GVC participation for host countries' economic growth and development depends on two main factors.

- The first is the nature of the GVC itself. Is it the type of chain that presents potential for learning and upgrading? Will it enable capabilities to be acquired by firms that can be applied to the production of other products or services? In the garments industry, Mexican firms have been able to acquire new skills and functions, becoming full-package suppliers,[11] while it seems very difficult for firms in sub-Saharan Africa supplying garments under the African Growth and Opportunity Act programme to move beyond cut, make and trim.
- The second factor is the business and institutional environment in the host economy. Is there an environment conducive to firm-level learning and have investments been made in technical management skills? Are firms willing to invest in developing new skills, improving their capabilities and searching for new market opportunities? Local firms' capabilities and competences determine their ability to gain access to cross-border value chains, and to be able to learn, benefit from and upgrade within GVCs. Government policies can facilitate this process.

Although *indicators* of the development impact of GVCs are well established – for example, UNCTAD developed and tested a set of GVC impact indicators in partnership with the G-20[12] – the *measurement* of GVC impact on host countries is difficult, not least because of the multiplicity of actors involved in the GVC (*directly* in terms of the value chain modularity encompassing integrated firms, retailers, lead firms, suppliers, subcontractors, or *indirectly* in the rest of the economy) and the spatial scope of value chains (not just globally but within countries, at the local, subregional or country level). A novel contribution of the section is that UNCTAD combines empirical evidence drawn primarily from the UNCTAD-Eora GVC Database, with case study evidence drawn from UNCTAD field work on GVCs in developing countries, together with existing knowledge from the vast literature and case studies produced by scholars in pertinent fields, including economics, international business, development studies and sociology, reflecting the multidisciplinary nature of the topic.

1. Local value capture

Value capture in GVCs depends on the use of imported contents, on the role of foreign affiliates in value added creation and on TNC policies with regard to income repatriation and transfer pricing.

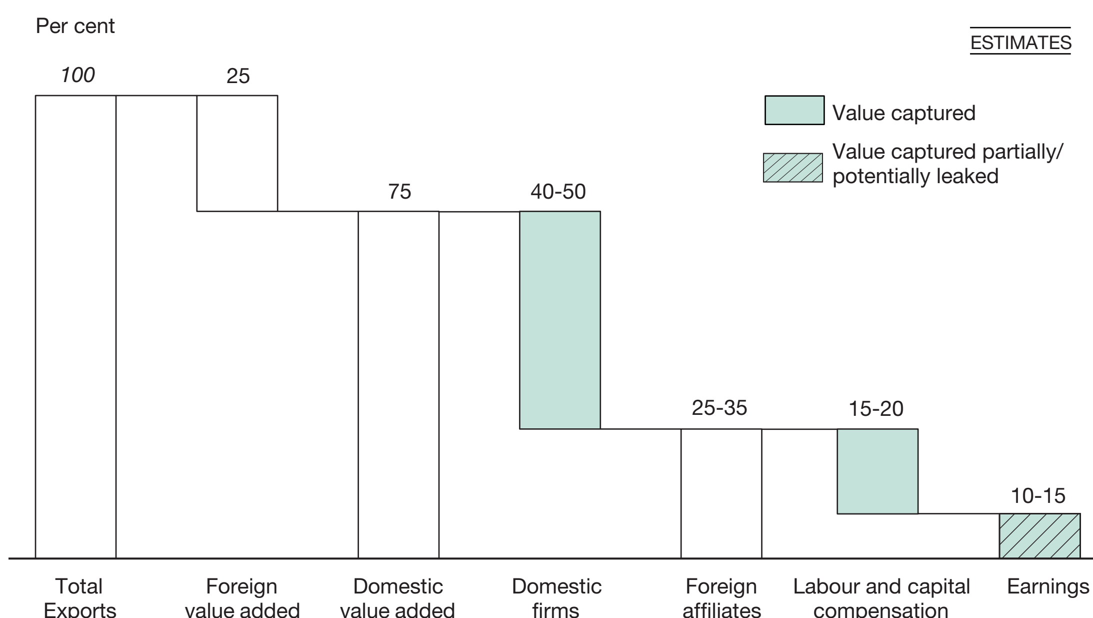
Production for exports directly generates value added and contributes to GDP. However, as shown in Section A, local value added contributions and income generation in GVCs can be limited through the use of foreign value added in exports. In developing countries, on average,

Table IV.6. Development impact of GVCs: highlights of findings

Impact areas	Highlights of findings
Local value capture	• GVC participation can generate value added in domestic economies and can contribute to faster GDP growth. • Concerns exist that the value added contribution of GVCs is often limited where imported contents of exports are high and where GVC participation is limited to a small or lower value part of the overall GVC or end-product. • TNCs and their affiliates can provide opportunities for local firms to participate in GVCs, generating additional value added through local sourcing, often through non-equity relationships. • A large part of GVC value added in developing economies is generated by affiliates of TNCs. This raises concerns that value can be leaked, e.g. through transfer price manipulation. Also, part of the earnings of affiliates will be repatriated, with possible effects on the blance of payments, although evidence shows that these effects are limited in most cases.
Job creation, income generation and employment quality	• GVC participation tends to lead to job creation in developing countries and to higher employment growth, even if GVC participation depends on imported contents in exports; GVC participation tends to have, with variations by country and industry, a positive effect on the employment of women. • GVC participation can lead to increases in both skilled and unskilled employment; skill levels vary with the value added of activities. • Pressures on costs from global buyers mean that GVC-related employment can be insecure and involve poor working conditions. • Stability of employment in GVCs can be relatively low as oscillations in demand are reinforced along value chains, although firm relationships in GVCs can also enhance continuity of demand and employment.
Technology dissemination and skills building	• Knowledge transfer from TNCs to local firms operating in GVCs depends on knowledge complexity and codifiability, on the nature of inter-firm relationships and value chain governance, and on absorptive capacities. • GVCs can also act as barriers to learning for local firms, or limit learning opportunities to few firms. Local firms may also remain locked into low-technology (and low value added) activities.
Social and environmental impacts	• GVCs can serve as a mechanism for transferring international best practices in social and environmental efforts, e.g. through the use of CSR standards. Implementation of standards below the first tier of the supply chain remains a challenge. • Working conditions and compliance with applicable standards in firms supplying to GVCs have been a source of concern where they are based on low-cost labour in countries with relatively weak regulatory environments. Impacts on working conditions can be positive within TNCs or their key contractors, where they operate harmonized human resource practices, use regular workers , comply with applicable CSR standards and mitigate risks associated with cyclical changes in demand. • GVCs cause environmental impacts (such as greenhouse gas emissions) of demand in one country to be distributed across many other countries. Lead firms in GVCs are making efforts to help supplier firms reduce environmental impacts.
Upgrading and building long-term productive capabilities	• GVCs can offer longer-term development opportunities if local firms manage to increase productivity and upgrade to activities with higher value added in GVCs. • Some forms of GVC participation can cause long-term dependency on a narrow technology base and on access to TNC-governed value chains for activities with limited value added. • The capacity of local firms to avoid such dependency and the potential for them to upgrade depends on the value chain in which they are engaged, the nature of inter-firm relationships, absorptive capacities and framework conditions in the local business environment. • At the country level, successful GVC upgrading paths involve not only growing participation in GVCs but also the creation of higher domestic value added and the gradual expansion of participation in GVCs of increasing technological sophistication.

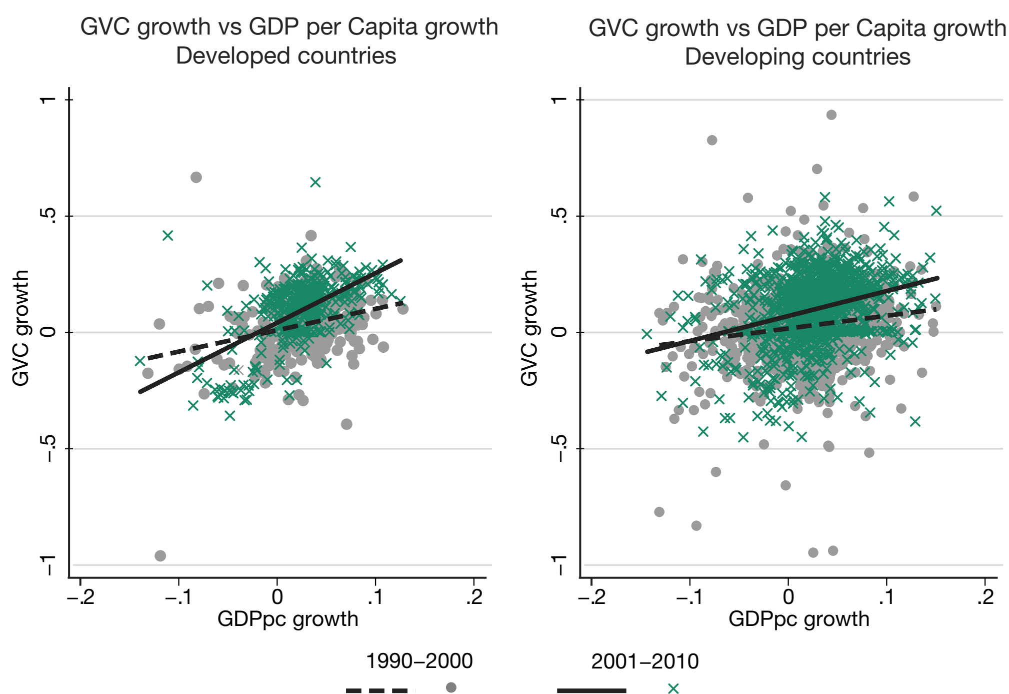
Source: UNCTAD.

Figure IV.18. Value capture in GVCs: value added trade shares by component, developing country average



Source: UNCTAD estimates based on the UNCTAD-Eora GVC Database and the Business Group Database (see box IV.4).

Figure IV.19. Correlation between growth in GVC participation and GDP per capita



Source: UNCTAD-Eora GVC Database, UNCTAD analysis.

Note: The regression of the annual real GDP per capita growth on the annual GVC participation growth yields a positive and significant correlation (at the 5 per cent level) both for developed and developing countries (R^2 = 0.43 and 0.30, respectively). The correlation remains significant considering the two time periods 1990 - 2000 and 2001 - 2010 separately. To avoid picking-up a compositional effect resulting from the correlation between a country's domestic value added (affecting the GVC participation) and its per capita GDP, all regressions use lagged (one year) GVC participation growth rates. Regressions include country and year fixed effects to account for unobserved heterogeneity.

foreign value added in exports is about 25 per cent (see figure IV.18). However, not all domestic value added is preserved for the domestic economy. In most developing countries, the share of domestic value added in the exports produced by foreign affiliates rather than domestic firms is very high – UNCTAD estimates this share to revolve around 40 per cent on average in developing countries, with significant variations (leading to a range estimate of foreign affiliate domestic value added in exports of 25–35 per cent). The lion's share of the value added produced by foreign affiliates is still preserved for the domestic economy, through compensation for factors of production, in particular labour and capital (and levies on production net of subsidies). However, the operating surplus component of value added produced by foreign affiliates – on average some 40 per cent in developing countries – can have multiple destinations. It can pay for corporate income taxes in the local economy, it can be reinvested in the local economy or it can be repatriated to the home country of the parent TNC. Furthermore, where the value added produced by foreign affiliates is exported to parent firms or other affiliates within the TNC network, the overall size of the earnings component of value added depends on intra-firm transfer pricing decisions by the TNC.

These key considerations – (a) domestic value added share, (b) value added produced by domestic firms, (c) foreign affiliate value added preserved for the local economy, and (d) transfer pricing – largely determine the actual value captured from GVCs by participating countries and will be examined further in this section.

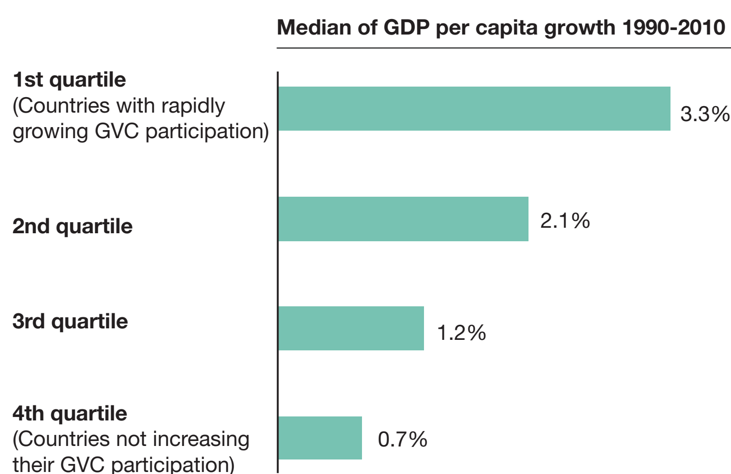
a. GVC contribution to GDP and growth

GVCs can contribute to domestic value added creation even where participation requires higher imported content of exports. GVC participation is positively correlated with GDP per capita growth.

Experience over the past 20 years shows that, as countries increase their participation in GVCs, their growth rates tend to increase as well. A statistical analysis correlating GVC participation and per capita GDP growth rates shows a significant and positive relationship, for both developed and developing economies (figure IV.19).

Although this statistical analysis, despite the strong correlation, cannot show direct causality, increased GVC participation tends to go hand in hand with faster GDP per capita growth (figure IV.20). The 30 developing economies with the highest GVC participation growth rates in the 20-year period from 1990 to 2010 (first quartile) show a median rate of GDP per capita growth in the same period of 3.3 per cent, compared with 0.7 per cent for the bottom 30 countries.

Figure IV. 20. GDP per capita growth rates by quartile of growth in GVC participation, developing economies only, 1990–2010



Source: UNCTAD-Eora GVC Database, UNCTAD analysis.
Note: Data for 120 countries, ranked by GVC participation growth and grouped in quartiles; growth rates reported are median values for each quartile.

Because not all exports constitute domestically produced value added, the share of domestic value added in trade for a given country can be quite different from its share in global exports. Looking at the relative value added contribution from trade for the top 25 developing country exporters (excluding predominantly oil exporters), in the countries with low shares of global value added trade relative to their global export shares, exports contribute on average about 30 per cent to GDP. In contrast, in the countries with high shares of global value added trade relative to their export shares, exports contribute on average less than 20 per cent to GDP. This result shows that focusing on increasing the domestic value added share in exports

is not always the most effective policy objective. Entering dynamic value chains even if doing so implies a relatively modest domestic value added share may yield better results (see discussion in section IV.5.b).

A country's share of domestic value added in trade can also be compared with its share in global GDP – another relative measure of value added trade performance. The absolute contribution of value added trade to some economies can be significant, even when the share of domestic value added in exports is low (this is the case for selected countries in East and South-East Asia). In this case, GVC participation is achieved, maintained and consolidated by using imported intermediary goods and services. Such a strategy may be particularly important for small economies that may not be in a position to provide domestic inputs across the entire value chain for any industry.

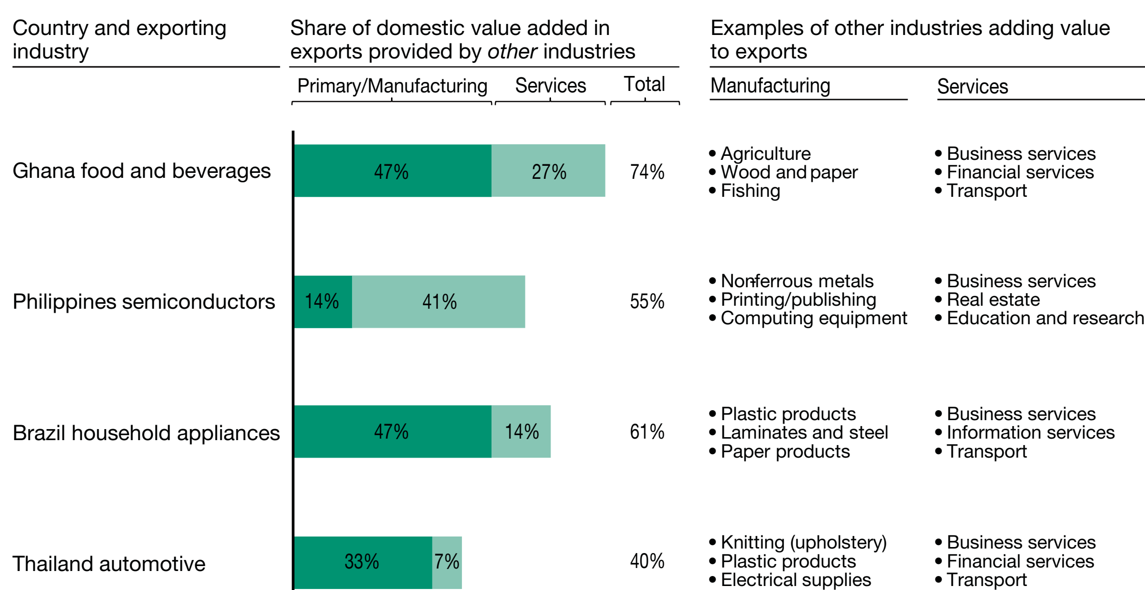
b. Domestic value added in trade and business linkages

Within countries participating in GVCs, the domestic value added content of exports is produced not only by the exporting firms themselves, but also by other firms involved in the supply chain through backward linkages. Such suppliers may operate within the same industry or in other industries, including services. Thus, the domestic value added incorporated in exports can be broken down into value added provided by the exporting industry and value added contributed by other activities, which can be considered a rough proxy for the scope of business linkages (although linkages between exporting firms, often TNC affiliates, and local firms may also occur within the same industry, where component suppliers may have the same industry classification).

The potential for business linkages – connecting local firms to GVCs by linking them to lead firms and affiliates operating in their countries – can be high both in manufacturing and in services.

Figure IV.21 shows a breakdown of domestic value added in exports for four country-industry cases – the Thai automotive industry, the Brazilian household appliances industry, the Philippine semiconductor industry and the Ghanaian food and beverages industry. The total share of domestic value added in exports varies between these countries and industries. It is high for Brazilian household appliances (86 per cent) and Ghanaian food and beverages (73 per cent). By contrast, the share is less than half for the Philippine semiconductor industry (44 per cent) and the Thai automotive industry (48 per cent).

Figure IV.21. Origin of domestic value added in exports: the scope for linkages, 2010



Source: UNCTAD-Eora GVC Database, UNCTAD analysis.

Table IV.7. Examples of financing schemes offered by lead firms in business linkages programmes

Types of schemes	Examples
Own financing institutions	• Anglo American's Anglo Zimele • Grupo Martins' Tribanco • ECOM Supplier Finance
Capitalization of external (often joint) funds	• The $15 million Supplier Finance Facility of BP and IFC in Azerbaijan • The Aspire SME-financing facilities of GroFin and the Shell Foundation, together with local banks in Africa • Starbucks' investment in Root Capital to provide financing for small-scale coffee suppliers in Central America
Links with microfinance institutions	• Pepsico and BASIX in India
Non-traditional collateral	• Barclays accepts grain stocks as collateral in Zambia • Barclay accepts purchasing agreements as guarantees to BL suppliers in Uganda • Spar supermarkets in South Africa accept special advance payments to their small suppliers
Links with commercial banks	• Chevron's partnerships with Kazakh banks BankTuranAlem and KazKommertzBank • Votorantim Papel e Celulose helps eucalyptus farmers access credit from Banco Real in Brazil • Mundo Verde refers suppliers to Caixa Econômica Federal and Banco do Nordeste in Brazil
Develop financial literacy	• Anglo Zimele incorporates financial literacy into its Small Business Start-Up Fund's lending requirements instead of loans • Real Microcrédito credit agents provide financial education along with other skills development programmes • IPAE-Empretec in Peru, jointly with UNCTAD, offers accounting and financial management courses • Empretec Jordan-BDC offers financial literacy and special programmes for female entrepreneurs

Source: Jenkins, B., A. Akhalkatsi, B. Roberts and A. Gardiner (2007) "Business Linkages: Lessons, Opportunities, and Challenges", IFC, International Business Leaders Forum, and the Kennedy School of Government, Harvard University.

The findings confirm that key exporting firms in these industries provide opportunities for local firms to participate in GVCs, generating additional value added through local sourcing within and across industries.[13] In the selected cases, between one fifth and one third of domestic value added originates from within the industry of the export (39 per cent of the domestic value added in exports for the Brazilian household appliances originates from within the industry – i.e. within the producing firm itself or from suppliers within the same industry – whereas this share in Ghana is 26 per cent). The scope of linkages with suppliers across sectors is highest in the Brazilian household appliances (61 per cent of domestic value added in export). In this industry, suppliers produce a variety of steel (semi-fabricates, laminates, bars and tubes), plastic or paper products, and the services sector accounts for 14 per cent of value added (providing business services, finance and insurance, information services and freight transport).

In some cases the value added of indirect exports – or supplier firms contributing domestic value added to exporters – remains predominantly with other TNCs located in host economies. For instance, the automotive industry, where lead firms develop close and complex relationships with suppliers, is characterized by mega-suppliers that can co-locate and co-produce with their customers on a global scale, taking prime responsibility for selecting and coordinating lower-tier suppliers. As a result, domestic value added may occur predominantly among TNCs. Evidence of TNC dominance in specific industry segments was found mostly among first-tier suppliers in the automotive industry,[14] e.g. in the Czech Republic and in Colombia. TNCs can also dominate the value capture along a single product value chain, as in the well-known case of the iPod cross-border value chain.[15]

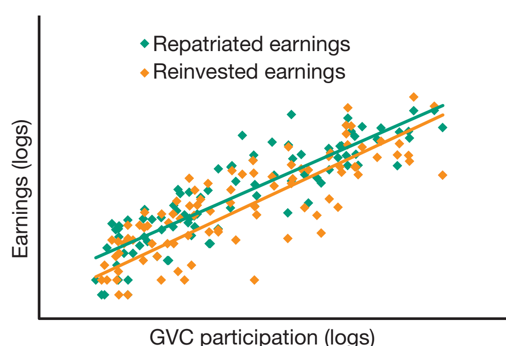
TNC lead firms can provide support to local firms in developing countries to strengthen linkages in

their mutual interest. Table IV.7 presents examples of lead firms that have developed schemes to facilitate suppliers' access to finance. Corporations and financial institutions can accept different forms of collateral when suppliers are part of a value chain. Suppliers in a value chain can present a joint investment plan with a lead firm. Other measures may involve making lending to small and medium-sized enterprises (SMEs) viable for financial institutions.

Not all local firms have the ability or potential to take part in GVCs. Smaller local firms may have fewer opportunities to become part of GVCs because of limited resources, and asymmetric information and bargaining power. Smallholders in the agriculture sector have limited access to information concerning market trends, and how product prices, royalties and dividends are calculated, which puts them at a disadvantage to large-scale producers in accessing GVCs. These disadvantages may be overcome, partly, when smallholders enhance their CSR, gain legitimacy in local markets or create niche products.

Within individual industries and sectors, linkages with firms locally vary over time (the more mature the industry is, the higher the potential share of local goods and services) and depend upon global competition (i.e. potential access to competitively priced and quality supplies elsewhere).[16]

Figure IV.22. GVC participation, repatriated and reinvested earnings, 2010



Source: IMF Balance of Payments database and UNCTAD calculations.
Note: Data are for 2010 for all reporting countries, excluding top and bottom deciles ranked by repatriated earnings share in total FDI income. Repatriated earnings correspond to debit entry for current account item. All data are natural logarithms of absolute values.

c. Foreign affiliates and value added retention for the local economy

There is a strong correlation between countries' GVC participation and both repatriation and reinvestment of earnings. The net effect on countries' balance of payments is mostly marginal.

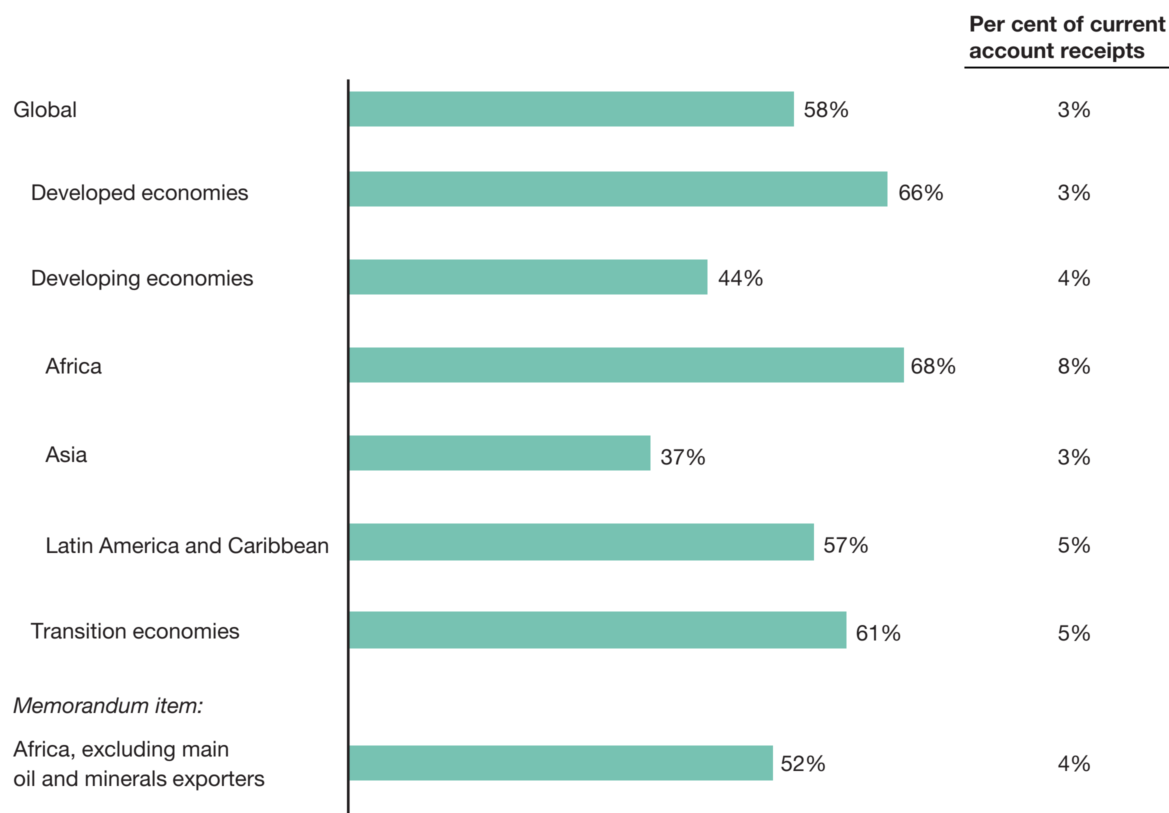
Given that key exporters and their suppliers in GVCs are often TNCs, there are concerns that value added created by foreign affiliates in developing countries does not confer the same benefits as value added created by local firms. This is because foreign affiliates may repatriate the earnings component of value added. Although overall domestic value added trade in developing economies in 2010 was more than 20 times higher than total repatriated FDI income from developing countries, the situation for individual countries may be more nuanced.

There is indeed a strong positive relationship between repatriated profits from a host country and its participation in GVCs. This is a corollary of the fact that GVC participation is driven by TNC activities. Increased TNC activity equally results in increased reinvested earnings (figure IV.22). GVC participation can thus induce further productive investment in the host economy.

Globally in 2010, about 60 per cent of total FDI income on equity was repatriated (figure IV.23). To some extent, the share may vary according to the type of GVC involvement of foreign affiliates in host countries and the value chain segments in which they operate. Income on market-seeking FDI at the end of value chains appears to be less likely to be reinvested. Foreign affiliates in countries involved in the middle of GVCs, in both manufacturing and services activities, may be more likely to invest further in production facilities, expanding efficiency-seeking FDI. Investment in extractive industries embodies a short value chain with high upfront investments and a higher propensity to repatriate. For example, although reinvestment rates appear low in aggregate for Africa, once the main oil and minerals exporters are removed from the sample, reinvestment rates are broadly in line with the global average.

The overall level of GVC participation of countries does not appear to significantly influence countries'

Figure IV.23. Repatriated earnings as a share of total FDI equity income, by region, 2010



Source: IMF Balance of Payments database and UNCTAD calculations.
Note: Data are for 2010 for all reporting countries. Repatriated earnings correspond to the debit entry for current account item "*dividends and withdrawals from income of quasi-corporates*".

reinvested and repatriated earnings ratios. The median repatriated earnings share for the top quartile of developing countries ranked by GVC participation rate is 50 per cent; for the bottom quartile, it is 52 per cent.

Finally, the overall current account effect of repatriated earnings is very low, at an average of 4 per cent of total current account receipts in developing countries, and rarely exceeding 8 per cent. In most cases, negative income effects from repatriated earnings are marginal in comparison to the positive current account effects of higher net export generation in GVCs.

d. GVCs and transfer pricing

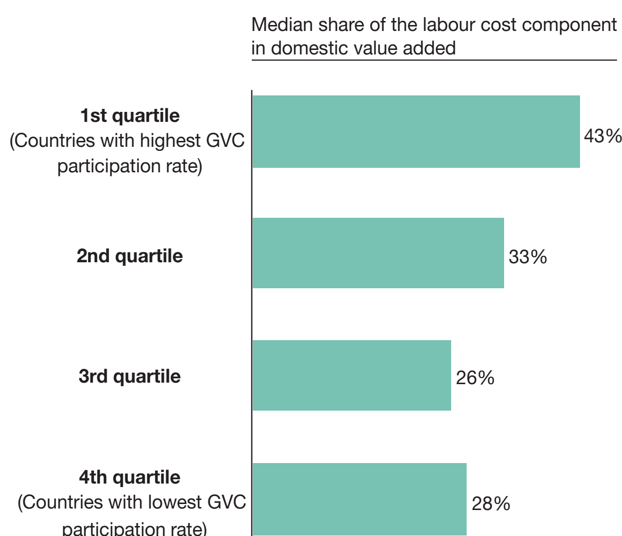
Transfer pricing is the setting of prices for products and services that are traded between related parties. Where firms share equity ownership, opportunities exist to maximize joint profits by manipulating the prices of products moving between them, i.e. through transfer price manipulation.

Where TNCs view government policies as a cost (e.g. trade and corporate income taxes, foreign exchange controls) or opportunity (e.g. export subsidies), transfer price manipulation provides a method by which TNCs can cut their costs and take advantage of opportunities. Such trade mispricing, however, can lower the effectiveness of host country policies, significantly weaken the national tax base and deprive national governments of their fair share in global value added.[17] In order to discourage this behaviour, governments have adopted the OECD's arm's-length standard, requiring TNCs to set transfer prices based on what independent enterprises would have done under the same or similar facts and circumstances.

Transfer price manipulation is highly relevant in the context of GVCs, for two main reasons:

- *GVCs and value added trade have significantly widened the scope for transfer price manipulation by TNCs*. GVCs enable TNCs to fine-slice their international production networks, locating each value adding activity in its lowest-cost location on a regional or global basis. The greater fragmentation of international production increases cross-border trade in intermediate goods (i.e. raw materials, parts, components and semi-finished goods), and generates a rising share of foreign value added in world exports. Fine-slicing value adding activities increases the length and variety of GVCs, providing more cross-border opportunities for transfer price manipulation of goods and services by TNCs.
- *The importance of services in GVCs make transfer price manipulation harder to combat*. Almost half of value added in exports comes from service-related activities, which is more than twice the share of services in worldwide gross exports. Whereas price comparisons with external markets may be possible for intra-firm transactions in the agriculture and manufacturing sectors (i.e. there may be enough inter-firm transactions to apply the arm's-length standard), this is less likely to be the case for intra-firm transactions in services (e.g. front and back office functions) and intangibles (e.g. patents and licenses) where comparable arm's-length prices are less likely to exist.

Figure IV.24. GVC participation and the labour component of domestic value added, 2010



Source: UNCTAD-Eora GVC Database, UNCTAD analysis

Note: Data for 187 countries ranked according to the 2010 GVC participation rate and grouped in quartiles; the reported share of the labour cost component of the domestic value added is the median value of the quartile.

Transfer price manipulation may actually influence the distribution of value added in GVCs. The development contribution of exports rests in the domestic value added generated from trade. To the extent that domestic value added is created by foreign affiliates of TNCs – a high share, in the case of many developing countries – the profit component of value added (about 40 per cent in developing countries on average) may be affected by transfer price manipulation, potentially "leaking" value added and associated fiscal revenues and reducing value capture from GVCs.

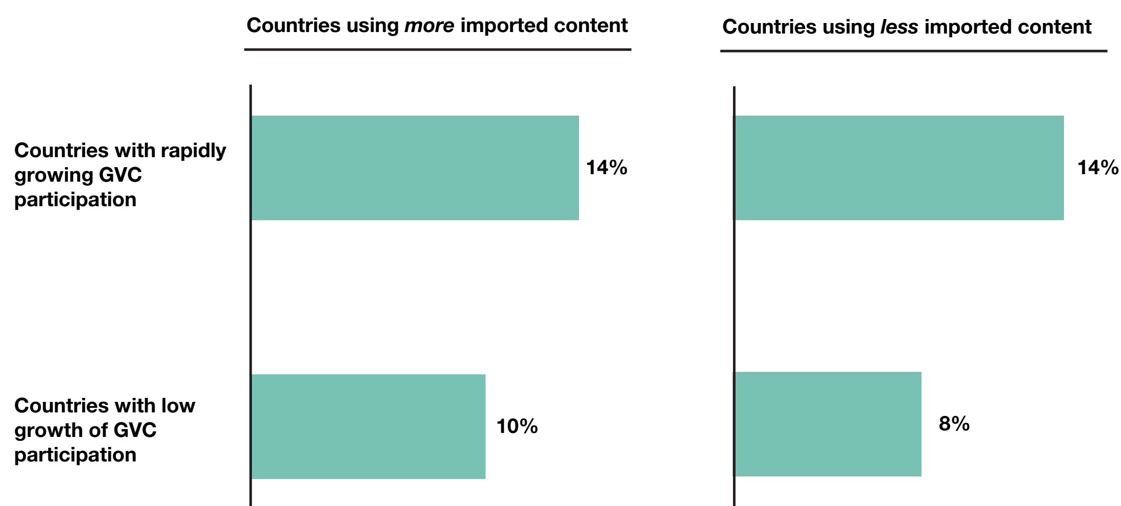
2. Job creation, income generation and employment quality

a. GVC participation, job creation and income generation

GVC participation tends to lead to higher domestic employment generation from exports and faster employment growth, even if it implies a higher imported content of exports.

Overall, employment increases with trade, but the employment effects of trade and participation in GVCs are highly variable. First, some industries are more labour-intensive than others: exports of garments or agricultural products are more labour-intensive than exports of minerals. Second, even within the same industries, some product lines are more labour-intensive than others: cultivation of fruit and vegetables is more labour-intensive than growing cereal crops. Third, the size and composition of the labour force involved in generating exports depends on the position of countries within GVCs: countries specializing in high value added activities have a higher demand for high-skilled employees and higher wages. One analysis of the computer hard disk industry in the 1990s estimated that the United States had 20 per cent of the worldwide labour force in this industry and accounted for 40 per cent of the global wage bill, while South-East Asia had 40 per cent of the labour but only 13 per cent of the wage bill.[18]

Figure IV.25. Growth of the labour component of domestic value added in exports, by level of GVC participation growth and foreign value added



Source: UNCTAD-Eora GVC Database, UNCTAD analysis.
Note: Data for 187 countries. "Countries with rapidly growing GVC participation" refers to the 50% of countries with the highest 2000-2010 GVC participation growth rate. "Countries using more imported content" refers to the 50% of countries with the highest foreign value added share in exports in 2010.

GVCs tend to generate employment. The labour cost component of domestic value added in exports – a proxy for the employment generation potential of exports – increases with higher GVC participation (see figure IV.24). The median share of labour reaches 43 per cent for countries within the highest quartile of GVC participation, against a share of 28 per cent for countries that participate least in GVCs. Further, from 2000 to 2010, the countries that experienced high growth in GVC participation saw the labour component of exports rise faster (at 14 per cent) than countries with low growth in GVC participation (9 per cent) (see figure IV.25). This effect holds irrespective of whether GVC participation occurs in conjunction with high foreign value added in exports. In other words, even when countries' participation in GVCs depends on higher imported content that reduces the share of domestic value added, the growth of the overall labour component of exports is higher than in cases where countries are less involved in GVCs.

The employment rate of women has been rising in export-oriented industries (such as apparel, footwear, food processing and electronics assembly), services (such as business services outsourcing, including call centres) and agriculture – although the impact of GVCs on female employment in agriculture varies considerably with the type of production and gender divisions of labour in different countries. The relative dynamism of female employment growth tends to decrease as countries move up the value chain.[19]

b. GVCs and the quality of employment

Jobs created by GVCs vary in quality. Workers can face low pay, tough working conditions, and insecurity as GVC jobs are more exposed to the vagaries of international demand and competition.

As a result of the rise of global production capabilities and the growth of export-oriented industries in many developing countries, combined with intensifying global competition due to the entry of major new producers and exporters (located largely in Asia), TNCs face significant pressure to reduce costs and increase productivity in their GVCs (also referred to as "global factories"). In turn, this is putting considerable pressure on both wages and working conditions. Especially in labour-intensive sectors (such as textiles and garments) where global buyers can exercise bargaining power to reduce costs,

Table IV.8. Examples of workforce development initiatives

Private sector workforce initiatives	• Intra-firm on- and off-the job training programmes (includes corporate training centres) • Inter-firm training programmes (lead exporters training suppliers) • Specialized training companies providing training services to lead exporters and suppliers • Private specialized colleges, vocational schools, universities • Private employers association (e.g. Turkish Textile Employers' Association)
Sectoral initiatives	• Tourism: UNWTO training programmes in the Tourism Sector, Association of Community-Based Tourism (ACTUAR in Costa Rica) • Agriculture: Kenya Horticulture Practical Training Centre • Textile and Garment Associations (e.g. Garment Manufacturers Association Cambodia; Turkish Clothing Manufacturers Association; Bangladesh BIFT Sweater Manufacturing Training Centre, etc.)
Public-private collaboration	• Public-private training partnerships: selected examples include - Skills Development Centres Malaysia - CORFO – Chile fruit and vegetables industry "Plan Fruticola" involving a partnership between Universidad de Chile and Instituo Nacional de Investigación Agropecuaria - Professional qualifications authority (e.g. Mesleki Yeterliki Kurumu Resmi for Turkish textiles and apparel) - "Buenas Practicas Agricolas" in Chile (training programme coordinated by the government, private sectors and other stakeholders in agriculture) • Government incentives for investment in training by private firms • ILO Better Work Programme: for instance, in Lesotho, it works with the Industry Employers Association, the Textile Exporters Association and five major international buyers: Gap Inc., Jones New York, Levi Strauss & Co., Primark and Walmart

Source: UNCTAD, based on various country and industry cases (Gereffi, G., K. Fernandez-Stark and P. Psilos (2011) "Skills for upgrading: Workforce Development and Global Value Chains in Developing Countries", Durham: Center on Globalization, Governance & Competitiveness, Duke University.).

this pressure often results in lower wages, although there are substantial variations between countries and across sectors within countries.[20]

Various initiatives aim to develop workforce skills, which enables producers to enhance productivity, meet industry and global standards, and align skills with demand needs (see table IV.8 for examples of workforce development initiatives). In the horticulture industry, labour training is needed to meet food safety and health standards. Such training may even be provided to the temporary workforce.[21] In tourism, the type of training varies along the value chain, from hospitality training (hotel cuisine, food preparation, wait services, housekeeping and reception) to tour operator training, language training[22] and soft skills training (such as communication skills, customer services and time management).

Despite such initiatives, some employment in GVCs provides insecure incomes and job prospects for workers. Participating countries face a number of potential employment-related risks:

- Pressures on costs from global buyers mean that GVC-related employment can be insecure and involve poor working conditions. While some core workers for key suppliers gain most in terms of pay and benefits, companies supplying global buyers frequently reduce costs by employing temporary or casual workers in their plants and outsourcing work to subcontractors where working conditions are considerably poorer.[23]
- Some GVC activities are footloose, and relocation can lead to a decline in local employment.[24] TNCs have more options for switching production between countries than most domestic firms. For the simplest tasks in the value chain and where the domestic value added component is low, the costs of relocation tend to be lower. Equally, global buyers that use NEMs to source products from local suppliers (domestic- or foreign-owned) can switch orders from one country to another. The increasing use of global intermediaries that actively seek out and choose between low-

cost locations for order fulfilment increases this pressure. Conversely, the more production is embedded in the local economy and the more the local supplier base has been built up, the greater the costs of switching locations.

- Export-oriented employment in general is more subject to fluctuations in global demand and supply, and therefore influenced by factors occurring far from where employment takes place. GVC-related jobs can be lost in case of demand fluctuation and economic crisis.[25] Fluctuation in demand can be seasonal (as in the fashion industry), resulting from weather conditions (in the food industry), or caused by economic downturns and crisis. Temporary workers are more at risk of losing their job, but permanent workers can be affected too.
- For subcontractors at the end of the value chain, which are often used as "pop-up" suppliers to provide additional capacity, these fluctuations in demand are particularly harmful as they are the marginal producers whose output is most likely to be cut. This effect is further exacerbated by lags between demand fluctuations and order fluctuations, resulting in greater variation upstream in the supply chain with negative consequences on suppliers in developing countries, a phenomenon referred to as the "bullwhip effect".[26]

3. Technology dissemination and skills building

a. Technology dissemination and learning under different GVC governance structures

The governance structure of GVCs affects the scope for and methods of knowledge transfer to developing-country firms operating in GVCs.

Business relations and governance structures in value chains are determined by the complexity of information and knowledge transfer required to sustain transactions, the codifiability of information and knowledge, and the ease with which it can be transferred, as well as by firms' capabilities and competence (Section B). The types of governance structures in GVCs are thus an indication of the potential for technology and skills transfer between various actors in the chain, and related learning mechanisms (see table IV.9).

When operating through *pure market transactions*, suppliers learn from the demands placed upon them by buyers and from feedback about their performance. Learning by exporting can be an effective way for companies to acquire capabilities, but it requires investment by these companies so that they can respond to the challenges that they encounter. Firms can even benefit from learning by importing. In Uganda, firms learned through the process of importing pharmaceuticals to start activities in packaging, assembly and original equipment manufacturing.[27] In this case, imports of products provided an initial impetus for domestic economic activity.

Other forms of GVC governance structure are more conducive to learning. *Value chain modularity* occurs when it is possible to codify specifications for complex products. In this case, turnkey suppliers have sufficient competences to engage in full-package activities.[28] Although this reduces the need for buyers to engage in inter-firm technology transfer, local suppliers learn through the need to comply with firm or industry standards, and technology transfer is embodied in standards, codes and technical definitions.

By contrast, in *relational value chains*, specifications cannot be codified, transactions are complex, and the capabilities of the suppliers are high. In this case, suppliers possess complementary competences of interest to buyers, and tacit knowledge must be exchanged between buyers and sellers. Both buyers and suppliers benefit from mutual learning, predominantly arising from face-to-face interactions.

In *captive value chains*, complexity and the ability to codify specifications are high, but suppliers do not possess the needed competences. This encourages technology transfer from buyers but can lead to transactional dependencies, with suppliers locked into supply relationships. For example, TNCs may establish very structured supplier development programmes in which local partners receive training and transfers of technology. These are designed to increase the capabilities of the local supply base. In order to protect their investments in these suppliers, companies may ensure a high degree of

Table IV.9. Learning mechanisms within GVCs

Governance type	Technology/knowledge-related determinants of governance types: Complexity of transactions	Codification of transactions	Competence of suppliers	Predominant learning mechanisms
FDI (ownership hierarchy)	High	Low	Low	• Imitation • Turnover of skilled managers and workers • Training by foreign leader/owner • Knowledge spillovers
NEMs:				
- Modular	High	High	High	• Learning through pressure to accomplish international standards • Transfer of knowledge embodied in standards, codes, technical definitions
- Relational	High	Low	High	• Mutual learning from face-to-face interactions
- Captive	High	High	Low	• Learning through deliberate knowledge transfer from lead firms; confined to a narrow range of tasks – e.g. simple assembly
Trade (market)	Low	High	High	• Learning from exporting or importing • Imitation

Source: Adapted from Pietrobelli, C. and R. Rabellotti (2011) “Global Value Chains Meet Innovation Systems: Are There Learning Opportunities for Developing Countries?”, *World Development*, 39:1261-9.

transactional dependence, making the suppliers “captive”. In the Vietnamese software industry, IBM has developed a programme called “PartnerWorld” to integrate its suppliers into its GVC. The Vietnamese partners provide IBM software services and solutions to their own clients, which include banks, enterprises and the Government; other partners distribute hardware including servers.[29] In some cases, training is conducted in conjunction with external bodies, such as the collaboration between TNCs with local or national governments in the Penang Development Centre in Malaysia. Development agents may also try to promote such linkages, as seen in the case of the Projeto Vinculos in Brazil, with involvement from the United Nations.

Under the *hierarchy* governance type (FDI), or *vertical integration*, the lead firm takes direct ownership of the operations and engages in intra-firm trade. This structure takes place when suppliers lack competences; where they are small and dependent on larger, dominant buyers that exert high levels of monitoring and control and where transactions are easy to codify. TNCs’ technology transfer occurs within and across firms in a variety of ways.[30] The internal configuration of TNCs facilitates intra-firm knowledge transfer, predominantly from headquarters to local subsidiaries. Local subsidiaries also increasingly engage in R&D activities and build their own competences. This means that TNCs engage in intra-firm trade as well as inherent technology and skills transfer; these occur within the firm across borders and benefit both headquarters and affiliates. These unique ownership advantages distinguish TNC affiliates from other local firms in host economies, and subsequent technology spillovers are enhanced. Although the degree of horizontal and vertical spillovers varies by country and industry, FDI impact does tend to be positive, especially in developing countries.

Knowledge transfer effects tend to be more positive when TNCs act directly as lead firms within the value chain, as opposed to supply chain management firms (to whom TNCs may outsource part of the burden of coordination of GVCs) or global buyers (e.g. for retailers).[31] When global buyers have operations in the host country, technology and skills transfer do occur more efficiently. However, compared with global buyers and supply chain management firms, TNCs are generally more inclined to initiate supplier development programmes in developing countries. This is illustrated in the automotive industry with

AB Volvo and its suppliers across Asia and Latin America, as well as with IKEA in the home-furnishing industry.

b. Learning in GVCs: challenges and pitfalls

Learning in GVCs is not automatic. It depends on numerous factors, including local absorptive capacities. Skills transfers to lower tier suppliers are often limited

There are caveats to knowledge transfer:[32] (i) learning is *not costless* (access to external knowledge means that local firms use resources to identify, absorb and utilize knowledge);[33] (ii) not all knowledge is *useful* (the knowledge imparted by global buyers is specific to the products bought and may not be useful for the local firm in developing its own product lines and competences); (iii) even for lead firms there are *risks involved in knowledge sharing* (especially if the knowledge recipient possesses the resources and competences to become a competitor);[34] and (iv) transfer is not automatic (to facilitate transfer, mechanisms must be put in place in both the transferor and the recipient).

Local firms' competences and absorptive capacity affect technology and skills transfer within GVCs. For local firms to develop, they need to engage in internal investment in equipment, organizational arrangements and people. Local firms can then either try to penetrate markets in which their global buyers do not operate (with the proviso that entering new markets requires additional capabilities that local firms may not have) or move into functions which their global buyers are willing to relinquish. The first case was illustrated by electronic contract manufacturers from Taiwan Province of China, including Acer, which applied knowledge learned from one part of its production to supply customers in other markets.

A number of actions can be adopted by local firms to enhance the potential for and assimilation of knowledge transfer.[35] One is to operate across value chains. Another is linked to strategies to raise local firms' bargaining power (e.g. diversification of buyers, proactive internal technology development to expand their product portfolio). Collective actions by local producers in developing countries can also facilitate knowledge transfer and absorption. This can take place in industry clusters, where SMEs combine knowledge and technical resources to improve their export potential or facilitate adoption of standards.

For developing countries, the development of lower-tier suppliers is critical, not all suppliers have similar access to technology.[36] In the automotive sector, *tier 1 suppliers* are typically dominated by a small number of foreign TNCs, particularly so since the emergence of global mega-suppliers that meet the needs of their customers across many countries has undermined the position of mostly domestically oriented local companies. Domestic suppliers tend to be numerous in *tier 2 and tier 3*. However, the highly concentrated structure of the industry means there is little room for knowledge transfer to lower-tier suppliers (which operate predominantly through market transactions). In Mexico, very few, if any, of the SMEs in the second and third tiers have been able to leverage their links to GVCs as springboards for their own internationalization. Market pressures and the introduction of international standards do encourage suppliers to improve both product and processes when they first join GVCs, but the use of modularization (driving suppliers to produce standardized components) limits access for the lower-tier suppliers to the new information, knowledge and activities of assemblers and top-tier suppliers.[37]

4. Social and environmental impacts

TNC CSR programmes have had some successes, but their ability to mitigate negative social and environmental impacts in GVCs is limited and must be complemented by public policies.

The social impact of GVCs has been mixed. Positive impacts have been achieved through strengthened formal job opportunities and poverty reduction along with the dissemination of environmental management systems and cleaner technology. However, the downward pricing pressure found in many GVCs has led to significant negative social and environmental impacts. Addressing these issues at the firm level throughout a GVC is a key challenge of CSR initiatives. TNC CSR programmes have had some successes, but their limited ability to influence practices must be complemented by public policies.

a. CSR challenges in GVCs

Implementing good CSR practices throughout a GVC is challenging. Reaching beyond first-tier suppliers remains difficult. And from a supplier perspective, compliance efforts can be costly.

For many years, TNCs have been working, primarily at the first-tier level, to promote improved social and environmental impacts, but the nature of GVCs makes this work complicated and its uneven success is due at least in part to differences in GVC structures. TNC efforts beyond the first-tier level of suppliers are especially fraught with challenges and require public policy assistance and collective action within multi-stakeholder initiatives. The 2013 Rana Plaza disaster in Bangladesh demonstrates that TNC CSR programmes alone are not sufficient to address the challenges faced; public sector and multi-stakeholder support for suppliers is key to improving social and environmental impacts.

Buyer-driven GVCs are typically focused on reduced sourcing costs, and in many labour-intensive industries this means significant downward pressure on labour costs and environmental management costs. Some suppliers are achieving reduced labour costs through violations of national and international labour standards and human rights laws. Practices such as forced labour, child labour, failure to pay minimum wage and illegal overtime work are typical challenges in a number of industries. In addition to downward pressure on wages, the drive for reduced costs often results in significant occupational safety and health violations. Common examples in factories include inadequate or non-existent fire safety features, leading to a number of well-publicized deaths in factory fires, and poor ventilation systems leading to chemical exposures and "dust disease" illnesses (pneumoconioses) that the ILO characterizes as a "hidden epidemic".[38]

Similarly, downward pricing pressure has created economic incentives for violating environmental regulations and industry best practices, leading to the increased release of disease-causing pollutants and climate-change-related emissions. Cutting costs by engaging in negative social and environmental practices is a particularly acute trend in developing countries, which often lack the regulatory infrastructure to ensure compliance with the laws and/or have lower social and environmental standards in place as a result of the competitive pressures of GVCs.

For more than a decade, large global companies, whether they be TNCs with operations in many countries or global buyers working through NEMs, have faced increasing pressures to take responsibility for these social and environmental challenges in the value chain. These pressures are particularly strong in sectors such as food, electronics and garments, where consumers can perceive a direct relationship between the products they buy and the conditions under which those products are produced.

Companies have responded to these pressures by adopting a range of standards and codes of conduct. In most companies, these codes are supported by specific staff with responsibility for the code's implementation and complemented by CSR management systems (including supplier oversight programmes) and corporate reporting. Despite the advancement of CSR management practices in recent years, addressing social and environmental problems in value chains remains a challenge.

The international instruments of the United Nations (e.g. ILO Core Labour Standards, the UN Guiding Principles on Business and Human Rights) represent a global consensus on CSR and are commonly cited by TNCs in their company codes of conduct.[39] While there is strong consensus on the normative dimension of what *should* be done, the practical implementation of CSR standards is the key challenge, especially in the context of complex GVCs and when working with suppliers beyond the first tier.

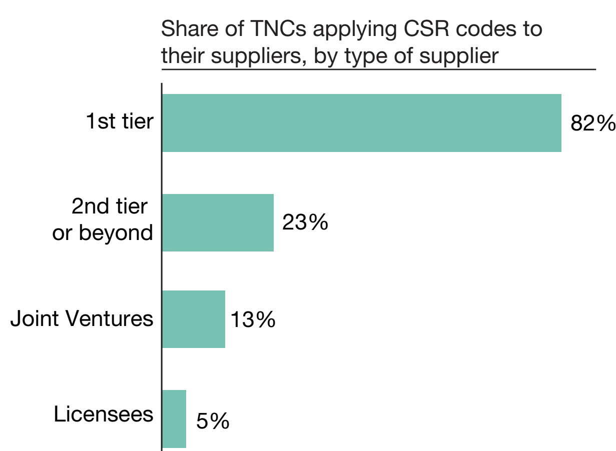
The impact of supplier codes of conduct on GVC members is not uniform; rather, most of it is concentrated on first-tier suppliers. At this level, TNCs in many industries have more influence and are engaged in a number of monitoring activities. Some companies require their suppliers to undergo an audit before the first contract is established and then expect their suppliers to be monitored every three to four years. In other industries, suppliers can be inspected as frequently as every six months.

Generally, the audit process involves an inspection of the factory site, interviews with management and workers (individually and in groups) and an analysis of company files and records, such as time sheets, wage records and employment contracts. The time required to complete an audit can vary between half a day and six days, depending on the size of the supplier.

These CSR programmes can have a beneficial impact at the level of tier-one suppliers, improving some aspects of their social and environmental practices. They do not, of course, solve all problems at the tier-one level, where TNCs still face many challenges implementing their codes. Such programmes, however, can also place a burden on suppliers who are often the subject of frequent (sometimes weekly) inspections from multiple customers. And there is little investment in capacity building and training for suppliers, especially SME suppliers, to improve their social and environmental practices.

Beyond first-tier suppliers, the challenge of influencing the CSR practices of value chain members becomes increasingly difficult. Companies are beginning to apply their CSR codes to members of the value chain beyond first-tier suppliers (figure IV.26). However, the influence of TNCs at these lower levels of the value chain is typically very weak.

Figure IV.26. Application of CSR codes beyond tier-one suppliers



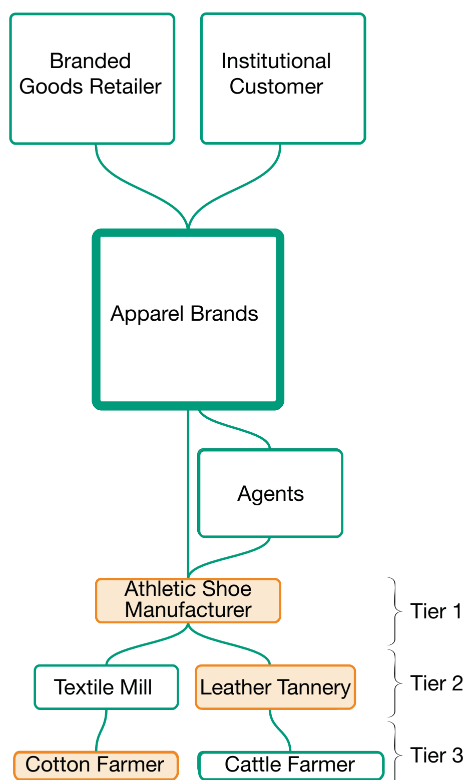
Source: UNCTAD (2012), "Corporate Social Responsibility in Global Value Chains".
Note: Based on study of 100 TNC CSR codes. Indicates what value chain member the company says its code applies to.

One of the key factors in determining the potential usefulness of company CSR codes is the power of the TNC relative to other members of the value chain, and the proximity of the TNC to those members in terms of direct and indirect dealings. Power differentials between members of a GVC can differ vastly across industries, and sometimes even across specific product categories within an industry. Within apparel, for example, lead firms in some product categories (such as athletic shoes) maintain significant power in relation to their first-tier suppliers, while in other product categories (such as t-shirts) TNCs have much less power over their suppliers.[40] A significant factor influencing power differentials is the level of concentration at different levels in a GVC, as indicated by the market share that any one buyer or supplier maintains for a given product. TNCs will typically, but not always, have the most influence in value chains where they are a part of a highly concentrated set of buyers dealing with a large number of suppliers at the tier-one level (e.g. the branded athletic shoe market). Their power is much reduced when they are part of a large group of potential buyers (e.g. the t-shirt market). Influence is also significantly reduced as TNCs attempt to reach deeper into their GVCs. To influence the social and environmental practices of suppliers at the second or third tier, TNCs will typically need to form industry associations, join multi-stakeholder initiatives and/or rely on public policy solutions (figure IV.27).

Watchdog organizations, such as non-governmental organizations and trade unions, and strong national laws help to develop an institutional framework in which corporate behaviour can be adequately monitored and violations can be tracked and corrected. An immediate impact of the Rana Plaza disaster in Bangladesh, for example, was a public policy shift allowing the formation of labour unions without prior consent by the employer. The strengthening of watchdog organizations, including trade unions, can have a positive impact on CSR issues by shedding light on violations and empowering workers to self-regulate the industries in which they work. These impacts can be further strengthened through a vibrant civil society network, including open dialogue and opportunities for press publications on all issues surrounding corporate environmental, social and governance practices.

Figure IV.27. TNC influence on CSR practices in the athletic shoes GVC

Orange indicates areas that have come under scrutiny for CSR issues. Size of box indicates relative power in the GVC.



Source: UNCTAD.
Note: Tier 1: Use of company codes and inspections; Tier 2 and 3: Use of industry associations and multi-stakeholder initiatives (e.g. Better Leather Initiative, Better Cotton Initiative).

b. Offshoring emissions: GVCs as a transfer mechanism of environmental impact

Offshoring of emissions will remain a challenge even with best practice environmental management systems. Deliberations on global emissions reduction must take into account the effect of GVCs.

Trade and GVCs are the mechanism through which the emission impact of final demand is shifted around the globe. Manufacturing for exports was responsible for 8.4 billion tons of carbon dioxide in 2010, or 27 per cent of global carbon dioxide emissions (roughly in line with the share of gross exports in GDP of 30 per cent in 2010). As developing countries continue to engage in export-oriented industrialization, they tend to have a higher share of emissions caused by final demand in other countries (i.e. trade- or GVC-related emissions) as compared with developed countries (figure IV.28). Only 8 per cent of total carbon dioxide emissions produced in developed countries were used to satisfy final demand in developing countries, whereas more than double that proportion (17 per cent) of emissions produced in developing countries served final demand in the developed economies. Africa and the least developed countries account for small fractions of global emissions (4 per cent and 1 per cent respectively), but relatively large shares of those emissions are transferred through GVCs to satisfy demand elsewhere.

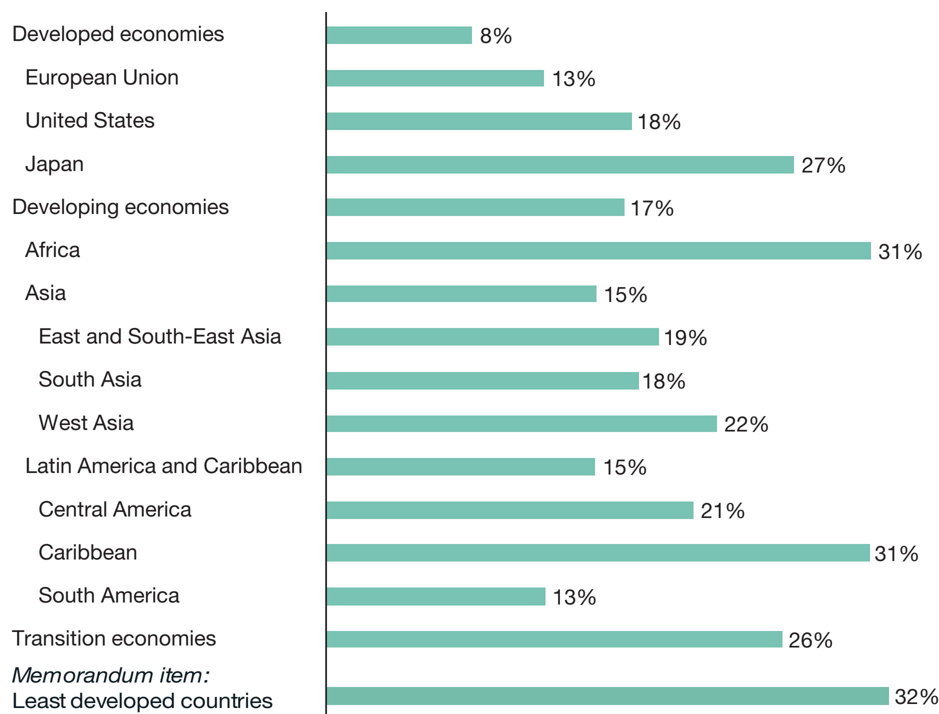
This offshoring of emissions facilitated by GVCs can have a significant impact on a country's ability to achieve its national environmental goals, as well as its ability to meet internationally negotiated emissions reductions targets. Deliberations on global emissions reduction must take into account this offshoring effect when considering national emissions targets.

Engaging in GVCs, even when firms employ environmental best practices, will typically lead to a shifting of the burden of emissions reduction to developing countries, which often have the least capacity to address it. The situation can be further exacerbated by the energy sources used in different countries: shifting energy-intensive manufacturing from a country with low-carbon energy sources (e.g. nuclear, hydro, solar) to a country with high-carbon energy sources (e.g. coal) can lead to higher overall emissions even when all manufacturing processes remain the same. Addressing the issue of emissions offshoring can involve greater coordination between investment promotion and export promotion authorities, on the one hand, and environmental protection authorities, on the other, as well as coordination with the energy production strategy for the country.

5. Upgrading and industrial development

The previous sections have demonstrated that participation in GVCs can yield *direct* economic benefits to developing countries such as the value added contribution to GDP, job creation and export generation. A number of mechanisms have been addressed through which participation in GVCs can improve the *longer-term* development prospects

Figure IV.28. Share of total emissions that are "imported" through GVCs, by region, 2010



Source: UNCTAD analysis, based on information from the Eora MRIO database.
Note: The UNCTAD-Eora GVC Database has its origins in the Eora MRIO (multi-regional input-output) database which was conceived as a means to track the true carbon footprint of countries and other economic agents.

GVCs can offer longer-term development opportunities – in addition to direct economic impacts – if local firms manage to increase productivity and upgrade to higher value added activities in GVCs.

of countries, in particular the potential for technology dissemination and skill building, which can help firms (i) improve their productivity in GVCs and (ii) enter or expand into higher value added activities in GVCs. Both are essential ingredients of industrial upgrading.

a. Upgrading dynamically at the firm level

(i) GVCs and firm productivity

Firm-level evidence shows that participation in GVCs is linked to firm *productivity*. Compared with non-exporters (or non-importers), firms that engage in international activities show significantly higher productivity levels. Similarly, firms that engage in GVCs with NEMs have productivity levels that are lower than those of TNCs, which have activities in more than one country. Internationalization is therefore closely linked to productivity levels of firms (figure IV.29).

Firm-level productivity and country competitiveness go hand in hand. It is firms with high productivity levels that are behind countries' participation in GVCs, and it is the further improvement of these firms' productivity that is, to a great extent, behind countries' success in upgrading.

Firms can enhance capabilities in GVCs through product, process, functional and chain upgrading. Upgrading is a function of GVC structure and governance, lead and local firm characteristics, and host country context.

(ii) Types of firm upgrading

Local firms can enhance their competences in GVCs through four main channels, namely products, processes, functional areas and inter-chain interactions.[41]

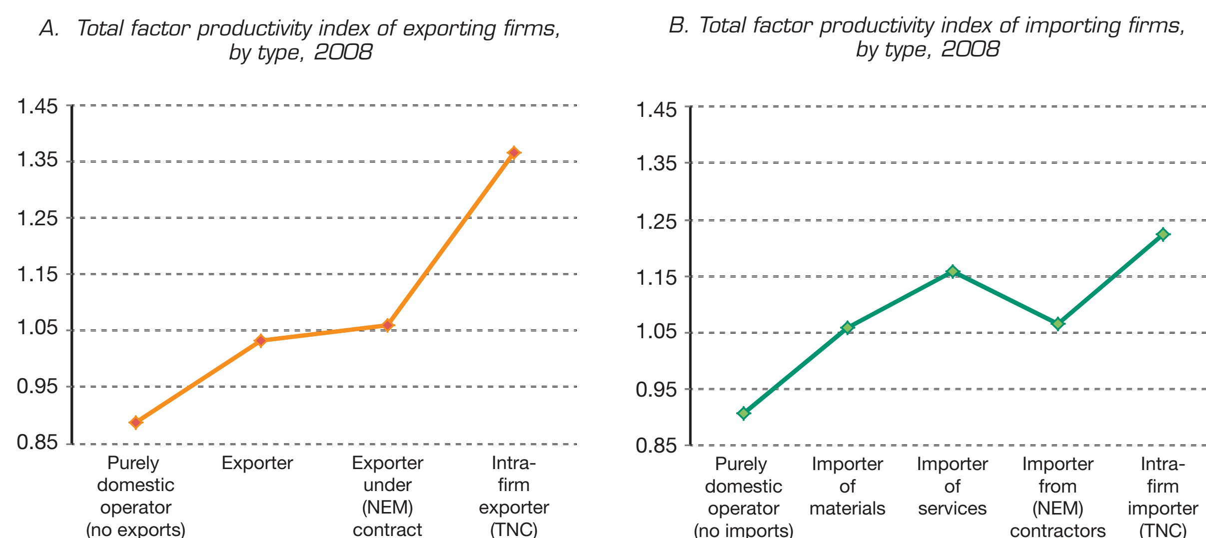
- *Product upgrading*. Firms can upgrade by moving into more sophisticated product lines

(which can be defined in terms of increased unit values). For instance, in the tourism value chain, firms can upgrade within the hotel segment by offering higher-quality hotels or by adding niches such as ecological or medical tourism.

- *Process upgrading*. Firms can upgrade processes by transforming inputs into outputs more efficiently through superior technology or reorganized production systems. Increased efficiency includes processes within the firm as well as processes that enhance links in the chain (e.g. more frequent, smaller and on-time deliveries). The dissemination of business practices and standards among firms serving GVCs can be triggered by lead firms or market pressures. For example, to meet higher standards in agricultural produce, many TNCs encourage adoption of "GAP" (good agricultural practice) among their suppliers in developing countries, offering them training and technical assistance in field care, post-harvest practices, storage and transportation.
- *Functional upgrading*. Firms can acquire new functions in the chain, such as moving from production to design or marketing, to increase the overall skill content of activities. For instance, in the global apparel value chain, functional upgrading would involve a move from cut, make and trim forms of offshore contracts to a model where the firm offers a wider range of production capacities and services to buyers (such as limited design, warehousing and embellishment), to ODM (own design manufacturers) where firms carry out all parts of the production process including design, to OBM (own brand manufacturers) where firms engage in R&D, design and marketing functions.
- *Chain upgrading*. Firms apply the competence acquired in a particular function of a chain to a new industry. For example, firms in the apparel industry may shift into other value chains such as automotive (e.g. providing seat covers) or technical textiles for non-apparel uses. In the case of the Indian offshore services value chain, local firms became involved in software development in the 1990s (and still are today), before developing competences in business process and knowledge process outsourcing in the early 2000s.

The route to upgrading is unique to individual industries and countries. Various types of upgrading can take place simultaneously. In tourism,[42] for example, upgrading paths and policies have included (i) pro-FDI policies to attract international

Figure IV.29. Firm participation in GVCs and productivity



Source: UNCTAD analysis, based on EFIGE; Altomonte, C., T. Aquilante and G. Ottaviano (2012) "The Triggers of Competitiveness: The EFIGE Cross-Country Report", Bruegel Blueprint Series, Vol. XVII.

Note: Reference productivity index for the sample set to 1.00.

hotel chains and coordination between global tour operators and local incoming agents (in Viet Nam and Costa Rica, agents upgraded to serve as regional tour operators as well as in-country tour coordinators), (ii) IT utilization (the Viet Nam National Administration of Tourism focused attention on developing a web presence for the country), and (iii) diversification of product offerings (such as eco-tourism in South India).

Recent evidence suggests that through upgrading, local firms can also create new chains. Through its internationalization and with incentives from the Brazilian Government, Foxconn now assembles iPhones in Brazil. The location of a lead firm in this large emerging country is expected to not only increase consumer electronics manufacturing but also generate demand for locally made components (although, for the moment, many of the components are still shipped from Asia).

(iii) Factors driving firm-level upgrading

A number of factors influence the potential for local firm upgrading through GVCs, including the nature, structure and governance of GVCs and their lead firms' characteristics, as well as host country and local firm characteristics (see table IV.10).

In terms of structure and governance, a GVC that involves too many intermediaries limits the potential for local firms to learn from lead firms. Some governance mechanisms, particularly the modular or relational forms of business relationships, lead to enhanced firm-level upgrading. And lead firms have an incentive to encourage product and process upgrading but may raise entry barriers through brand names, technology or R&D, which can mean functional upgrading is more difficult to achieve.

Focusing on host country and firm-level characteristics, it is clear that physical infrastructure (ports, roads, power, telecommunications), knowledge infrastructure (universities, technology parks, etc.) and business infrastructure (EPZs, clusters, agglomerations, etc.) increase the upgrading potential of local firms. The quality, quantity and cost of appropriate factors of production (labour, capital, natural resources) facilitate upgrading. Local firm competences and absorptive capacity determine upgrading potential. And the value chain position (e.g. first-, second- or third-tier supplier), and power relations within the value chain mean that local firms have varying access to lead-firm technology and knowledge and related upgrading potential.

The nature of GVCs means that *authority* and *power relationships* are key to explaining learning by local producers. In addition, there are *sector-specific differences* in the ways firms can learn. In *buyer-driven GVCs*, buyers tend to intervene directly in local firm processes. In *producer-driven GVCs*, especially in the case of complex product systems, the potential for technological upgrading is high, first because suppliers tend to already possess technological capabilities, and second because purchasers provide incentives to upgrade. However, the potential for upgrading is higher for first-tier suppliers than for second- and third-tier suppliers.

For local firms, operating in multiple value chains, including TNC-independent chains, can act as an impetus for upgrading. First, when local firms operate in value chains that are not dominated by global buyers or TNCs, such as national or regional chains, they often need to develop their own competences across a variety of functional activities (without the fear of competing with their key customers).[43] Second, once local firms have acquired the competence to develop and sell products under their own names within their own markets, they are in a position to start exporting these under their own brands and designs to export markets.[44] Third, when a number of local firms in an industry or cluster develop such a range of competences, their effects may subsequently spill over to other local firms.

The origin of lead firms can result in varying benefits.[45] The Zambian copper mining sector provides a good ground to compare various lead firms in GVCs. North American, European and South African buyers have aligned their supply chain practices to global practices that are increasingly dominant in the mining sector, characterized by emphasis on quality, lead times and trust as key market requirements, with support and cooperative practices for suppliers to improve their management and technological competences. Chinese buyers are considered result-oriented buyers, but their

Table IV.10. Factors influencing firm-level upgrading potential in GVCs

Driving force	Factors	Description
Lead firms and GVC structure and governance	Fragmentation and configuration	• Spatial scale (within and across borders), number of stages of the value chain, number and types of key actors involved (lead firms, intermediaries, suppliers)
	Governance mechanism	• Governance in terms of market, modular, relational, captive and hierarchy and its implication in terms of the type of relationship between lead and local firms
	Technology level	• Levels of technology in various segments of the value chain within an industry
	Dynamic changes	• Speed with which global competition changes (global strategic rivalry, threats of new entrants) and changes in the GVC structure and governance
	Entry barriers	• Number of existing competitors at various stages of the value chain, type of entry barriers such as brand names, technology or R&D
	Bargaining power	• Degree of power held by the lead firms in terms of decisions over suppliers and guidance in activities performed by key suppliers
	Organizational convergence	• Harmonization of key activities and standards across various locations (such as human resources and environmental practices, inter-firm cooperation), supplier auditing and monitoring practices
Host country and firm-level characteristics	Infrastructure	• Physical infrastructure (ports, roads, power, telecommunications), business infrastructure (EPZ, SEZs, Industrial Zones)
	Key resources	• Availability, quality and cost of key resources (labour, capital, natural resources)
	Supply conditions	• Availability, quality and cost of supplies locally, technological competence of local suppliers
	Market conditions	• Local (and regional) market size, growth, consumer preferences
	Knowledge environment	• Macro-innovatory, entrepreneurial and educational capacity environment
	Degree of specialisation	• Country's past, current and future specialization in specific GVC segments, tasks and activities
	Geographic position	• Size and potential of regional markets, membership of a regional integration agreement facilitating inter-country division of labour,
	Firm resources	• Local firm's own resources, capabilities and degree of absorptive capacity
	Value chain position and involvement	• Position of the firm (1st, 2nd or 3rd tier supplier), including bargaining power, and number, type and geographic spread of value chains the firm is involved in.
	Competitive dynamics	• Local (regional or global) strategic rivalry, threats of new entrants, threats of substitutes

Source: UNCTAD.

supply chain is governed more at arm's length. Indian buyers are more price-driven, but by adopting low entry barriers and low performance requirements, they ensure high levels of competition in the supply chain. Different supply chain practices have been found to affect upgrading efforts of local suppliers in different ways.

Local firms often have to enhance their competences as a result of country, industry or firm standards related to the production and processing of various products.[46] Firm-specific standards are driven by organizations that reflect the interests of the corporate sector (i.e. ISO 9000 quality procedures or ISO 14000 environmental standards). Once lead firms implement these quality standards, there is often a cascade effect, as numerous suppliers need to follow suit and adopt similar procedures. Implementation of such procedures can improve processes among a wide range of companies involved in the value chain.

Agglomeration and clustering facilitate economic benefits from GVC participation. Local firms have a greater chance of capturing the benefits of GVC participation when they are located in clusters because of *collective efficiency*[47] resulting from geographical proximity and increased potential for business interactions and learning.

(iv) Upgrading risks

Local firms may find themselves *locked into* low value added activities despite having successfully gone through product and process upgrading, because functional upgrading is more difficult to achieve. This can result from a number of factors, namely prevailing business *practices of lead firms*,[48] global *competitive dynamics* of value chains and *local firms acting inefficiently* by maximizing short-term profits at the cost of long-term efficiency, as well as the *routines of contractors* involved in the value chain.[49]

Access to various functions may be more contentious if local producers start engaging in activities conducted by the lead firms.[50] In such cases, power relations may limit knowledge flows within the chain. Local firms become tied into relationships that prevent functional upgrading, especially when they depend on powerful buyers for large orders. This is illustrated in the Sinos Valley shoe cluster in southern Brazil. In the 1960s, new buyers from the United States drove a change in the configuration of the cluster from numerous small producers to larger producers that could deliver larger volumes of standardized products. This affected power relations within the cluster. Process standards and product quality rose, as local firms gained access to international markets. The early 1990s saw the rise of rival Chinese producers and downward price pressure. Despite this competition, large producers in the Sinos Valley were reluctant to move up to areas of design and marketing for fear of consequences from the cluster's main buyers, which represented nearly 40 per cent of the total cluster exports. It became apparent that the Brazilian producers achieved high production standards but lagged behind in terms of innovative design. These competences were instead developed by firms targeting the local Brazilian market or regional Latin American export markets.

Other risks associated with upgrading relate to the *impact* of the upgrading process. Economic upgrading can have detrimental social impacts.[51] This can take place, for instance, when greater process efficiency leads to an increased use of casual labour. In a few cases (as in the agro-food sector of some countries), process improvements have been accompanied by weak pro-poor, environmental and gender outcomes.

Rising standards in an industry can also create barriers to entry into the value chain for local firms.[52] In the horticultural industry, new supplier countries often start in export markets where standards are less stringent. To upgrade, e.g. from production to packing, suppliers must first understand the market (especially when buyer-driven), invest in new technologies (for instance, to meet high hygiene standards in packhouse operations, they need to set up on-site laboratories for product and staff health tests), and have access to a local packaging industry that can supply appropriate containers. Where a good local packing supply industry does not exist, value loss can occur initially as producers shop their products to neighbouring countries for repackaging before final exports.

b. Upgrading at the country level and GVC development paths

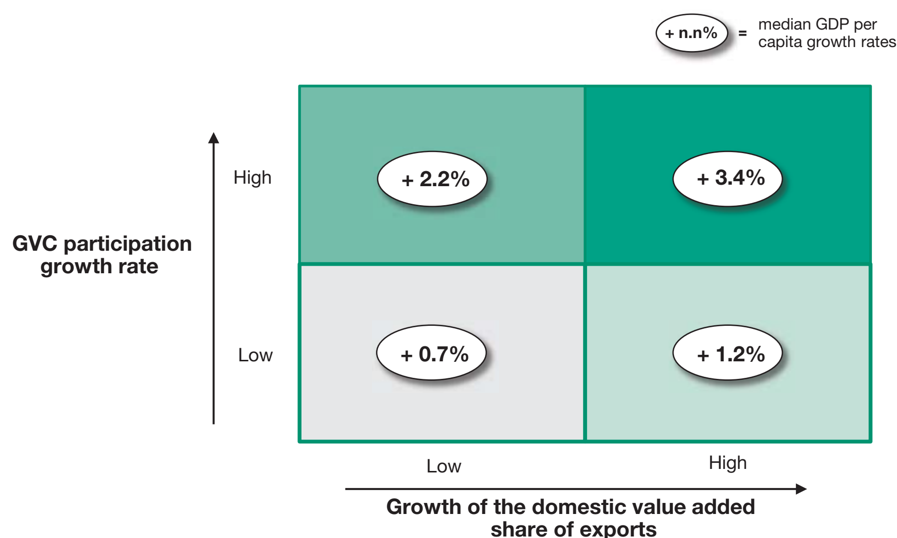
(i) Participation in GVCs and domestic value added creation

Most developing countries have increased their participation in GVCs over the past 20 years, usually at the cost of a higher share of foreign value added in exports. The optimal policy outcome is higher GVC participation and higher domestic value added creation.

When firms enter or expand into *higher value added activities* in GVCs, they create more domestic value added from trade for the country in which they are based. This is not automatic. Participation in GVCs often implies entering more fragmented value chains that are, by definition, characterized by a higher use of foreign value added inputs. At the entry level, the share of domestic value added in exports thus tends to decrease initially when countries increase GVC participation, although the absolute value of the contribution of exports to GDP is likely to increase.

This conceptual trade-off between GVC participation and domestic value added creation from trade is shown in figure IV.30. At the country level, as seen in section A, GVC participation

Figure IV.30 GDP per capita growth rates for countries with high/low growth in GVC participation, and high/low growth in domestic value added share, 1990–2010



Source: UNCTAD-Eora GVC Database, UNCTAD analysis.
Note: Data for 125 developing countries, ranked by growth in GVC participation and domestic value added share; high includes the top two quartiles of both rankings, low includes the bottom two; GDP per capita growth rates reported are median values for each quadrant.

depends on both upstream and downstream links in the value chain. Countries increase their GVC participation both by increasing imported content of exports (foreign value added in exports) and by generating more value added through goods and services for intermediate use in the exports of third countries. Naturally, the latter mechanism yields the positive results for the domestic economy, as it implies growing domestic value added in exports.

In fact, both the right hand quadrants in figure IV.30 – countries that reduce their reliance on foreign value added in exports – indicate higher GDP per capita growth results than the left hand quadrants. Examples of countries that have achieved such results include China, Chile, the Philippines, Thailand and Morocco.

Interestingly, both the top quadrants in the matrix – countries with faster GVC growth rates – have significantly higher GDP per capita growth rates than the bottom quadrants. This suggests that even those countries that rely more on foreign value added in exports, on average, may be better off if it results in higher GVC participation. Countries with high GVC participation growth rates include Indonesia, Malaysia, Viet Nam, Bangladesh, Mexico and Turkey.

Clearly the optimal policy outcome is depicted in the top right hand quadrant, where countries increase GVC participation through growth in the domestic value added in exports. Examples of countries in the top right quadrant include China, Indonesia, Thailand and Peru. While increasing foreign value added content in exports may be a short-term trade-off for policymakers, in the longer term the creation of domestic productive capacity yields the better results.

Although the matrix is a simplification of reality that cannot capture all the dynamics of development, the different outcomes in each of the combinations of GVC participation and domestic value added creation suggest that there may be a set of distinct “GVC development paths” or evolutionary lines in countries’ patterns of participation in GVCs.

Figure IV.31, based on an analysis of value added trade patterns of 125 developing countries over 20 years, shows the frequency of the various directions in which countries tend to move in terms of participation and domestic value added creation. The implicit trade-off between participation and domestic value added share is confirmed by the high frequency of moves towards higher GVC

participation at the cost of domestic value added share.

GVC development paths are not one-off moves along the participation and upgrading dimensions, they are a *sequence* of moves. The most commonly observed sequential moves can be grouped into a number of prototypes. For most countries (some 65 per cent), increasing participation in GVCs over the past 20 years has implied a reduction in domestic value added share, with the increase in GVC trade significantly outweighing the decline in value added share such that the result in terms of absolute contribution to GDP was positive. Some countries (about 15 per cent) have managed – often after initial rapid increases in GVC participation – to regain domestic value added share, mostly by upgrading within the GVCs in which they gained strong positions and by expanding into higher-value chains.

A number of countries have, over the past 20 years, not seen a significant increase in the relative contribution of GVCs to their economies. This group includes countries that may have started out on a path towards higher GVC participation but dropped back to below the starting point, as well as countries that maintained the role of GVCs in their economies at a low level or decreased it.

Figure IV.31. Frequency of moves along dimensions of GVC participation and domestic value added creation, developing economies, 1990–2010, five year intervals

Type of Move			Number of cases	%
GVC integration	DVA creation	Direction of move		
(+)	(−)	↖	216	43%
(+)	(=)	↑	46	9%
(+)	(+)	↗	46	9%
(=)	(+)	→	51	10%
(−)	(+)	↘	35	7%
Others			106	21%
Total			500	100%

Source: UNCTAD-Eora GVC Database, UNCTAD analysis.

Each of the prototypes of GVC development paths tends to show a predominant pattern of trade and investment:

- When developing countries increase participation in GVCs, they have tended to see increases in imports of intermediate goods, components and services increase, as well as in the importance of processing exports. In many countries – as in Bangladesh, Costa Rica, Mexico, and Viet Nam – this pattern has coincided with an influx of processing FDI or the establishment of NEM relationships (e.g. contract manufacturing) with TNCs.
- Some developing countries that have managed to increase domestic value added in GVCs, after achieving a significant level of GVC participation, have succeeded in increasing exports of higher value added products and services or in capturing a greater share of value chains (covering more segments). In many countries, including China, Malaysia, the Philippines and Singapore, such export-upgrading patterns have combined with an influx of FDI in adjacent value chain segments and higher-technology activities. A few countries, including Thailand, have experienced very rapid development of domestic productive capacity for exports that compete successfully at relatively high value added levels. In these cases, FDI has often acted as a catalyst for trade integration and domestic productive capacity building.
- A number of countries that have not seen a significant increase in the relative contribution of GVCs to their economies have seen exports remain predominantly within sectors and industries that have domestic productive capacity (with limited need for imported content). This does not mean in all cases that these countries have remained entirely isolated from GVCs. In a few cases, FDI inflows have been aimed at producing intermediate goods and services for export products, substituting imports. These patterns of trade and FDI preserve domestic value added in trade, but at the cost of more rapid growth in GVC participation.

(ii) Upgrading and industrial development

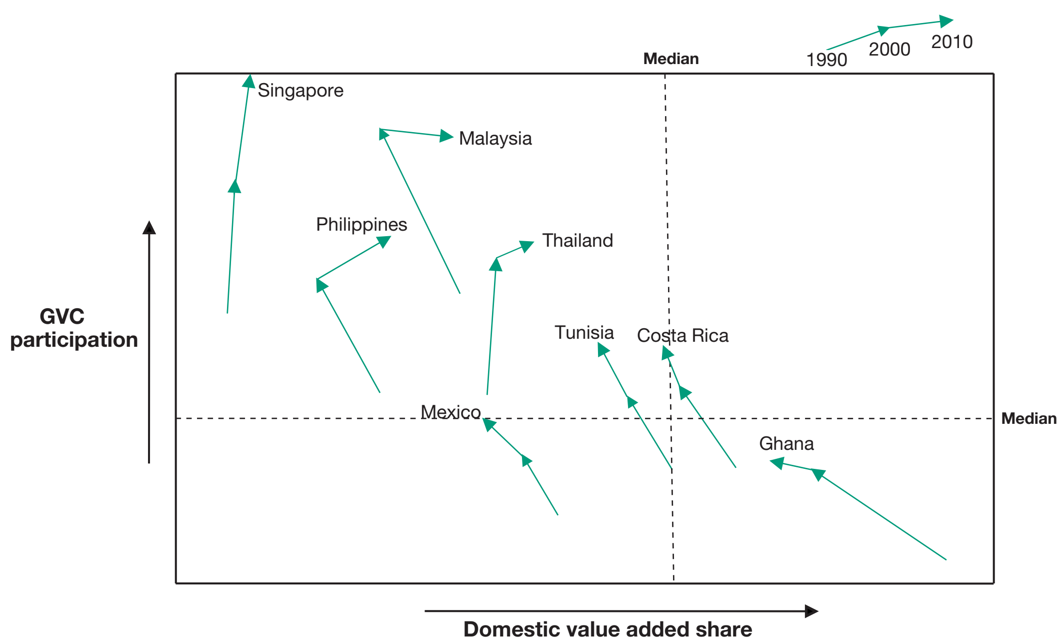
Any analysis of GVC development paths at the country level risks overlooking the fact that countries may have moved along the dimensions of GVC participation and domestic value added creation in different ways. They may rely on different industries and GVC segments, which they may have grown by different means – including through FDI, NEMs or domestic enterprise development. The overall GVC development path of countries is an average of the development paths of many industry and GVC activities, which may have followed different paths.

Moreover, domestic value added creation should not be equated with upgrading. Upgrading may be one (important) factor behind increasing domestic value added. But even countries with decreasing shares of domestic value added in exports may well be on an upgrading path, if they increasingly participate in GVCs that create higher overall value, or engage in GVC tasks and activities at higher levels of technological sophistication that generate more value in absolute terms but at the same time depend on increasing foreign content in exports.

Figure IV.33 shows a number of examples of countries participating in GVCs at different levels of sophistication, from resource-based exports to low-, medium- and high-tech manufacturing exports, to exports of knowledge-based services. Upgrading paths for these countries could include process, product or functional *upgrading within* each of the categories of technological sophistication, or *diversifying* and expanding into higher-level categories.

Upgrading and industrial development can come from improving productivity and expanding the range of tasks and activities within, e.g. resource-based GVCs, where countries move from exporting commodities to processing raw materials. It can mean moving to adjacent categories of increasing technological sophistication and value added, such as moving into medium-technology manufacturing after learning and building productive capacities through low-tech manufacturing activities. Or it can mean jumping into categories several levels

Figure IV.32. GVC Development Paths: country examples



Source: UNCTAD-Eora GVC Database, UNCTAD analysis.

up the technology ladder, often using skills related to existing exports, such as engineering skills employed in resource-based activities that can be exported as knowledge-based engineering services.

A number of examples illustrate how some countries have succeeded in upgrading through investment in GVCs. China has successfully expanded into ever more high-tech export-oriented activities (figure IV.34). Knowledge-based services exports from China also increased eight-fold between 2000 and 2010 (although the total value of these exports is dwarfed by exports of goods). The basis for the export growth from China, and for the expansion of productive capacity in higher-technology GVCs, can be found initially in the influx of foreign investment and the establishment of contract-based links (NEMs) with TNCs, but the growth of capacity of domestic firms has kept pace.

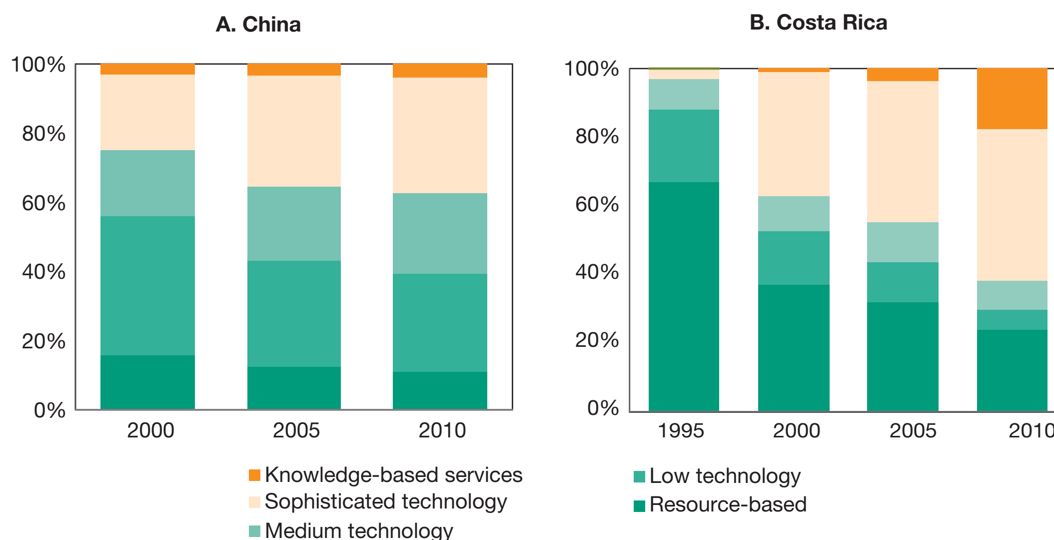
In Costa Rica, a large initial foreign direct investment project (by Intel in 1996) resulted in a jump in high-tech exports, from a starting point of predominantly resource-based exports (figure IV.34). Subsequently, the attraction of further investment by services outsourcing firms, benefiting from spillovers from the high-tech segment, has led to an expansion of knowledge-based services exports.

Figure IV.33. Examples of countries participating in GVCs at different levels of technological sophistication and value added, 2010

Country	Exports by level of technological sophistication				
	Resource-based	Low-tech manufacturing	Mid-level manufacturing	Sophisticated manufacturing	Knowledge-based services
Brazil	60%	5%	15%	5%	10%
China	10%	25%	20%	30%	5%
Costa Rica	20%	5%	5%	35%	15%
India	35%	15%	10%	5%	25%
Lesotho	30%	60%	0%	5%	0%
Malaysia	30%	10%	15%	30%	5%
Russian Federation	75%	5%	10%	0%	5%
Singapore	20%	5%	15%	35%	15%
South Africa	55%	5%	25%	0%	5%

Source: UNCTAD analysis, based on Globstat.
Note: Product categories are based on Lall's classification of technology-intensity. Knowledge-based service exports include insurance, financial services, computer and information services, royalties and license fees, and other business services. See Lall, S. (2000) "The Technological Structure and Performance of Developing Country Manufactured Exports, 1985-1998", *QEH Working Paper Series*, Queen Elizabeth House, University of Oxford. Other, non-knowledge-based services are excluded from calculations, hence percentages do not sum to 100. Resource-based products is the sum of commodities and natural resource-based manufacturers.

Figure IV.34. Exports by category of technological sophistication



Source: UNCTAD analysis, based on Globstat.
Note: For method and source, see figure IV.33.

* * *

This section has demonstrated that participation in GVCs can bring benefits for developing countries, including direct contributions to value added and GDP, job creation and income generation. However, capturing the value of GVCs is not a given, and the social and environmental consequences of GVC participation can be significant.

The section has also shown that GVC participation can bring long-term development benefits in the form of upgrading opportunities and industrial development options. However, relatively few developing countries have made significant inroads into increasing domestic value added share and upgrading, and the build-up of technological capabilities and productive capacity through GVCs is not automatic. *Policies matter* to maximize the development contributions of GVCs and minimize the risks involved.

D. Policy implications of GVCs

Countries can make a strategic choice whether or not to actively promote GVC participation. However, the key question for most is how to incorporate GVCs in development strategy.

As shown in the preceding sections, participation in GVCs can generate considerable economic development benefits but also involve risks. The potential social and environmental consequences of GVCs, and the experience of some countries with limited local value capture from GVCs, have led many developing-country policymakers to ask the legitimate question; are active promotion of GVCs and GVC-led development strategies the only available options or are there alternatives?

Active promotion of GVCs and GVC-led development strategies imply the encouragement and provision of support to economic activities aimed at generating exports in fragmented and geographically dispersed industry value chains, based on a narrower set of endowments and competitive advantages. And they imply active policies to encourage learning from GVC activities in which a country is present, to support the process of upgrading towards higher value added activities and diversifying into higher value added chains.

The alternative, by implication, is an industrial development strategy aimed at building domestic productive capacity, including for exports, in all stages of production (extending to the substitution of imported content of exports) to develop a vertically integrated industry that remains relatively independent from the key actors of GVCs for its learning and upgrading processes.

As seen in the previous sections, almost all countries have increased their GVC participation over the past two decades, but a significant group (about 20 per cent) has not seen a relevant increase in GVC growth relative to the size of their economies. Some countries, those with either significant resource-based exports, or sufficient growth potential based on domestic demand, or a combination of both size and resource factors, have seen economic performance in line with the most successful GVC-led-growth countries.

It thus appears that countries can make a strategic choice whether to promote or not to promote GVC participation. To do so, they need to carefully weigh the pros and cons of GVC participation, and the costs and benefits of proactive policies to promote GVCs or GVC-led development strategies, in line with their specific situation and factor endowments. It should be noted that promoting GVC participation implies targeting specific GVC segments, i.e. GVC promotion is often selective by nature. Moreover, promotion of GVC participation is only one aspect of country's overall development strategy.

However, for the majority of smaller developing economies with limited resource endowments there is often little alternative to development strategies that incorporate a degree of participation in GVCs. The question for those countries is not *whether* to participate in GVCs, but *how*.

To help answer that question, a number of key policy challenges can be distilled from the findings presented in the previous sections on patterns of value added trade and investment, drivers and locational determinants for GVC activities, and the development impact of GVCs:

- Most developing countries are increasingly participating in GVCs, but many are still at an early stage of GVC development. An encouraging aspect of GVCs is that the prerequisites for the development of activities within value chains, and the determinants of investment in such activities, are generally fewer than the prerequisites for industries as a whole. Nevertheless, a key challenge for policymakers remains *how to gain access and connect local firms to GVCs*.
- GVC links in developing countries can play an important role in developing economies, in particular by contributing to GDP, employment and growth. The scope for these potential contributions depends on the configuration and governance of GVCs and on the economic context in GVC participant countries (including productive capacities and firm capabilities). The policy challenge is thus *how to maximize the development benefits from GVC participation*.

- In the longer term, GVCs can support the build-up of productive capacity, including through technology dissemination and skill building, and bring opportunities for industrial upgrading and increasing domestic value added in trade. However, the potential development benefits of GVCs – in particular technology dissemination, skill building and upgrading – are not automatic. Developing countries can remain locked into low value added activities. A strategic policy challenge is *how to ensure that opportunities to upgrade in GVCs are realized*.
- There are other risks and potential downsides to GVC participation, including negative effects on working conditions and job security, as well as social and environmental impacts. The question is *how to mitigate the risks involved in GVC participation*.
- Countries' participation and role in GVCs and their value added trade patterns are often shaped by TNCs' decisions on where to invest and with whom to partner. The challenge for policymakers is thus *how to align and synergize trade and investment policies* in a world in which the two are inextricably intertwined.

Gaining access to GVCs, benefiting from GVC participation and realizing upgrading opportunities in GVCs requires a structured approach that includes (i) embedding GVCs in overall development strategies and industrial development policies, (ii) enabling GVC growth by maintaining a conducive investment environment and by putting in place infrastructural prerequisites, and (iii) building productive capacities in local firms. Mitigating the risks involved in GVC participation requires (iv) a strong environmental, social and governance framework. And aligning trade and investment policies implies the identification of (v) synergies between the two policy areas and in relevant institutions. These key elements of a policy framework for GVCs and development are summarized in table IV.11 and provide the structure of the remainder of this section.

Table IV.11. Building a policy framework for GVCs and development

Key elements	Principal policy actions
Embedding GVCs in development strategy	• Incorporating GVCs in industrial development policies • Setting policy objectives along GVC development paths
Enabling participation in GVCs	• Creating and maintaining a conducive environment for trade and investment • Putting in place the infrastructural prerequisites for GVC participation
Building domestic productive capacity	• Supporting enterprise development and enhancing the bargaining power of local firms • Strengthening skills of the workforce
Providing a strong environmental, social and governance framework	• Minimizing risks associated with GVC participation through regulation, and public and private standards • Supporting local enterprise in complying with international standards
Synergizing trade and investment policies and institutions	• Ensuring coherence between trade and investment policies • Synergizing trade and investment promotion and facilitation • Creating "Regional Industrial Development Compacts"

Source: UNCTAD.

1. Embedding GVCs in development strategy

GVCs imply a new role for trade and investment in industrial development strategies, which should be based on countries' starting points and growth opportunities along GVC development paths.

In most developing countries, economic development requires not just increased productivity of the existing industrial structure but also a change in the structure of production (e.g. diversifying from a resource-based economy into manufacturing and services), involving industrial transformation and higher value-added activity. As production is increasingly organized within GVCs, development is likely to occur within such chains. Economic upgrading in GVCs – moving into higher value added functions within chains and into more technologically sophisticated value chains – is thus an important channel of development and industrialization.

Industrial policies focused on final goods and services are less effective in a global economy characterized by GVCs.[53] GVCs require a new approach to industrial development, one based on new markets, new products and new skills. Policymakers must understand the key elements of a GVC-based approach to industrial development:[54]

- *GVCs require more finely targeted policies*. GVC-based industrial development policies require a shift away from traditional industrial policies aimed at developing production capacity for final goods and services. Improvements in competitiveness do not necessarily arise from the development of integrated industries, but from upgrading to higher value tasks within industries. Measures aimed at encouraging the development of a vertically integrated industry can be an inefficient use of scarce resources.
- *GVCs increase the need for policies dealing with the risk of the middle-income trap*. The fragmentation of industries increases the risk of "thin" industrialization, where a country enters an industry, but only in its low-value and low-skill aspects, such as assembly of electronics products or call centres in the services sector, without the ability to upgrade (see Section C). Although countries can also get stuck producing low value added final goods, in GVCs the risk of getting stuck in low-value added tasks and activities is arguably greater.
- *GVCs require a new approach to trade policies in industrial development strategies*. Protective trade policies can backfire in the context of GVCs if imports are crucial for exports, and non-tariff barriers to a country's imports can have a negative impact on its export competitiveness. To the extent that intermediate goods and services produced abroad are necessary for the production of a country's own exports, GVC participation requires easy and cheap access to such imports, especially on a regional basis and in a South-South context, as imports for export production involve a high degree of regional trade (see Section A).
- *GVCs increase the importance of regional production networks*. The rationale for regional integration is no longer just market expansion; it is now also based on the organization of GVCs. For developing countries, whereas export-oriented industrial policies were typically focused on exports to advanced economies, GVC-based industrialization relies on stronger ties with the supply base in neighbouring developing economies. As an industrialization strategy, GVC-based industrial development (unlike export orientation) can thus also be utilized to promote upgrading for regional markets.
- *GVCs strengthen the rationale for governments to seek mutually beneficial partnerships with lead firms for industrial development*. Upgrading in GVCs and moving into higher value added activities involves raising productivity and skills and the introduction of new technologies, which requires connecting closely with lead firms. At the same time, while traditional trade policy was based on the assumption that industry value added accrued to the domestic economy, value capture in GVCs depends on power relationships in the chain. In this respect, competition policies take on a crucial role in surveying such power relationships and preventing or sanctioning anti-competitive behaviours by lead firms as countries increase GVC participation.

- *GVCs require institutional support for social and environmental upgrading*. Active intervention is needed for industrial upgrading within GVCs to translate into sustainable social gains, including employment and wage growth and improved labour and environmental standards. As highlighted in Section C, industrial upgrading does not always necessarily bring social upgrading. Joint economic and social upgrading can be facilitated by multi-stakeholder initiatives and linkages between firms, workers and small-scale producers.
- *GVCs require a more dynamic view of industrial development*. The location of tasks and activities within GVCs is determined by dynamic factors – including relative labour productivity and cost, as well as other determinants – and as such can shift around the international production networks of TNCs (they can be footloose), causing disruption in industrial upgrading processes and negative social impacts. On the one hand, industrial policies and trade and investment strategies can include measures to improve stickiness, e.g. by building partnerships with investors and creating GVC clusters (focusing on complementary tasks in GVCs, rather than generic industrial clusters), including regional GVC clusters through regional government partnerships (cross-border industrial cooperation). On the other, industrial policies should aim to develop long-term competitive advantages along GVCs by selectively investing in building and improving investment determinants (e.g. skill development, access to finance, trade facilitation) for higher value-added activities and by building partnerships with investors for co-creation of markets, co-development of skills, co-establishment of clusters, co-nurturing of new value chains (e.g. green GVCs).

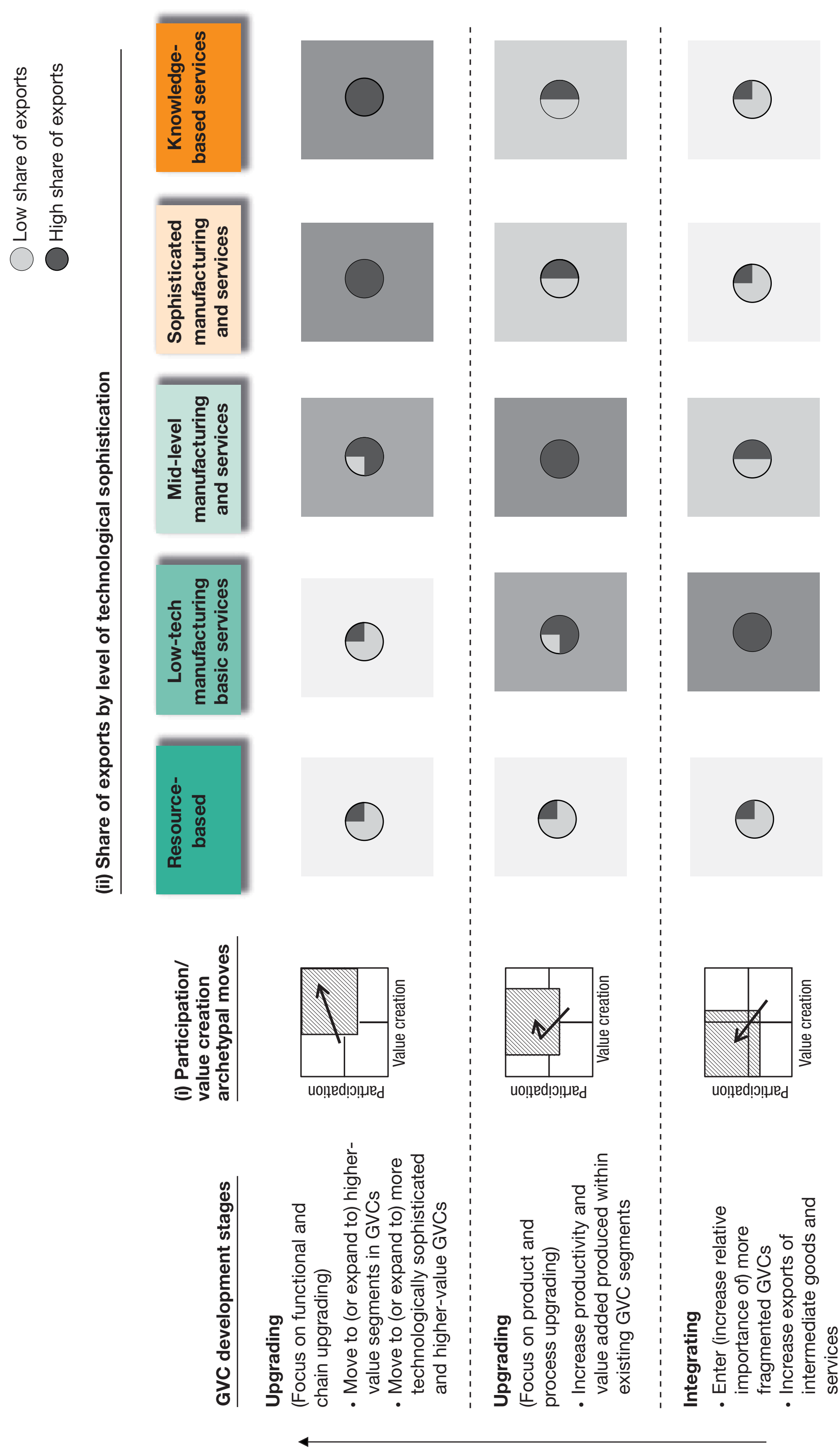
A starting point for the incorporation of GVCs in development strategy is an understanding of countries' current positioning in GVCs. Two key variables determining countries' positioning are (i) the level of participation of domestic economic activity in GVCs and domestic value creation (see the matrix in the previous section) and (ii) the existing presence and strengths of the economy in GVCs of different degrees of technological sophistication and value, from resource-based activities to low-, medium- and high-tech activities, to knowledge-based activities positioned at the high-value ends of chains, e.g. design, innovation, R&D, marketing and branding.

These two variables (i) and (ii), discussed empirically in section C, are mapped in figure IV.35, which offers a tool for policymakers to assess their economy's position along GVC development paths. A country's position can be plotted by looking at the distribution of its exports by level of sophistication, at the imported contents of exports and at domestic value added created. From the starting point, policymakers can set objectives for growth along GVC development paths for *strategic positioning*.

For countries with a resource-based economy, GVC development typically implies increasing GVC participation through diversification into more fragmented value chains and increased exports of intermediate goods and services, often starting with manufacturing exports at the lower end of technological sophistication, on the basis of low-cost labour. This pattern mostly results in increased GVC participation and a lower share of domestic value added in exports (but higher absolute levels of domestic value added creation). Alternatively, GVC development for resource-based economies can occur by attracting investment in processing activities, increasing domestic value added, where advantages from proximity to resources outweigh economies of scale.

Upgrading mostly implies, first, upgrading products and processes, increasing productivity and value added creation within existing GVC segments and activities, before functional and chain upgrading opportunities materialize, allowing countries to move into GVCs at higher levels of technological sophistication. Moving into more sophisticated and fragmented GVCs often implies higher foreign content in exports. Paradoxically, upgrading may often result in a lower domestic value added share in exports, especially in early stages of GVC participation. Subsequently, upgrading opportunities will aim to increase domestic value added share – although more important than the domestic value added *share* is the *absolute* GDP contribution of GVCs (see section A).

Figure IV.35. Assessing a country's position along GVC development paths



Source: UNCTAD analysis.
Note: The "moons" refer to the level of GVC participation in the different industries grouped by level of technological sophistication. As countries access GVCs and engage in product/process upgrading and functional/chain upgrading, they will increase their participation in more sophisticated GVCs, relative to other GVCs.

As seen in Section C, countries can simultaneously develop in GVCs at different levels of technological sophistication. This may occur where they can exploit capabilities honed in lower-level GVCs or GVC segments to expand into higher levels. Or it can occur where the facilitating factors and conditions for GVC development at different levels are in place, either built gradually based on GVC participation at lower levels or helped by active policy intervention (figure IV.36).

These facilitating factors and conditions are akin to determinants of foreign and domestic investment in GVC activities. As seen in Section B, the prerequisites for the development of activities, and the determinants of investment in such activities, are different (and fewer) compared with those for industries as a whole. Development strategy and industrial policy should focus on determinants that can be acquired or improved in the short term and selectively invest in building others for medium- and long-term investment attractiveness.

In identifying the potential for accessing and upgrading GVCs, policymakers should be aware of a number of considerations:

- Priorities for GVC development – in terms of growing GVC segments and activities, and in terms of building facilitating factors and conditions – should be based on both *existing and future domestic factor endowments and prerequisites* for successful progression along GVC development paths.
- Upgrading can become a necessity for countries. For example, in the case of China, economic development and increasing per capita incomes are pushing up wages, causing the country to no longer be competitive in the less sophisticated sectors (e.g. garments), even though it has many advantages of agglomeration and infrastructure. Similar paths of forced upgrading as a result of success were seen in Japan and the Republic of Korea.
- The domestic value added impact of GVC growth opportunities at higher levels of sophistication, and the wider effects on the economy, may not always be positive. At times, participation at higher levels of sophistication may imply capturing a smaller share of value created, generating less employment and exposing the economy to greater competitive risk. Strengthening participation at existing levels or even *"strategic downgrading"* can be a viable option.
- Upgrading options have consequences that extend beyond economic development impacts. Social consequences and the participation of the poor differ at each level. Employment creation and poverty alleviation effects may well be stronger at lower levels of technological sophistication and GVC participation. Policymakers must consider options congruous with their *overall inclusive and sustainable development strategies*.

2. Enabling participation in GVCs

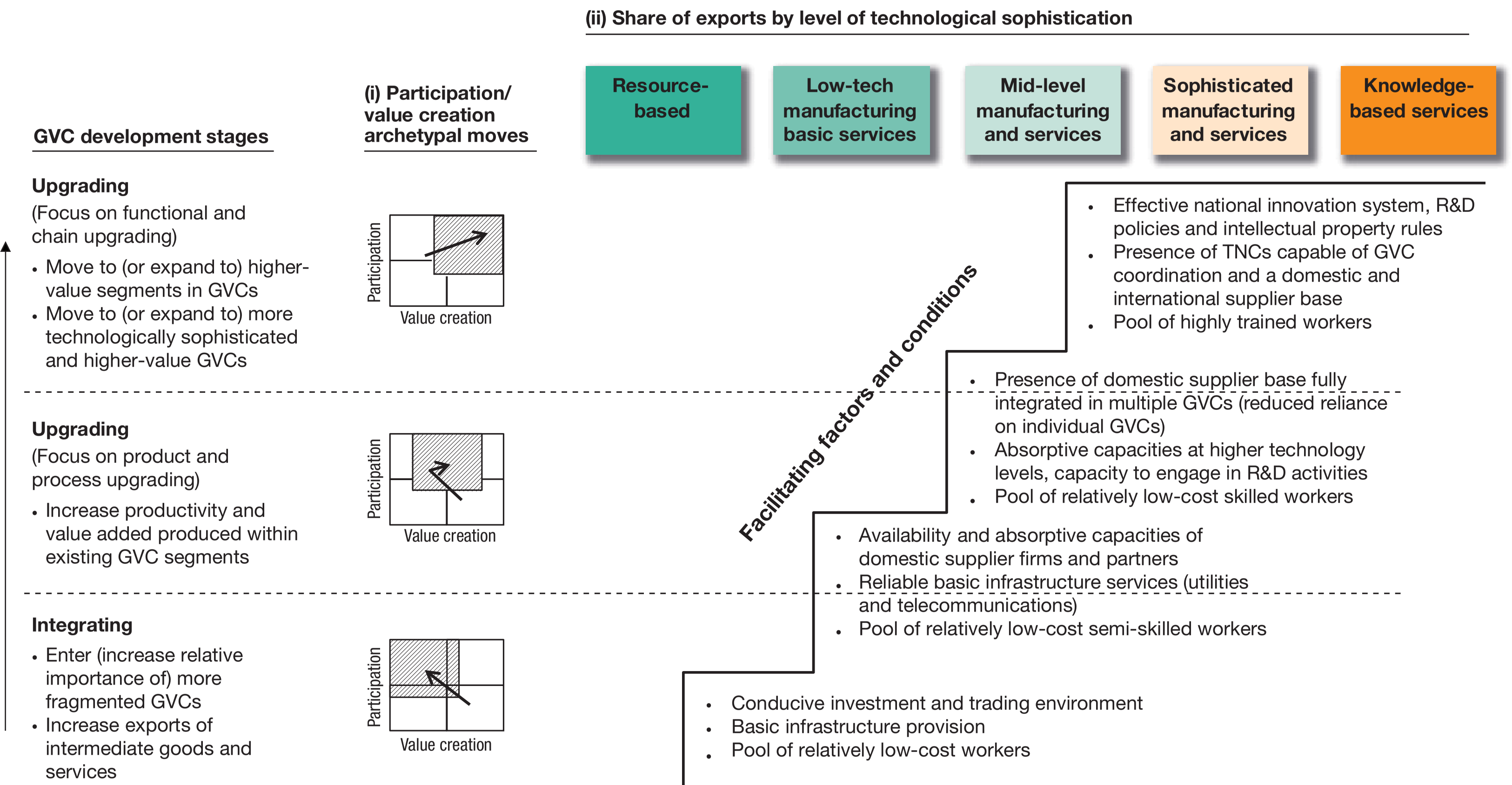
Enabling GVC participation implies facilitating investment and trade and building infrastructural prerequisites.

Enabling the participation of local firms in GVCs primarily implies creating and maintaining an environment conducive to investment and trade, and putting in place the infrastructural prerequisites for GVC participation, in line with the locational determinants of GVCs for relevant value chain segments (see Section B).

A conducive environment for trade and investment refers first and foremost to the overall policy environment for business, including trade and investment policies, but also tax, competition policy, labour market regulation, intellectual property rights, access to land and a range of other policy areas (see UNCTAD's Investment Policy Framework for Sustainable Development, or IPFSD, which addresses relevant trade and other policy areas).

For example, competition policies take on a crucial role as countries increase GVC participation. Value capture for the domestic economy in GVCs is often determined by power relationships in GVCs. Such relationships may involve contractual arrangements between independent operators in GVCs which can restrict competition. Examples are the fixing of purchase or selling prices or other trading conditions, the territorial distribution of markets or sources of supply and the application of different conditions to equivalent transactions with different

Figure IV.36. Factors and conditions that facilitate climbing the GVC development ladder



Source: UNCTAD analysis.

trading parties. Competition policies can play a crucial role in preventing or sanctioning such anti-competitive behaviours. GVCs thus require enhanced competition-law enforcement.

Beyond the general policy framework for trade and investment, trade facilitation specifically is key to the creation of a conducive environment for trade and investment. The international community aims to make progress on the trade facilitation agenda in a new WTO agreement. The importance of trade-facilitating measures, such as fast, efficient port and customs procedures, has risen exponentially with the growth of GVCs in which goods now cross borders multiple times, first as inputs and ultimately as final products. The WTO estimates that the cost of trading across borders amounts to some $2 trillion, two thirds of which is a result of border and customs procedures, and notes that the gain in global trade from smoother border procedures could be higher than the gain from tariff reduction. UNCTAD has provided active assistance to developing countries on trade facilitation and on border and customs procedures since the early 1980s, through various capacity-building programmes including ASYCUDA, the automated system for customs data, which is now used in over 90 countries.[55]

Trade facilitation measures are usually uncontroversial, not coming at the expense of firms, political constituents or other policy imperatives. The benefits of trade facilitation measures tend to have a positive ripple effect on the economy, as imports and exports are less costly and flow more freely across borders in GVCs. Comprehensive trade facilitation reform is more effective than isolated or piecemeal measures. The most beneficial areas for reforms tend to be reducing or eliminating the "procedural obstacles" to trade, such as harmonising and simplifying documents, streamlining procedures, automating processes, ensuring the availability of trade-related information and providing advance rulings on customs matters.[56]

Investment facilitation measures can be equally important for building up productive capacity for exports. The most important facilitation measures relate to entry and establishment processes, e.g. procedures for the start-up of foreign-invested businesses, registration and licensing procedures, and access to industrial land, as well as procedures for the hiring of key personnel (including foreign workers) and the payment of taxes.[57] UNCTAD's work in investment facilitation includes assistance to investment authorities and investment promotion agencies (IPAs), as well as the e-Regulation programme – deployed in 27 countries – which helps governments (including subnational administrations) to simplify procedures for investors and businesses, and to automate procedures where possible.[58]

Providing reliable *infrastructure* (e.g. roads, ports, airports, telecommunications, broadband connectivity) is crucial for attracting GVC activities. Improvements in technology and decreasing data transmission costs can facilitate the sourcing of services, in particular, "knowledge work" such as data entry, research and development or remotely supplied consultancy services. Energy and transportation costs are an issue in particular for those countries that are connected to GVCs over longer distances. Developing good communication and transport links can also contribute to the "stickiness" of GVC operations.

Methods that governments have employed to improve infrastructure in support of local GVC development include public-private partnerships (PPPs) in infrastructure – such as roads, telecommunication, office buildings and the establishment of industrial clusters. Such GVC-targeted PPP initiatives can help firms, including SMEs, to better connect to GVCs and increase the attractiveness of domestic suppliers.[59] In particular the establishment of industrial parks for GVC activities – with good communication and transport links – can be instrumental, including at the regional level. As value chains are often regional in nature, international partnerships for infrastructure development can be particularly beneficial. Governments can usefully promote inter-agency cooperation for export and investment promotion in regional partnerships, including through the redefinition of export processing zones (EPZs) to satisfy the needs of regional value chains. *Regional development banks* can also play a role, bolstering investment-export links in those sectors that are strategic for the enhancement of value added in

regional value chains. By pooling risks, regional groups of developing economies can improve their terms of access to donor funding, leveraged technical assistance and global capital markets.[60]

Building the infrastructural prerequisites to enable GVC participation and building productive capacity (the subject of the next section), are the two key elements of the WTO initiative *Aid for Trade*. Aid for Trade is aimed at lowering the cost of trade, thereby raising a recipient country's export competitiveness. The majority of infrastructure support under Aid for Trade relates to improvements in ports, railroads and roads, although some of the aid in this category involves utilities and communication infrastructure. Aid for productive capacity is more varied and includes training programmes, machinery and equipment, support for cooperatives and other forms. Aid for Trade can therefore represent an important vehicle for the international community to help developing countries access GVCs. To do so, a priority area should be trade facilitation, as the implementation of reforms, such as customs reforms, can be very costly for developing countries.

To help countries to increase GVC participation and reap the benefits of GVCs for long-term development, Aid for Trade could also be better targeted to ensure that the benefits accrue to intended recipients (see box IV.7). In addition, the programme could adopt a wider set of objectives in addition to boosting trade, including diversifying trade, increasing participation in GVCs, reducing the price of imported inputs and moving to higher value-added segments in GVCs. Doing that would imply not just addressing barriers to trade, but explicitly addressing investment issues, as well as a broader range of barriers to GVC participation, focusing on, e.g. improving the business environment, strengthening the services sector, supporting adherence to standards in production, increasing the legal security of investment, fostering innovation and enabling companies to find new markets and new buyers.

3. Building domestic productive capacity

GVC participation requires the prior build-up of a minimum level of productive capacity in order to step on the first rung of the GVC development ladder. Subsequently, the sequence of economic roles in GVCs involves an expanding set of capabilities that developing countries must aim to attain in pursuing an upgrading trajectory in diverse industries, by developing the capabilities of local enterprise and of the local workforce.[61]

Proactive enterprise development policies and a strategy for workforce and skills development are key to improving the chances of successful upgrading in GVCs.

A number of focus areas are key for proactive enterprise development policies in support of GVC participation and upgrading:

- *Enterprise clustering*. Enterprise agglomeration may determine "collective efficiency" that in turn enhances the productivity and overall performance of clustered firms. It is particularly relevant for SMEs in developing countries, which often participate in clusters and value chains at the same time, with the local and global dimensions operating simultaneously. Both offer opportunities to foster competitiveness via learning and upgrading.
- *Linkages development*. Domestic and international inter-firm and inter-institution linkages can provide local SMEs with the necessary externalities to cope with the dual challenge of knowledge creation and internationalization, needed for successful participation in value chains as first, second or third-tier suppliers.
- *Science and technology support and an effective IP rights framework*. Technical support organizations in standards, metrology, quality, testing, R&D, productivity and SME extension are increasingly needed to complete and improve the technology systems with which firms operate and grow. Appropriate levels of IP protection can help give lead firms confidence in employing advanced technologies in GVC relations, and provide incentives for local firms to develop or adapt their own technologies.
- *Business development services*. A range of services can facilitate GVC-related trade and investment, and generate spillover effects. Such services might include business development services centres (BDSCs) and capacity-building facilities to help local firms

Box IV.7. Targeting Aid for Trade at the upstream part of GVCs

A key concern related to Aid for Trade, stemming from the rise of GVCs, is that gains resulting from lower trade costs may mostly flow downstream – that is, to TNC lead firms in GVCs – rather than to supplier firms in developing countries and to their workers and communities.

In general, the economic gains from GVCs are not distributed equally along the chain. The ability of local firms and workers to capture value depends to a significant extent on power relationships in the chain. TNCs with a multitude of potential supply sources will be in a strong position to dictate contractual terms with suppliers. Also, the greater the depth of the supply chain, the greater the capacity of TNCs to exploit the segmentation of labour markets, such that non-organized workers, among which women, seasonal workers or homeworkers can be paid less. The benefits from Aid for Trade may thus largely accrue to lead firms in a chain and not to the workers, small producers and local communities that are the intended beneficiaries.

Aid can enter a value chain at different points. A port improvement will lower transport costs at the border, affecting mostly the link between a first-tier supplier and a lead firm. Aid to build a refrigerated warehouse for a local agricultural cooperative or to train garment workers enters the value chain at or near the bottom of the chain. Other forms of aid may enter at other points in the chain: a road linking a rural region to an international trade hub, for example, may strengthen the link between small suppliers and a first-tier supplier. Because few of the benefits of aid travel down the supply chain, if the goal of Aid for Trade is to benefit those at the bottom, it needs to be targeted at that point of the chain.

Aid might be targeted more directly at workers in one of two ways. The first is by improving their productivity by investing in training or providing technology. Such measures will increase the overall economic efficiency of the chain, leaving more of the benefits at lower ends in the chain. The second is by empowering workers and small producers in relationship with buyers further up the chain, e.g. by facilitating collective action, supporting the establishment of agricultural cooperatives or associations of female garment workers. Such interventions might not increase the overall economic efficiency of the value chain, but they do have the potential to alter the allocations of gains within the chain.

Source: UNCTAD, based on Mayer, F. and W. Milberg (2013), "Aid for Trade in a World of Global Value Chains: Chain Power", working paper, Sanford School of Public Policy, Duke University.

meet technical standards and improve their understanding of international trade rules and practices.

- *Entrepreneurship promotion*. Entrepreneurial development policies aim to support existing entrepreneurs and encourage new enterprise creation, thereby supporting development. University and public research institute spin-offs, incubator programmes and other forms of clustering; managerial and entrepreneurial training; and venture capital support are some of the tools of entrepreneurship development policy. A detailed discussion on all the elements of entrepreneurship development policies can be found in UNCTAD's Entrepreneurship Policy Framework.[62]
- *Access to finance for SMEs*. Inclusive finance initiatives and programmes to increase access to finance for micro, small and medium-sized enterprises are fundamental mechanisms for supporting the development of domestic productive capacity and directing development efforts at the upstream end of value chains where they most directly benefit local firms, small producers and workers.

Enterprise development and workforce skills development go hand in hand. Without sufficient investment in skills, technological progress and involvement of local firms in GVCs may not translate into productivity growth, and countries can no longer compete in an increasingly knowledge-based global economy. An effective skills strategy is key to engagement and upgrading in GVCs and to the necessary adjustment:

- Skills strategies in GVCs should be based on a thorough understanding of the economy's position in GVCs and the most likely trajectory of upgrading, which will determine skill requirements.
- GVC skill strategies should recognize the rising importance of training to comply with product

and process standards and internationally recognized certifications.

- International partnerships are more important in GVC skill strategies because lead firms act as gatekeepers to enforce skill requirements and product quality.

In addition, as discussed in Section C, GVC participation and upgrading processes imply economic adjustments. Skill strategies should facilitate this adjustment process and help displaced workers find new jobs. Social policies and a well-functioning labour market, including re-employment and vocational training programmes, can also help this process.

A broad package of labour and product market reforms is more likely to deliver larger overall gains in job creation and labour market performance than piecemeal reforms. Several countries have recently announced or implemented reforms to tackle labour market duality – a risk in GVCs, as discussed in Section C – by reducing the gap in employment protection between permanent and temporary workers. Such reforms, accompanied by re-employment programmes and adequate safety nets, promote labour adaptability and facilitate the adjustment of the labour market to the dynamics of GVCs.

Finally, success in both enterprise and workforce development is influenced by power relationships in GVCs. Policymakers should consider options to strengthen the bargaining power of domestic producers relative to their foreign GVC partners, to help them obtain a fair distribution of rents and to facilitate their access to higher value added activities in GVCs. There are several ways to strengthen the bargaining position of local firms in GVCs. First, supporting collective bargaining, including the formation of domestic producer associations, can help to create a better counterweight to the negotiating power of TNCs. Second, host countries can develop specific laws and regulations for individual GVC activities, such as contract farming. Third, governments can offer training courses on bargaining or provide model contracts, covering the economic aspects of GVC participation (e.g. distribution of business risks), financial considerations (e.g. taxation) and legal elements (implications of the contract) (*WIR11*).

4. Providing a strong environmental, social and governance framework

a. *Social, environmental and safety and health issues*

Addressing social, safety and environmental risks associated with GVCs requires effective regulation, social dialogue and an active civil society.

Strong social and environmental policies to minimize risks associated with GVCs are essential to maximizing the sustainable development impact of GVC activities, creating better jobs and improving environmental practices while also promoting the stable business and investment climate required for GVC development.

At a minimum – and in line with the United Nations Guiding Principles on Business and Human Rights – host countries have an obligation to protect the human rights. They also need to ensure that GVC partners respect international core labour standards as embodied in ILO Conventions. Equally important are the establishment and enforcement of occupational safety and health standards in GVC production sites (such as safe construction standards and fire protection) alongside strong environmental protection standards. Lead firms in GVCs, TNCs and their home countries can make an important contribution to safer production by working with suppliers to boost their capacity to comply with host country regulations and international standards, strengthening the capacity of watchdog organizations such as trade unions and civil society groups, and avoiding suppliers that persistently fail to work towards full compliance with such regulations and standards.

In the medium and long run, upgrading strategies of developing countries that involve a move towards more value added GVC activities and services are likely to contribute to raising living standards in host countries over time, including an improvement of social and environmental conditions. In the short run, regulatory measures must address urgent safety and health issues – such as those found in the wake of the recent Rana Plaza tragedy in Bangladesh. That instance led the Government of Bangladesh to change laws to allow garment workers to form trade unions without prior permission from factory

owners, and to announce a plan to raise the minimum wage for garment workers.

In addition to adopting and enforcing domestic laws, government procurement policies that require compliance with international core labour and human rights standards in GVCs can further foster such compliance among TNCs and their suppliers. Governments can also promote the use of multi-stakeholder industry-specific standards such as those developed by the Marine Stewardship Council or Forest Stewardship Council. Governments may wish to incorporate some aspects of successful voluntary multi-stakeholder standards into regulatory initiatives in order to scale up compliance.

When designing and enhancing their domestic policy framework related to socially and environmentally sustainable GVC activities, host countries can derive guidance from various international principles and standards. They cover social, human rights, health, economic and environmental risks associated with GVCs (table IV.12).[63] More international coordination in the promotion and implementation of these standards would help to alleviate the "first mover" problem, as countries may hesitate to move forward unilaterally out of fear of losing a perceived GVC-related competitive advantage. Even without such international coordination, host countries are increasingly realizing that a social and environmental framework in line with international standards enhances international competitiveness because consumers pay increasing attention to production conditions in developing countries. Similarly, companies engaged in GVC activities have an interest in showing compliance with higher standards for commercial and reputational reasons.[64]

In many industries, SMEs must often comply with CSR standards imposed by TNCs as a condition of entry into GVCs (*WIR12*). However, enterprise development programmes in most countries do not provide any form of capacity-building to assist SMEs in meeting these standards. Meanwhile, in some GVCs, as many as half of all potential suppliers can be rejected because of CSR concerns. The capacity constraints SMEs (in particular developing-country SMEs) face in meeting these private sector CSR codes can present a significant competitive challenge. Promoting capacity-building through existing enterprise development programmes can help SMEs to better meet the demands of their clients, while improving their overall contribution to sustainable development.

Dozens of industry-specific multi-stakeholder initiatives are currently influencing sustainability practices throughout GVCs (*WIR11*). These include such initiatives as the Fair Labour Association in the apparel industry, and the International Cocoa Initiative in the cocoa/chocolate industry. Each of these initiatives provides practical, market-tested approaches to promoting sustainable business practices throughout a GVC, typically affecting multiple members in the chain.

Policymakers can enhance the sustainable development benefits of GVCs by promoting the adoption and further development of such sector-specific initiatives. In some countries, governments require certification to one or more of the standards promoted by these sustainability initiatives as a condition for investment in certain sectors or for government procurement. This can be a useful policy approach that promotes wider adoption of a standard, while allowing for the flexible and dynamic development of a multi-stakeholder-driven process. Governments can also participate in the development of such standards by contributing directly as stakeholders, or by hosting or otherwise providing material support to the process that develops the standard. Ultimately, governments should note that CSR programmes will not be sufficient to meet all of the social and environmental challenges found in complex GVCs – public policy solutions will be required to complement private sector and multi-stakeholder initiatives.

b. Transforming EPZs into centres of excellence for sustainable business

TNCs around the world are increasingly demanding that their products be produced in line with international social and environmental standards. Suppliers are under pressure to adapt to CSR policies in order to ensure their continuing role in GVCs (*WIR12*). As EPZs are an important hub in GVCs, policy makers could consider adopting improved CSR *policies*, *support services* and *infrastructure* in EPZs, transforming them into

Table IV.12. Examples of international standards for responsible investment in GVCs

International principles or initiatives
• Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework ("Ruggie Principles")
• United Nations Global Compact
• OECD Guidelines for Multinational Enterprises
• ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy
• United Nations Convention Against Corruption
• OECD Convention on Combating Bribery of Foreign Public Officials
• "Rio Declaration" on environmental standards
• Principles for Responsible Agricultural Investment (PRAI) (UNCTAD, FAO, IFA, World Bank)
• African Union Declaration on Land Issues and Challenges in Africa
• Extractive Industries Transparency Initiative
• International Conference on the Great Lake Region Initiative (extractive industries)
• OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas
• ISO 14001 Environmental Management System Standard
• ISO 26000 Guidance Standard on Social Responsibility

Source: UNCTAD (based on *WIR11*) and the report to the G-20 on "Promoting Standards for Responsible Investment in Value Chains" produced by an inter-agency working group led by UNCTAD.

Sustainability is an important factor in the attraction of GVC activities. EPZs could adopt improved CSR policies, support services and infrastructure, evolving into centres of excellence for sustainable business.

centres of excellence for sustainable business. That would be a significant shift away from previous practices: EPZs have long been criticized by intergovernmental organizations, non-governmental organizations, academia, and the private sector for their poor labour, environmental and health and safety practices.

Around the world there are thousands of EPZs, which have long been a popular policy tool to attract export-oriented FDI. EPZs employ over 66 million people worldwide[65] and play an important role in global value chains, providing a vehicle for efficiency-seeking FDI and a mechanism for host countries to develop light manufacturing skills and a competitive industrial labour force. As governmental or quasi-governmental entities, EPZs have an obligation to protect the human rights of their workers and promote environmental best practices. Adding sustainable development services also makes good business sense: with increasing scrutiny into the social and environmental conditions in GVCs, creating infrastructure and services to promote sustainable business practices will enhance EPZs' ability to attract and retain investment. The competitive landscape for EPZs is changing because of the WTO's *Agreement on Subsidies and Countervailing Measures* which may limit financial incentives for investing in EPZs in the future. Thus investment promotion policymakers may wish to expand the portfolio of services and infrastructure that EPZs offer. Providing the sustainable development services demanded by TNCs is one way of doing this.

Sustainable development support services and infrastructure would bring a number of potential benefits to firms in EPZs. The costs of such services would be shared, leading to economies of scale. Centralized services would lead to standardization and harmonization of practices. The number of on-site inspections, often a key issue in suppliers' CSR compliance efforts (see *WIR12*), could be reduced. And public oversight might bring further benefits, including in terms of positive "branding" of zones.

A survey of 100 EPZs conducted by UNCTAD in 2013 shows that, today, most provide very limited sustainability related services, if any.[66] However, a handful of pioneering EPZs offer services across multiple areas of sustainability.

Responsible labour practices. Some EPZs provide assistance with labour issues to companies operating within their zone, ranging from policy (informing about national labour regulations including minimum wages and working hours), to support services (e.g. an on-site labour and human

resources bureau that assists in resolving labour disputes), to infrastructure (e.g. labour inspectors). The majority only state the legal obligations of employers towards their employees. Some EPZs maintain clear policies on labour practices, including minimum wage standards, regulations on working hours, and trade unions. In most cases these stated labour standards conform to local and national laws, however, in a few cases these standards are higher. Very few EPZs explicitly indicate the availability of services to assist companies in implementation, although some indicate that labour inspectors are present within the EPZ. The ZONAMERICA, in Uruguay, provides management assistance services through skills training for employees as well as training on business ethics.

Environmental sustainability. Sustainability policies can include standards concerning land, air, and water pollution, waste, noise and the use of energy. Some zones have relatively well developed environmental reporting requirements under which companies are required to report their anticipated amounts of wastes, pollutants, and even the decibel level of noise that is expected to be produced. This is the case in approximately half of the zones in Turkey, two of the three zones in South Africa, several in India, the United Arab Emirates, and Morocco, and to a degree in zones in Argentina and China. In addition to policies, some EPZs provide support services and infrastructure to assist companies and ensure standards are complied with. Most common is the availability of hazardous waste management systems, including methods for how waste should be disposed of properly, which can be found in EPZs in, for example, Argentina, Saudi Arabia, South Africa, the Republic of Korea and Turkey. Only a few EPZs provide recycling services (South Africa, Saudi Arabia, Uruguay, and two in the Republic of Korea and Turkey). To complement standard energy services, a few EPZs offer alternative low-carbon energy services to the companies operating within their zone, including EPZs in Saudi Arabia, South Africa, the Republic of Korea and Turkey. Some EPZs located in China's "low carbon cities" provide a broad package of environmental sustainability services including the development of alternative sources of energy, enhanced waste management systems, grey water recycling and waste recycling systems. In addition, several EPZs around the world have been certified to the ISO 14001 environmental management system standard, including locations in China and India. The EPZ authority of Kenya has launched a strategic plan to achieve ISO 14001 certification for all of its zones.

Health and safety. Very few EPZs have stated policies and regulations on employee occupational safety and health (OSH) and few, if any, EPZs provide services to assist companies in developing improved OSH practices. A notable exception is the ZONAMERICA, which offers labour risk prevention programs. Elsewhere, support is generally limited to infrastructure. Medical clinics or on site medical personnel are available in approximately half of all EPZs, offering assistance during medical emergencies as well as routine medical exams. The majority of EPZs offer firefighting services for all factories within the EPZ. Nearly all EPZs include 24 hour surveillance and security.

Good governance: combating corruption. Very few EPZs offer any services to assist companies in combating corruption. One EPZ from South Africa has a clear no tolerance policy for corruption, and offers contact phone numbers for companies to raise complaints. However, the service is not explicitly geared towards corruption-related complaints. Very few EPZs make note of any structured system for curbing corruption, or advertise systems in place to assist companies.

Policymakers should consider broadening the availability of sustainable development related policies, services and infrastructure in EPZs to assist companies in meeting stakeholder demands for improved CSR practices and meeting the expectations of TNC CSR policies and standards. This should also strengthen the State's ability to promote environmental best practices and meet its obligation to protect the human rights of workers. EPZs pursuing this path should also improve their reporting to better communicate the sustainable development services available for companies operating within zones.

International organizations can assist countries in transforming EPZs through the establishment of benchmarks, exchanges of best practices, and capacity-building programmes to assist the

management of EPZs and other relevant zones. UNCTAD could provide this assistance, working together with other UN bodies such as the High Commissioner for Human Rights, UNEP and the ILO, international organizations such as the World Bank, and relevant bodies such as the World Economic Processing Zones Association (WEPZA) and the World Association of Investment Promotion Agencies (WAIPA).

c. Other concerns and good governance issues in GVCs

Improving the corporate governance of GVCs encompasses a range of issues, including addressing transfer price manipulation. As discussed in Section C, GVCs have expanded the scope for transfer price manipulation and made it more difficult to detect. Governments of both developed and large emerging economies such as India and China, in particular, have been very responsive to such trends, strengthening their regulatory frameworks for transfer pricing and assessing more tax fines and penalties for noncompliance with the arm's-length standard. This has created the potential for increased litigation between TNCs and tax authorities worldwide (box IV.8).

Greater international cooperation on transfer pricing issues is needed if host countries are to reap the tax benefits that come from participation in GVC networks. More use of advance pricing agreements between TNCs and national tax authorities – through which they agree on an appropriate transfer pricing method for transactions over a period of time – is one important means to create more predictability in the taxation of GVC-related operations. Also, international cooperation to reduce the complexity of national taxation rules and price computing methods can be instrumental in improving the governance of GVCs. For example, a group of countries are now working on new United Nations transfer pricing guidelines designed specifically for developing-country governments.

Finally, development strategies with regard to GVCs should seek to foster a resilient supply chain that is prepared for and can more readily withstand shocks, and recover quickly from disruption. Governments can put in place policies to mitigate systemic vulnerability as well as policies to promote speedier trade resumption. Coordination with the international community and foreign stakeholders that have key supply chain roles and responsibilities can also enhance GVC security. To this end, countries may seek to develop and implement global standards, strengthen early detection systems, interdiction, and information sharing capabilities, and promote end-to-end supply chain security efforts (box IV.9).

Box IV.8. Examples of transfer pricing litigation

In the *United States*, software maker Veritas (later bought by Symantec) set up a cost-sharing arrangement and transferred its European market rights and pre-existing intangibles to a wholly owned Irish affiliate in return for a lump-sum buy-in payment of $118 million by the affiliate in 2000. In 2009, the United States tax revenue agency (the IRS) filed a claim against Veritas, arguing the Irish affiliate had underpaid for the buy-in rights. Using an income-based method to estimate the net present value of the transferred intangibles, the IRS set the arm's-length price as $1.675 billion and claimed over $1 billion in taxes, penalties and interest. The Tax Court found the IRS's allocation to be unreasonable, and found in favour of Symantec.[a]

In *India*, a special bench of the Income Tax Appellate Tribunal ruled in favour of the tax department that advertising, marketing and promotional expenses of TNCs incurred by Indian subsidiaries to promote the brand and trademarks will be taxable in India. It also upheld the usage of the Bright Line test, which uses the expenses incurred by comparable companies to decide arm's-length pricing. The ruling came on an appeal by LG Electronics, but 14 other Indian arms of TNCs also argued as "interveners" against a decision of a transfer pricing officer. Pepsi Foods, Maruti Suzuki, Glaxosmithkline, Goodyear India, Bausch & Lomb, Amadeus, Canon, Fujifilm, Star India, Sony, Haier Telecom, Haier Appliances, LVMH Watch and Jewellery, and Daikin Industries also faced transfer pricing adjustments on excessive advertising, marketing and promotional expense.[b]

Source: UNCTAD.
Note: Notes appear at the end of this chapter.

Box IV.9. The United States National Strategy for Global Supply Chain Security

Through the National Strategy for Global Supply Chain Security, the United States Government articulates its policy to strengthen the global supply chain in order to protect the welfare and interests of the American people and secure the country's economic prosperity. The strategy includes two goals:

Goal 1: Promote the efficient and secure movement of goods – to promote the timely, efficient flow of legitimate commerce while protecting and securing the supply chain from exploitation, and reducing its vulnerability to disruption. To achieve this goal, the Government will enhance the integrity of goods as they move through the global supply chain. It will also understand and resolve threats early in the process, and strengthen the security of physical infrastructures, conveyances and information assets, while seeking to maximize trade through modernizing supply chain infrastructures and processes.

Goal 2: Foster a resilient supply chain – to foster a global supply chain system that is prepared for, and can withstand, evolving threats and hazards and can recover rapidly from disruptions. To achieve this, the Government will prioritize efforts to mitigate systemic vulnerabilities and refine plans to reconstitute the flow of commerce after disruptions.

The approach is informed by two guiding principles:

"Galvanize Action" – Integrate and spur efforts across the Government, as well as with state, local, tribal and territorial governments, the private sector and the international community; and

"Manage Supply Chain Risk" – Identify, assess and prioritize efforts to manage risk by using layered defences, and adapting the security posture according to the changing security and operational environment.

Source: The White House, National Strategy for Global Supply Chain Security. Available at http://www.whitehouse.gov (accessed 18 March 2013).

security efforts (box IV.9).

5. Synergizing trade and investment policies and institutions

a. Ensuring coherence between trade and investment policies

Investment policies affect trade in GVCs, and trade policies affect investment in GVCs. Policymakers need to make sure their measures work in the same direction.

Since investment and trade are inextricably linked in GVCs, it is crucial to ensure coherence between investment and trade policies. Inconsistent policies weaken the effectiveness of GVC-related policies and can ultimately be self-defeating. For example, import restrictions or tariff escalation on intermediate inputs discourage export-oriented investment in GVCs and can hurt a country's export competitiveness. Similarly, FDI restrictions in industries where foreign capital or skills are needed for the development of productive capacity can hinder access to GVCs and, hence, value added exports.

Avoiding inconsistent investment and trade policies requires paying close attention to those policy instruments that simultaneously affect investment and trade in GVCs, i.e. (i) trade measures affecting investment (TMAIs) and (ii) investment measures affecting trade (IMATs). Tables IV.13 and IV.14 illustrate the potential reciprocal effects between trade and investment measures.

(i) Trade measures affecting investment include various types of measures affecting market access conditions, market access development preferences, and export promotion devices, among others (table IV.13).

TMAIs can help capture and increase the benefits associated with GVCs. For example, rules of origin can be designed in ways that encourage greater local value added production and sourcing, thus strengthening linkages between domestic suppliers and TNCs. Export performance requirements have in the past played a crucial role in stimulating TNCs to reorient their patterns of international sourcing to include a given host country site within the parent firms' regional or global networks. Because most of these measures apply to *specific* goods or products – and not to trade in general – they can be designed in such a manner as to apply to individual activities or tasks within GVCs (e.g. the supply of specific inputs for the production process or GVC) or individual industries (e.g. car manufacturing). This allows host countries to use TMAIs for GVC-

Table IV.13. Potential effects of trade policy measures in GVCs

Trade policy measure	Potential investment-related effect (illustrative)
• Import tariffs, tariff escalation • Non-tariff barriers: regulatory standards (e.g. technical barriers to trade and sanitary and phytosanitary measures)	• Negative effect on export-oriented investment in operations that rely on imported content that is subject to the measure • Positive effect on market-seeking or import substitution investment (barrier-hopping)
• Trade facilitation (applying to both imports and exports) • Export promotion (e.g. export finance, credit guarantees, trade fairs)	• Positive effect on export-oriented investment by reducing the cost of multiple border crossings on both the import and export sides and through expedited exports (of particular relevance in time-sensitive GVCs) • Positive effect on market-seeking investment that benefits from facilitated (and cheaper) imports
• Preferential or free trade agreements (including rules of origin and sector-specific agreements)	• Positive effect on investment that benefits from easier (and cheaper) trade between member countries, strengthening regional value chains • Positive effect on market-seeking investment through economies of scale from serving a bigger market • Consolidation effect on investment (primarily through mergers and acquisitions) as a result of reconfiguration of GVCs in member countries
• Market access development preferences (e.g. GSP, EBA, AGOA)	• Positive effect on foreign investment in preference-recipient countries targeting exports to preference-giving countries
• Trade remedies (e.g. anti-dumping, safeguards and countervailing duties)[67]	• Negative effect on export-oriented investment in the country affected by the measure (and on existing export-oriented investors who made investment decisions prior to the measure's enactment)

Source: UNCTAD.

(ii) Investment measures affecting trade comprise a wide variety of policy instruments that apply to the activities of foreign investors in the host country. Broadly, they include entry and establishment rules, trade-related operational measures, production requirements and knowledge-related requirements, as well as promotion and facilitation measures (table IV.14).

IMATs can also be used for industrial development purposes related to GVCs, and their application can be tailor-made for specific sectors, industries or activities. Applied in the right context, they may help domestic suppliers connect to GVCs and upgrade their capacities. An important distinction needs to be made between mandatory performance requirements and those that are linked to the granting of an advantage to investors. While the former may constitute a disincentive for firms in selecting a host country for the location of GVC activities, foreign investors may accept certain performance requirements linked to fiscal or financial incentives.

WTO rules and some investment agreements limit countries' policy discretion to impose performance requirements. The WTO Agreement on Trade-Related Investment Measures (TRIMS), and its corollary in numerous preferential trade and investment agreements, specifically prohibits the application of trade restrictions that are incompatible with the obligation to provide national treatment or that constitute quantitative restrictions (e.g. the imposition of local content requirements, export controls, and trade balancing restrictions). Non-member countries are not bound by these disciplines (unless they are signatories to a free trade or regional trade agreement that contains restrictions on performance requirements). A number of WTO member countries would like to review the TRIMS agreement and its existing prohibitions with the objective of affording greater policy space.

Several international agreements concluded in the aftermath of the Uruguay Round have taken additional steps to curtail policy space linked to

Table IV.14. Potential effects of investment policy measures in GVCs

Investment policy measure	Potential trade-related effects (illustrative)
• Investment promotion, in particular for export-oriented FDI, including financial incentives; fiscal incentives; other incentives (e.g. subsidized infrastructure, market preferences and regulatory concessions in special economic zones (SEZs))	• Positive effect on exports, possibly with higher imported content, and at risk of distortive effects • Negative effect on export competitiveness where they result in an increase in costs of production once incentives are phased out
• Investment facilitation (e.g. reduced registration and licensing procedures, access to land)	• Positive effect on exports, possibly with higher imported content, where facilitation helps attract export-oriented (i.e. efficiency-seeking) investment
• Entry and establishment restrictions	• Negative effect on exports where restrictions discourage export-oriented investment • Negative effect on export competitiveness where restrictions discourage investors that produce critical inputs (intermediates) used by other firms (domestic or foreign) in the country for exports
• Joint venture requirements	• Negative effect on export competitiveness in the absence of a competent local joint venture partner • Positive long-run effect on export competitiveness of domestic firms and on domestic value added
• Export performance requirements • Trade balancing requirements *	• Positive immediate effect on exports, possibly with higher imported content, but with a risk of distortive effects • Negative effect on exports where requirements discourage export-oriented investors (or increase costs of production)
• Local employment requirements and restrictions on hiring key foreign personnel • Training, transfer of technology and R&D requirements • WTO TRIMs: Local content requirements *	• Positive long-run effects on export competitiveness of domestic firms, domestic value added, and upgrading potential • Negative effect on exports where requirements discourage export-oriented investors • Negative effect on export competitiveness where requirements result in an increase in costs of production

Source: UNCTAD.
* These measures as applied to trade in goods are prohibited for WTO member states.

performance requirements (so-called "TRIMs plus" provisions). This includes prohibitions on performance requirements in services or concerning trade in goods that are not covered by the WTO TRIMS Agreement. Whether countries should accept such additional reductions in policy space depends on their individual development strategies.

It should be noted that the actual effects of TMAIs and IMATs are more complex, and they are necessarily context (i.e. country- and sector-) specific. Also, individual measures do not act independently, such that different combinations of policy measures may generate different policy effects. Furthermore, these measures have other potential effects beyond trade and investment and therefore need to be viewed from a broader development impact perspective.

At the international level, GVCs are governed by both trade and investment agreements. Despite the close relationship between trade and investment, international law has largely developed separately in each policy area. While trade is primarily covered by WTO rules, foreign investment is subject to close to 3,200 IIAs. Other types of trade and/or investment treaties at the bilateral, regional, sectoral and plurilateral levels have added a multitude of layers, making both regimes highly complex (chapter III). Each body of law pursues its

Each body of law pursues its own set of objectives and imposes different kinds of obligations on contracting parties. Policymakers thus need to be aware of potential interactions and overlaps between international investment and trade law with a view to promoting policy synergies and avoiding inconsistencies.

Given the close link between trade and investment in GVCs, limitations of policy space in trade arrangements may indirectly impact on investment policies, and vice versa. There is a risk that countries' trade policies will be challenged under investment agreements, and that some aspects of their investment policies will be scrutinized under WTO rules or free and preferential trade agreements. For instance, most international investment agreements (IIAs) prohibit discrimination in respect of all economic activities associated with an investment, including its trade operations. Both the national treatment and the most-favoured-nation provisions in IIAs may therefore result in trade issues being adjudicated by investment arbitration tribunals. The fact that some WTO agreements (the WTO TRIMS Agreement and the General Agreement on Trade in Services) also deal with investment-related issues leaves room for raising such matters in trade disputes. Thus, when adopting trade (or investment) measures for GVCs, policymakers cannot limit themselves to verifying that such measures are in accordance with international trade (or investment) law. To be on the safe side, they also need to check whether trade measures could unduly interfere with IIAs, and investment measures with WTO rules or with the trade rules found in preferential trade agreements.

b. Synergizing trade and investment promotion and facilitation

In a world of GVCs, IPAs and TPOs should coordinate their activities closely. A country's GVC position and objectives should guide the institutional set-up for trade and investment promotion.

Ever intensifying trade and investment links in GVCs call for closer coordination between domestic trade and investment promotion agencies, as well as better targeting at specific segments of GVCs in line with host countries' dynamic locational advantages. The need for coordination is leading many policymakers in charge of Investment Promotion Agencies (IPAs) and trade promotion organizations (TPOs) to consider merging the two.

Combining different, although apparently related functions of trade and investment promotion in a single organization has both advantages and disadvantages. Commonly considered advantages include strategic benefits and cost savings potential.

- Strategic benefits:
  - Potential for greater policy coherence
  - Potential for enhanced continuity in service delivery for export-oriented investors
  - Common ground for policy advocacy in national competitiveness
- Cost savings:
  - Shared support services (IT, human resources, accounting, legal services,

Table IV.15. Key operational differences between IPAs and TPOs

	Trade promotion	Investment promotion
Clients	• In-country exporters (SMEs)	• Overseas TNCs
Targeting	• Purchasing director	• CEO, CFO, COO
Cycle	• Purchase (routine decisions)	• Strategic decision (years)
Business information	• Country production and exporters	• Investment climate and cost of operations
Staff skills	• Sales and marketing	• Location consultant
Performance indicators	• Exports, jobs	• FDI projects, jobs
Support	• Full support from local industry	• Partial support - pressure by local industry fearing competition

Source: UNCTAD (2009), based on "Promoting Investment and Trade: Practices and Issues", Investment Advisory Series, Series A, number 4.

public relations, research) and shared office accommodation
– Synergies in overseas promotion, branding and representation

However, joint trade and investment promotion does not result in automatic synergies or savings. From an operational perspective, the arguments for separate trade and investment promotion organizations remain compelling (table IV.15).

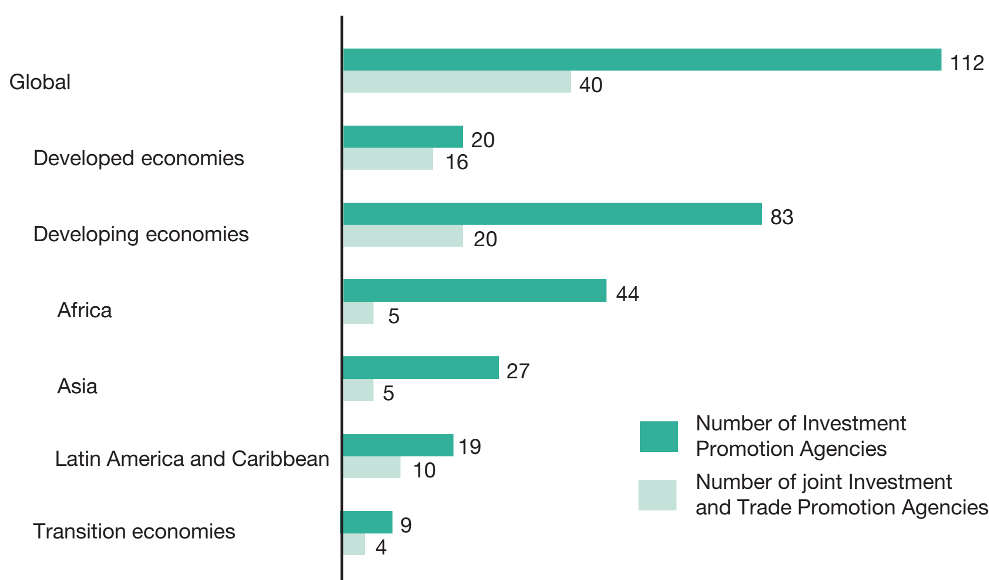
Over the years, the balance of advantages and disadvantages of joint trade and investment promotion, has resulted in as many agency mandate splits (e.g. Chile, Costa Rica and Ireland) as mergers (e.g. Germany, New Zealand, Sweden and the United Kingdom). The number of joint agencies has thus tended to remain relatively stable over time: from 34 per cent in 2002, stabilizing at about 25 per cent between 2008 and 2012. Interestingly, the share of joint agencies is significantly higher in developed countries (43 per cent).

From a strategic perspective, the growing importance of GVCs and the concomitant nexus between investment and trade it entails may well be changing the cost-benefit equation of joint investment and trade promotion. GVCs add to the potential strategic synergies that can be achieved through joint promotion, including relationship management with foreign investors and afterservices to promote and safeguard intra-firm exports, promoting investment with the objective to increase export capacities, engaging in matchmaking with investors to support exporting NEMs and targeting investment to reduce the import content of exports, thereby increasing domestic value added.

A number of objective criteria, based on a country's GVC participation and positioning, can help determine the most appropriate institutional set-up for trade and investment promotion:

- If a country depends significantly on the influx of foreign capital, skills and technologies for the build-up of export capacities, it may be a more effective use of resources to engage in joint trade and investment promotion in order to focus on attracting export-oriented FDI and projects contributing to the growth of productive capacities.
- If a country's existing exports are driven to a large extent by TNC foreign affiliates, it is likely that much of those exports will go to other parts of the parent firm's network. Rather than lobbying such firms to increase purchases from their own affiliates (export promotion), it may

Figure IV.37. Overview of institutional set-up of trade and investment promotion



Source: UNCTAD (2013), "Optimizing government services: a case for joint investment and trade promotion?", *IPA Observer*, No. 1.

be more effective to target them for further investment and to expand local production and exports of foreign affiliates (investment promotion).

- When domestic exporters are mostly engaged in NEMs, i.e. participating in GVCs (which can also be proxied by characteristics of exports, e.g. high shares of intermediate manufactures or services), a large share of exports will most likely go to other parts of a TNC network, with "pre-defined" or captive markets, making separate export promotion less effective.
- If the import content of a country's exports is high, those exports are already fully participating in GVCs. Rather than promoting such exports separately, it may be preferable to focus efforts on FDI attraction to increase the domestic value added of exports.

Overall, there is no "one size fits all" solution, as the pros and cons of joint agencies significantly depend on country-specific circumstances.

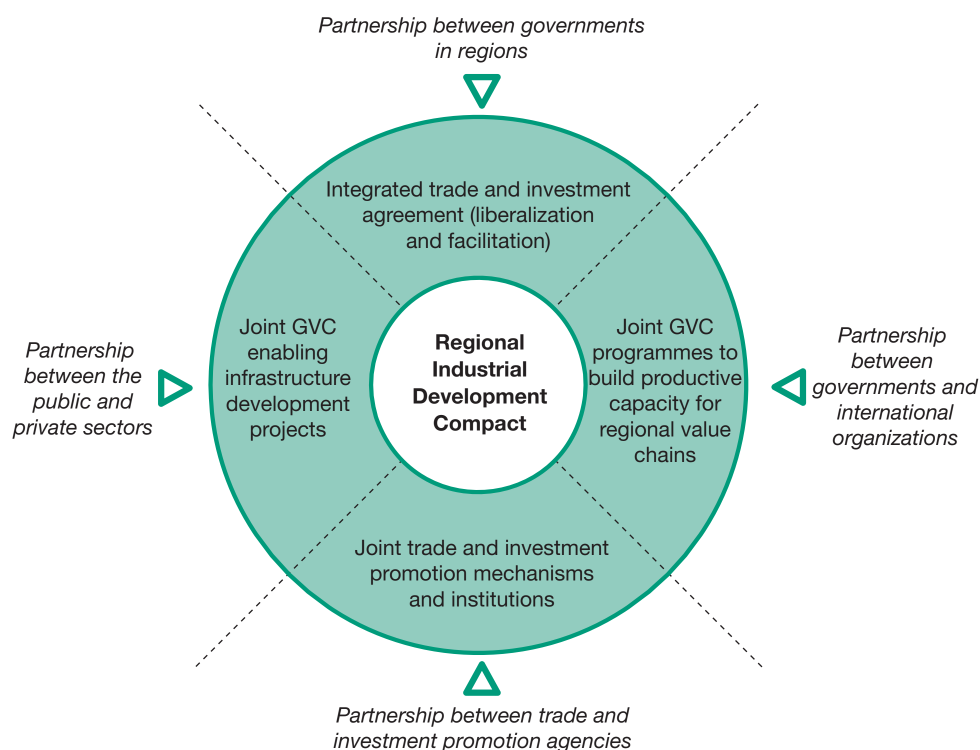
c. Regional industrial development compacts

The relevance of regional value chains underscores the importance of regional cooperation. Regional trade and investment agreements could evolve into industrial development compacts.

As seen in section A, regional production networks are important in GVCs. GVC-based industrial development benefits from strong ties with supply bases and markets in neighbouring economies. A key area where policymakers should seek to create synergies between trade and investment policies and institutions is thus in regional cooperation efforts.

Regional trade and investment agreements could evolve towards *"regional industrial development compacts."* Such compacts could focus on liberalization and facilitation of trade and investment and establish joint investment promotion mechanisms and institutions. An important challenge would be to reorient investment and

Figure IV.38. Regional industrial development compacts for regional value chains



Source: UNCTAD.

export promotion strategies from a focus on isolated activities as suppliers of GVCs to the needs of emerging regional markets.

Regional industrial development compacts could include in their scope all policy areas important for enabling GVC development, such as the harmonization, mutual recognition or approximation of regulatory standards and the consolidation of private standards on environmental, social and governance issues. And they could take steps in crucial policy areas such as the free movement of workers (the issue of migration and visas is crucial in value chains, which require people to be able to travel easily between countries to visit suppliers or work for periods in local operations to provide technical assistance) and services liberalization (particularly logistics and transportation), as regional value chains require intensified regional cooperation on a wider front.

Regional industrial development compacts could aim to create cross-border industrial clusters through joint investments in GVC-enabling infrastructure and productive capacity building. Establishing such compacts implies working in partnership, between governments of the region to harmonize trade and investment regulations, between investment and trade promotion agencies for joint promotion efforts, between governments and international organizations for technical assistance and capacity-building, and between the public and private sector for investment in regional value chain infrastructure and productive capacity (figure IV.38).

Concluding remarks: GVC policy development – towards a sound strategic framework

GVC policy development should begin with the strategic positioning of countries along GVCs, based on an assessment of the current position in GVCs and opportunities for growth.

This chapter has shown that GVCs are now a pervasive phenomenon in the global economy. Most countries are increasingly participating in GVCs, to different degrees and at various stages and levels in the chains.

GVCs and patterns of value added trade are shaped to a significant extent by TNCs – from mining TNCs to manufacturing or retail TNCs. Successful participation in GVCs for countries thus often hinges on the extent to which they can attract investment or the extent to which local firms manage to interact with TNC lead firms.

GVCs can bring a number of economic development benefits. They lead to direct economic impacts, in terms of value added, employment, income and exports. They can also contribute to longer-term economic development through technology and skills dissemination and industrial upgrading. However, none of these benefits are automatic, and countries can remain stuck in low-value activities, unable to upgrade and capture more value for economic development. In addition, GVC participation can exert negative social and environmental effects, including on wages and working conditions, on safety and health issues for workers, on the community, on emissions and others.

An important question facing policymakers is whether or not to actively promote GVC participation and adopt a GVC-led development strategy. For many countries, however, the question is less *whether* to promote GVC participation, but rather *how* to gain access to GVCs, maximize the benefits from participation, minimize the risks and upgrade in GVCs.

The policy section of this chapter has set out the main policy challenges stemming from the rise of GVCs and outlined a new GVC-based approach to industrial development policies with new roles for trade and investment policies. Key elements of the approach – the GVC Policy Framework – include (i) embedding GVCs in a country's overall development strategy, (ii) enabling participation in GVCs, (iii) building domestic productive capacity, (iv) providing a strong environmental, social and governance framework, and (v) synergizing trade and investment policies and institutions.

The starting point for strategy development is a clear understanding of the starting premise. Policymakers designing a GVC development

Table IV.16. GVC policy development: a tool for policymakers

Areas *(see also table IV.11)*	**Key questions**
Embedding GVCs in development strategy	
Position on GVC development paths *(see also figure IV.36)*	• What are the main exporting industries, and the main export products and services of the country? • Which industries are more export focused, or more focused on the domestic market? • What are the main import products and services of the country? • To what extent do imports consist of intermediate products or services? • To what extent do imports consist of raw materials? • Which industries require most imports of intermediates? • Which industries produce most export value added (exports minus imported content)? • To what extent do exports consist of the (non-processed) natural resources of the country? • How much value is added to the country's own natural resources before exports? • To what extent do exports consist of intermediate goods and services? • Which industries are more engaged in supplying intermediates exports rather than final goods? • Which third countries are most important in the country's GVC links, upstream and downstream? • Are most GVC trade links within the region or beyond?
GVC growth opportunities	• Which imported intermediates are produced through activities also present in-country? • What processing activities of exported natural resources could feasibly be carried in-country (before exports)? • What other value adding activities could be done on exported intermediates that currently occur in export markets? • What other industries (that do not yet feature in the country's exports) typically use the same value adding activities as the ones present? • What other activities could be developed in-country because their use of capital, technology and skills is similar to the ones present? • Which industries and activities provide the greatest marginal impact for each additional dollar of value added exports?
Enabling participation in GVCs	
Policy environment for trade and investment	• How would the country rate the general business climate and policy environment for investment? How does the policy environment compare against the UNCTAD IPFSD? • How easy is it to trade with the country? – Time to export and import – Cost to export and import – Procedures and documents to export and import • Are there any activities or plans concerning trade facilitation? • How easy is it to invest in the country? – Ease of establishment, access to industrial land – Treatment of investors and protection of intellectual property rights • Are there any activities or plans concerning business facilitation (e.g. UNCTAD's eRegulations programme)?
Infrastructure	• What are the main infrastructure bottlenecks for the growth of exports (physical infrastructure, utilities, telecom)? • What physical infrastructure bottlenecks hamper the development of productive capacity for exports at different links in the value chain: e.g. – At the border (international road links, ports) – Inland (road and rail links to regions) – Industrial facilities (industrial zones, business parks) – Logistics facilities (warehouses, refrigerated warehouses, etc.) • What infrastructure bottlenecks hamper imports?
Building domestic productive capacity	
Domestic productive capacity	• For each exporting industry, what are the primary value adding activities taking place in the country? • Which value adding activities contribute more to the GDP and employment contribution of exports? • Which value adding activities contribute most to the growth of exports? • Which value adding activities require most capital investment, technology and skills? • Which exporting industries and activities generate more value added for other domestic industries (spillovers)? • What are the main technology and skills bottlenecks for the growth of exports? • What investments are required to build the productive capacity needed to realize the opportunities identified? Where could the investment come from? • Does the country have a strategy for entrepreneurship development (e.g. UNCTAD's Entrepreneurship Policy Framework)?

/...

Table IV.16. GVC policy development: a tool for policymakers (concluded)

TNC involvement	• What is the involvement of TNCs in the country's economy and in each industry? • What is the involvement of TNCs in producing exports? • How much of the country's imports are brought in by TNCs? • To what extent do TNC imports consist of raw materials? And of intermediate materials? • To what extent are TNC imports of intermediate materials used in production for the domestic market or for exports? • Is the imported content of exports higher for TNC exports than for exports by domestic firms? • To what extent do TNCs present in the country rely on intra-firm trade, upstream and downstream?
Providing a strong environmental, social and governance framework	
Regulation, public and private standards	• What are the main "headline" social and environmental issues for the industries and GVCs in which the country is primarily engaged? • What is the social and environmental record of TNCs/lead firms and country suppliers with regard to these headline issues? • How strong are environmental regulations? • Has the country signed and ratified international environmental treaties? • What percentage of companies is certified to ISO 14001? • How strong are social regulations? • Has the country signed and ratified all of the core labour conventions of the ILO? • Do workers have the right to organize and form independent trade unions? • What percentage of workers is covered by collective bargaining agreements? • How strong are occupational safety and health regulations? • Are adequate resources available for enforcement of occupational safety and health regulations, e.g. skilled inspectors for on-site visits? • How many companies (TNCs/lead firms and local suppliers) are certified to multi-stakeholder or sector-specific multi-stakeholder standards, such as the Marine Stewardship Council or Forest Stewardship Council standards? • Does the country have a national standard to certify third-party auditors engaged in social auditing? • Does the country have a mandatory national standard for sustainability reporting? If not, does the country have a voluntary standard and what percentage of companies report to it?
SME compliance support	• To what extent does the country engage in capacity-building for SMEs on social and environmental management? Public sector programmes? • To what extent do TNCs/lead firms offer capacity-building for SMEs on social and environmental management?
Synergizing trade and investment policies and institutions	
Trade policy	• What are the current import tariff levels for different goods and services? • What non-tariff barriers exist in the country that could discourage GVC activities? • Have any sectors been affected by trade remedies (e.g. anti-dumping, safeguards and countervailing duties); do they require re-evaluating export-oriented growth strategies? • Have any export promotion instruments been set up (e.g. export finance, credit guarantees)? • To what extent are the country's exports hindered by trade barriers and trade remedies in importing countries?
Investment policy	• What industries face foreign investment restrictions, and what role do these industries play in exporting and importing in GVCs? • Are there screening/review procedures set up for investments and in what industries? To what extent do they affect GVCs? • Are there any performance requirements in place and in what industries? Do they hamper trade in GVCs? • What incentives policies have been set up, including EPZs, that could benefit GVC operations?
International commitments and constraints	• Is the country a WTO member? • How many preferential trade agreements has the country signed, and with which partners? • How many IIAs has the country signed, and with which partners? • Does the country pursue regional integration? • What market access development preferences (e.g. GSP, EBA) is the country eligible for?
Trade and investment institutions	• To what extent do trade and investment authorities coordinate their activities? • Does the country have joint or separate trade and investment promotion organizations? Has the importance of coordination been assessed, on the basis of: – dependence on foreign capital, skills and technologies for the build-up of export capacities? – extent to which exports are driven by TNC foreign affiliates? – extent to which domestic exporters are engaged in NEMs, i.e. participating in GVCs? – import content of exports?

Source: UNCTAD.

strategy should have the clearest possible picture of where their economy stands in relation to each of the elements of the GVC Policy Framework outlined in this chapter, to inform their strategic positioning based on factor endowments, dynamic capabilities and broader development vision.

Table IV.16 provides a tool to help policymakers assess their economy's current positioning in GVCs, the opportunities for growth, the strengths and weaknesses in enabling factors and productive capabilities for GVC participation, the social, environmental and governance framework, and the trade and investment policy context. The table does so by asking a series of questions, the answers to which should paint a clearer picture of GVC strengths, weaknesses, opportunities and threats. Some questions can be answered through empirical metrics, others can only be answered in a qualitative manner. The list is by no means exhaustive; it is meant only to guide the assessment process.

The tool can be read in concomitance with the earlier figure IV.36, which plots a GVC development path along the axes of increasing levels of technological sophistication on the one hand, and increasing levels of GVC participation and value creation on the other. Policymakers should aim to determine where their economy stands, where it can go and how it can get there.

Notes

1 In reality the GVC structure is not necessarily characterized by a linear sequencing of value added activities ("snake" configuration): it can be structured around one or more assembly hubs with parts entering from different production sites ("spider" configuration). However, this difference, while important from a conceptual perspective, does not affect the analytical treatment of value added data and double counting effects. See Baldwin, R. and A. Venables (2010) "Spiders and snakes: offshoring and agglomeration in the global economy", *NBER Working Papers*, No. 16611, National Bureau of Economic Research, Inc.

2 The Eora project, originally funded by the Australian Research Council, based at the University of Sydney and comprising an international team of researchers, developed the so-called "world multi-region input-output database" that is the basis for the generation of the value added trade estimates in the GVC Database discussed in this chapter. For details, see http://www.worldmrio.com/.

3 The UNCTAD-Eora GVC Database was launched earlier in 2013 in a WIR13 Preview Report available at http://unctad.org/en/PublicationsLibrary/diae2013d1_en.pdf.

4 Equating foreign value added with the double counting in global trade figures is a simplification. Some further double counting takes place within domestic value added, as exported value added can re-enter countries to be incorporated in further exports, and so forth. Such circular double counting can be significant in some countries and some industries, but is marginal in most.

5 These findings are consistent across all countries surveyed by the economic analysis over the recent years. See Bernard, A. B. et al. (2007) "Firms in International Trade", *NBER Working Papers No.* 13054, NBER, Inc. Also see Ottaviano, G. and T. Mayer (2007) "Happy few: the internationalisation of European firms. New facts based on firm-level evidence". Open Access publications from Sciences Po, hdl: 2441/10147, Sciences Po.

6 FDI stock in services is still more than 35 per cent of the total if only non-financial sector FDI is considered (although financial sector FDI is not only a value chain in its own right but also provides crucial services to other GVCs).

7 See Cooke, J. A. (2010) "From bean to cup: How Starbucks transformed its supply chain", *Supply Chain Quarterly*, Quarter 4.

8 Gereffi, G., J. Humphrey and T. Sturgeon (2005) "The governance of global value chains", *Review of International Political Economy*, 12: 78-104.

9 Horizontal diversification of a segment or subsegment of a value chain is also important but less well covered in the GVC literature. In the case of FDI, this commonly involves affiliates that replicate TNC segments in host economies (with no or little cross-segment vertical linkages), e.g. in manufacturing, extractive or services operations aimed at equivalent markets in host countries. Horizontal diversification can also be considered to apply to host country operations by lead TNCs which are essentially NEMs to other organizations.

10 Ivarsson, I. and C. G. Alvstam (2010) "Supplier Upgrading in the Home-furnishing Value Chain: An Empirical Study of IKEA's Sourcing in China and South East Asia", *World Development*, 38: 1575-87.

11 Bair, J. and Gereffi, G. (2002) "NAFTA and the Apparel Commodity Chain: Corporate Strategies, Interfirm Networks, and Industrial Upgrading", in G. Gereffi, D. Spener, and J. Bair (eds.), *Free Trade and Uneven Development: The North American Apparel Industry after NAFTA*. (Philadelphia, Temple University Press: 23–50.)

12 An Inter-Agency Working Group coordinated by UNCTAD supported the G-20 in *developing key indicators for measuring and maximizing the economic and employment impact of private sector investment in value chains*. Key indicators comprise (i) economic value added (with value added and gross fixed capital formation, exports, number of business entities, fiscal revenues), (ii) job creation (total employment, employment by category, wages), and (iii) sustainable development (social impact, environmental impact, development impact). For a full presentation, visit http://unctad.org/en/Pages/DIAE/G-20/measuring-impact-of-investment.aspx.

13 Variation in backward linkages was also highlighted in a recent study of 809 TNC affiliates across Eastern Europe (Croatia, Slovenia, Poland, Romania and the former East Germany) in manufacturing industries. About 48 per cent of inputs were bought from domestic suppliers (both foreign and locally owned). The highest share was found in East Germany and the lowest for Romania. The share of local suppliers was highest (55 per cent) in the medium- to low-tech industries.

See Giroud, A., B. Jindra and P. Marek (2012) "Heterogeneous FDI in Transition Economies - A Novel Approach to Assess the Developmental Impact of Backward Linkages", *World Development*, 40:2206.

[14] Rugraff, E. (2010) "Foreign direct investment and supplier-oriented upgrading in the Czech motor vehicle industry", *Regional Studies*, 44. This study showed that Czech-owned companies represent half of 173 first-tier suppliers in the automotive industry but account for only one fifth of the employees. Also see UNCTAD (2010) "Integrating Developing Countries' SMEs into Global Value Chains". It contains the example of the Colombian automobile industry, where 60 per cent of value added originates from car assembly which is performed by lead firms (TNC-led). By contrast, SMEs only account for less than 40 per cent of the total value.

[15] Dedrick, J., K. L. Kraemer and G. Linden (2009) "Who profits from innovation in global value chains? A study of the iPod and notebook PCs", *Industrial and Corporate Change*, 19:81-116. The authors apply a product-level approach to identify the financial value embedded in products and show how it is distributed across multiple participants in the supply chain across borders, from design and branding to component manufacturing to assembly to distribution and sales.

[16] For evidence on and examples of linkages in sub-Saharan Africa, see Morris, M., et al. (2012). "One thing leads to another – Commodities, linkages and industrial development", *Resources Policy*, 37:408-16.

[17] See UNCTAD 1999. *Transfer Pricing: UNCTAD Series on Issues in International Investment Agreements.* Geneva and New York. United Nations.

[18] Gourevitch, P., R. Bohn, and D. McKendrick (1997) *Who Is Us?: the Nationality of Production in the Hard Disk Drive Industry*, Report 97-01. La Jolla, CA: The Information Storage Industry Center, University of California. Available at http://isic.ucsd.edu/papers/whoisus.shtml.

[19] Tejani, S. (2011) "The gender dimension of special economic zones", in *Special Economic Zones: Progress, Emerging Challenges, and Future Directions*. Washington D.C: The World Bank; Braunstein, E. (2012) "Neoliberal Development Macroeconomics. A Consideration of its Gendered Employment Effects", *UNRISD Research Paper* 2012–1, Geneva: United Nations; Staritz, C. and J. G. Reis (2013) *Global Value Chains, Economic Upgrading*, *and Gender*. Case Studies of the horticulture, Tourism and Call Center Industries. Washington, D.C.: The World Bank.; Tejani, S. and W. Milberg (2010) *Global defeminization? Industrial upgrading, occupational segmentation and manufacturing employment in Middle-Income countries*. New York: Schwartz Centre for Economic Policy Analysis; Aguayo-Tellez, E. (2011) The Impact of Trade Liberalization Policies and FDI on Gender Inequality: A Literature Review. Washington, D.C.: World Bank.

[20] The few cross-country and cross-industry studies available in this area highlight notable differences in impact and find that (i) employment growth is not linked with comparable growth in real wages, and even in some case it is linked to declines in wages; (ii) upgrading in terms of real wages varies by country. Downgrading in terms of real wages is not uncommon. See, e.g., Milberg, W. and D. Winkler (2013) *Outsourcing Economics: Global Value Chains in Capitalist Development*. New York: Cambridge University Press; and Bernhardt, T. and W. Milberg (2011) "Does economic upgrading generate social upgrading? Insights from the Horticulture, Apparel, Mobile Phones and Tourism Sectors", *Capturing the Gains Working Paper*, No. 2011/07.

[21] This is illustrated by the example of Chile's National Labour Skills Certification System. See Fernandez-Stark, K., S. Frederick and G. Gereffi (2011) "The apparel global value chain: economic upgrading and workforce development", *Center on Globalization, Governance & Competitiveness*, Duke University, November 2011.

[22] As an example, in Costa Rica, the Instituto Nacional de Aprendizaje offered 25,000 scholarships in 2007 for English-language training, while the Asociación Costarricense de Profesionales de Turismo provides members with access to Mandarin Chinese, French and Italian classes. See Christian, M., K. Fernandez-Stark, G. Ahmed and G. Gereffi (2011) "The Tourism Global Value Chain: Economic Upgrading and Workforce Development", in *Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries*, Durham: Duke University, Center on Globalization, Governance and Competitiveness.

[23] Bair, J. and G. Gereffi (2003) "Upgrading, uneven development, and jobs in the North American apparel industry", *Global Networks*, 3:143–69; Barrientos, S., G. Gereffi and A. Rossi (2012) "Economic and social upgrading in global production networks: A new paradigm for a changing world", *International Labour Review*, 150:319-40. See also Barrientos, S., G. Gereffi and A. Rossi (2011) "Labour Chains: Analysing the Role of Labour Contractors in Global Production Networks", *International Labour Review*, Volume 150, Issue 3-4, pages 319–340, December 2011.

[24] Henderson, J., P. Dicken, M. Hess, N. Coe and H. W. Yeung (2002) "Global production networks and the analysis of economic development", *Review of International Political Economy*, 9:436-64; also Rugraff (ibid.).

[25] Trade in intermediate goods is more volatile than trade in either capital or consumption goods, suggesting that recessions and economic crises affect material, parts and component shipments more than final goods (see Sturgeon, T. J. and O. Memedovic (2011) "Mapping Global Value Chains: Intermediate Goods Trade and Structural Change in the World Economy". Vienna: UNIDO). With regard to the effect of economic crises, in the clothing industry, as a result of the 2008 crisis it is estimated that millions of jobs were lost globally because of slower demand in Europe and the United States. The number of job losses amounted to between 11 and 15 million in the first quarter of 2010, with the highest losses experienced in China (10 million), India (1 million), Pakistan (200,000), Indonesia (100,000), Mexico (80,000), Cambodia (75,000) and Viet Nam (30,000). See Staritz, C. (2011) "Making the Cut? Low-Income Countries and the Global Clothing Value Chain in a Post-Quota and Post-Crisis World". Washington, D. C.: The World Bank.

[26] Arnold, C. E. (2010) "Where the Low Road and the High Road Meet: Flexible Employment in Global Value Chains", *Journal of Contemporary Asia*, 40:612. The study notes that larger producers use sub-contractors to mediate the instability of international contracts, passing on uncertainty to smaller firms and their workforces.

[27] Haakonsson, S. J. (2009) "Learning by importing in global value chains: upgrading and South-South strategies in the Ugandan pharmaceutical industry", *Development Southern Africa*, 26:499-516.

[28] Gereffi, G. and O. Memedovic (2003) "The Global Apparel Value Chain: What prospects for upgrading by developing countries?". Vienna, Austria: UNIDO.

[29] UNCTAD (2010) "Integrating Developing Countries' SMEs into Global Value Chains".

[30] Dunning, J. and S. Lundan (2008) *Multinational Enterprises and the Global Economy*, Second Edition. Cheltenham: Edward Elgar Publishing Ltd.; Cantwell, J. and R. Mudambi (2005) "MNE competence-creating subsidiary mandates", *Strategic Management Journal*, 26 (12): 1109-1128; for a review of vertical spillovers, see Havranek, T. and Z. Irsova (2011) "Estimating vertical spillovers from FDI: Why results vary and what the true effect is", *Journal of International Economics*, 85(2): 234–244.

[31] Ivarsson, I. and C. G. Alvstam (2009) "Local Technology Linkages and Supplier Upgrading in Global Value Chains: The Case of Swedish Engineering TNCs in Emerging Markets", *Competition and Change*, 13:368–88; Ivarsson, I. and C. G. Alvstam, 2010 (ibid.). Furthermore, a study of 1,385 firms in Thailand shows that the presence of global buyers in the local market reduces behavioural uncertainty and increases the

likelihood of success in the selection of partners, leading to knowledge-intensive value chain agreements (Saliola, F. and A. Zanfei (2009) "Multinational firms, global value chains and the organization of knowledge transfer", *Research Policy*, 38:369).

[32] Zanfei, A. (2012) "Effects, Not Externalities", *The European Journal of Development Research*, 24:8-14; Pietrobelli, C. and R. Rabellotti (ibid.); Kaplinsky, R. (2010) *The role of standards in global value chains*. Washington, D.C.: The World Bank; Narula, R. and N. Driffield (2012) "Does FDI Cause Development? The Ambiguity of the Evidence and Why it Matters", *The European Journal of Development Research*, 24:1–7.

[33] Bell, M. and M. Albu (1999) "Knowledge Systems and Technological Dynamism in Industrial Clusters in Developing Countries", *World Development* 27.9: 1715–34.

[34] Sturgeon, T. J. and J. Lee (2004) *Industry Co-Evolution: A Comparison of Taiwan and North America's Electronics Contract Manufacturers*. ITEC Research Paper Series 04-03, Kyoto: Doshisha University. Available at http://itec.doshisha-u.jp/03_publication/01_workingpaper/2004/ITECRPS0403.pdf.

[35] Ivarsson, I. and C. G. Alvstam, 2010 (ibid.); Navas-Alemán, L. (2011) "The Impact of Operating in Multiple Value Chains for Upgrading: The Case of the Brazilian Furniture and Footwear Industries", *World Development*, 39:1386-97. A good analysis is made in the case of the South African furniture and timber firms in an effort to comply with environmental certification (Morris, M. and N. Dunne (2004) "Driving environmental certification: its impact on the furniture and timber products value chain in South Africa", *Geoforum*, 35:251–66.).

[36] Gereffi, G., J. Humphrey and T. J. Sturgeon, 2005 (ibid.); Giuliani, E., C. Pietrobelli and R. Rabellotti (2005) "Upgrading in Global Value Chains: Lessons from Latin American Clusters", *World Development*, 33:549-73.; Humphrey, J. and O. Memedovic (2003) "The Global Automotive Industry Value Chain: What Prospects for Upgrading by Developing Countries", UNIDO *Sectorial Studies Series*, Working Paper. Vienna: UNIDO; Gentile-Lüdecke, S. and A. Giroud (2012) "Knowledge Transfer from TNCs and Upgrading of Domestic Firms: The Polish Automotive Sector", *World Development*, 40(4): 796–807.

[37] Humphrey, J. (2003) "Globalisation and Supply Chain Networks: The Auto Industry in Brazil and India", *Global Networks* 3.2: 121–41.

[38] ILO (2013) Presentation on the World Day for Safety and Health at Work, 28 April. http://www.ilo.org.

[39] UNCTAD (2012) "Corporate Social Responsibility in Global Value Chains", p. 8.

[40] UNCTAD (2013), "Corporate Social Responsibility: a Value Chain Specific Approach", forthcoming.

[41] Humphrey, J. and H. Schmitz (2002) "How does insertion in global value chains affect upgrading in industrial clusters?", *Regional Studies*, 36:1017-27; Gereffi, G., et al., 2001 (ibid.).

[42] Christian, M. et al. (2011) (ibid.).

[43] This is well illustrated by the two Mexican footwear clusters of Guadalajara and León. They operate in chains dominated by United States buyers as well as in the domestic market. While United States buyers control design and product development for products sold in the United States market, local buyers and producers co-operate and share competences domestically for provision of products within the Mexican market (Giuliani, E. et al., 2005 (ibid.)).

[44] In the Brazilian furniture and footwear industries, producers operating in multiple chains (as opposed to those solely exporting) have a higher propensity to engage in functional upgrading (as well as product and process upgrading) – because they use the domestic or regional markets to learn how to design and market their products, before exporting them under their *own* brands and designs to the United States market (Navas-Alemàn, L., 2011 (ibid.)).

[45] Fessehaie, J. (2012) "What determines the breadth and depth of Zambia's backward linkages to copper mining? The role of public policy and value chain dynamics", *Resources Policy*, 37:443–51.

[46] Kaplinsky, R, et al., 2011 (ibid.); van Dijk, M. P. and J. Trienekens (2012) *Global Value Chains - Linking Local Producers from Developing Countries to International Markets*. Amsterdam University Press, p. 210.

[47] Giuliani, E. et al., 2005 (ibid.).

[48] Humphrey, J. and H. Schmitz, 2002 (ibid.); Guiliani, E. et al., 2005 (ibid.).

[49] Hanlin, R. and C. Hanlin (2012) "The view from below: 'lock-in' and local procurement in the African gold mining sector", *Resources Policy*, 37:468–74.

[50] Humphrey, J. and H. Schmitz, 2002 (ibid.) suggest that in the case of garment production, local producers will not face obstacles when moving from assembly of imported inputs to increased local production and sources. However, a move up to design and sale of own branded merchandise is less likely to be facilitated by global buyers.

[51] Bernhardt, T. and W. Milberg, 2011 (ibid.); Whittaker, D. H., T. Zhu, T. J. Sturgeon, M. H. Tsai and T. Okita (2010) "Compressed development", *Studies in Comparative International Development*, 45:439-67.; Barrientos, S. et al., 2008 (ibid.); Milberg, W. and D. Winkler, 2011 (ibid.); Rossi, A.(2011) "Economic and social upgrading in global production networks: the case of the garment industry in Morocco", Doctoral thesis, University of Sussex.

[52] Fernandez-Stark, K. et al., 2011 (ibid.).

[53] Baldwin, R. (2011) "Trade And Industrialisation After Globalisation's 2nd Unbundling: How Building And Joining A Supply Chain Are Different And Why It Matters", *NBER Working Papers*, No. 17716. This paper was one of the first to make the argument that GVCs have transformed the nature of industrialisation and called for more research.

[54] Based on W. Milberg, X. Jiang, and G. Gereffi (forthcoming), *Industrial Policy in the Era of Vertically Specialized Industrialization.*

[55] See www.asycuda.org.

[56] UNCTAD (2009) "Non-tariff measures: Evidence from Selected Developing Countries and Future Research Agenda". On the potential impact of automated processes, see also UNCTAD's 2011 Information Economy Report "ICTs as an Enabler for Private Sector Development".

[57] See UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) for a complete discussion. Available at http://investmentpolicyhub.unctad.org.

[58] See www.eRegulations.org.

[59] See van Dijk M. and J. Trienekens, 2012 (ibid.).

[60] See UNCTAD (2012) "Report of the Multi-year Expert Meeting on International Cooperation: South–South Cooperation and Regional Integration" on its fourth session (Geneva, 24–25 October). Available at http://unctad.org/meetings/en/SessionalDocuments/ciimem2d12_en.pdf.

[61] Gereffi, G. (2009), "Chains for Change: Third Max Havelaar Lectures", Rotterdam School of Management, p. 52. Available at http://www.maxhavelaarlecture.org.

[62] Available at http://unctad.org/en/Pages/DIAE/Entrepreneurship.

[63] See UNCTAD (2011) "Promoting standards for responsible investment in value chains", September. Available at www.unctad.org/csr.

[64] Gereffi, G. et al., (2009) (ibid.).

[65] Milberg, W. and M. Amengual (2008) "Economic development and working conditions in export processing zones: A survey of trends". Geneva: ILO.

[66] UNCTAD (2013) "Transforming Export Processing Zones into Centres for Excellence for Sustainable Development" forthcoming. This research was focused on government run industrial parks, even when these are termed differently in different markets (e.g. 'special economic zones', etc.). To evaluate the role of sustainable development services within EPZs a sample of 100 EPZs from around the world was

surveyed. Following an initial focus on developing countries of the G20 the research was broadened to search for best practices from additional countries around the world.

[67] Classified as contingent trade-protective measures in UNCTAD's 2012 Classification of NTMs, available at www.unctad.org.

Box IV.2

[a] This variable is related to an active literature on measuring vertical specialization, with the first indicator calculated being the value of imported inputs in the overall (gross) exports of a country. The refinement to this indicator of vertical specialization corrects for the fact that the value of (gross) imports used by country A to produce exports (as retrieved from "standard" I-O tables) in reality might incorporate the domestic value added of country A that has been used as an input by country B, from which country A then sources, allowing instead only for the foreign value added of country B to enter in the calculation of country A's inputs nets out this effect. See Hummels, D., J. Ishii and K.-M. Yi (2001) "The nature and growth of vertical specialization in world trade", *Journal of International Economics* 54(1): 75–96; and Johnson, R.C. and G. Noguera (2012) "Accounting for intermediates: Production sharing and trade in value-added", *Journal of International Economics* 86(2), 224–236.

[b] This indicator was first introduced in Koopman, R., W. Powers, Z. Wang and S.-J. Wei (2011) "Give credit to where credit is due: tracing value added in global production chains", *NBER Working Papers Series,* No. 16426, September 2010, revised September 2011.

[c] See Fally, T. (2011) "On the Fragmentation of Production in the US", University of Colorado-Boulder, July.

Box IV. 3

[a] Estimates are based on data from the United States Bureau of Economic Affairs ("U.S. Affiliates of Foreign Companies and U.S. Multinational Companies", 2012); China Ministry of Commerce; OECD; IDE-JETRO. Data for Europe from Altomonte, C., F. Di Mauro, G. Ottaviano, A. Rungi, and V. Vicard (2012) "Global Value Chains during the Great Trade Collapse: A Bullwhip Effect?", *ECB Working Paper Series,* No. 1412.

Box IV. 4

[a] As constructed by Altomonte, C. and A. Rungi (2013) "Business Groups as Hierarchies of Firms: Determinants of Vertical Integration and Performance", Working Papers 2013.33, Fondazione Eni Enrico Mattei. This dataset uses a definition of control as established in international standards for multinational corporations, where control is assumed if (directly or indirectly, e.g. via another controlled affiliate) the parent exceeds the majority (50.01 per cent) of voting rights (i.e. majority ownership) of the affiliate and can thus be considered as the Ultimate Beneficial Owner.

[b] Altomonte, C. et al., 2012 (ibid.)

Box IV. 5

[a] See Engel. B (2011) "10 best practices you should be doing now", *Supply Chain Quarterly,* Quarter 1. Perez, D. (2013) "Supply chain strategies: Which one hits the mark?", *Supply Chain Quarterly*, Quarter 1.

[b] See Cooke, J. A. (2012) "From many to one: IBM's unified supply chain", *Supply Chain Quarterly*, Quarter 4.

Box IV. 8

[a] See Reuters, "Factbox: Major U.S. Tax Court transfer pricing cases", 17 June 2012. Available at http://www.reuters.com (accessed 10 January 2013).

[b] See http://www.tax-news.com/news/IndianTribunal_Reaches_Key_Transfer_Pricing_Decision (accessed on 25 May 2013).

REFERENCES

Aguayo-Tellez, E. (2011). "The Impact of Trade Liberalization Policies and FDI on Gender Inequality: A Literature Review", World Development Report Background Papers, Washington, D.C.:World Bank.

Alix Partners (2012). "Executive Perspectives on Near-Shoring", Alix Partners Research Note, July.

Altomonte, C., F. Di Mauro, G. Ottaviano, A. Rungi, and V. Vicard (2012). "Global Value Chains During the Great Trade Collapse: a Bullwhip Effect?" ECB Working Paper Series, No. 1412. Frankfurt: European Central Bank.

Altomonte, C. and A. Rungi (2013) "Business Groups as Hierarchies of Firms: Determinants of Vertical Integration and Performance", Working Paper, 2013.33.

Fondazione Eni Enrico Mattei.

Arnold, C.E. (2010). "Where the Low Road and the High Road Meet: Flexible Employment in Global Value Chains", Journal of Contemporary Asia, 40: 612.

Arvis, J-F., G. Raballand, and J-F Marteau (2011). Connecting Landlocked Developing Countries to Markets: Trade Corridors in the 21st Century. Washington, D.C.: World Bank.

Asian Development Bank (2012). "CAREC 2020: A strategic framework for the Central Asia Regional Economic Cooperation Program 2011–2020". Mandaluyong City, Philippines: Asian Development Bank.

Axelson, U., T. Jenkinson, P.J. Strömberg, and M. Weisbach (2012). "Borrow cheap, buy high? The determinants of leverage and pricing in buyouts", CEPR Discussion Paper, No. 8914.

Bair, J. and G. Gereffi (2003). "Upgrading, uneven development, and jobs in the North American apparel industry", Global Networks, 3:143-69.

Bair, J. and G. Gereffi (2002). "NAFTA and the Apparel Commodity Chain: Corporate Strategies, Interfirm Networks, and Industrial Upgrading", in G. Gereffi, D. Spener, and J. Bair (eds.), Free Trade and Uneven Development: The North American Apparel Industry after NAFTA, Philadelphia, Temple University Press: 23-50.

Baldwin, R. (2011). "Trade and industrialisation after globalisation's 2nd unbundling: how building and joining a supply chain are different and why it matters", NBER Working Papers, No.17716. Cambridge, MA: NBER.

Baldwin, R. and A. Venables (2010). "Spiders and snakes: offshoring and agglomeration in the global economy", NBER Working Papers, No. 16611, Cambridge, MA: NBER.

Barrientos, S., G. Gereffi, and A. Rossi (2011). "Economic and social upgrading in global production networks: A new paradigm for a changing world", International Labour Review, 150:319-40.

Barros, C.D. and L.S. Pedro (2012). "O papel do BNDES no desenvolvimento do setor automotivo brasileiro", BNDES Publications, 10/2012.

Bhattacharya, A., T. Bradtke, T. Ermias, W. Haring-Smith, D. Lee, E. Leon, M. Meyer, D.C. Michael, A. Tratz, M. Ukon and B. Waltermann. (2013). Allies and Adversaries: 2013 BCG Global Challengers Report, The Boston Consulting Group.

Bell, M. and M. Albu (1999). "Knowledge Systems and Technological Dynamism in Industrial Clusters in Developing Countries", World Development, 27:1715-34.

Bernard, A., J. Bradford Jensen, S. Redding and P. Schott (2007). „Firms in International Trade," NBER Working Papers, No. 13054, Cambridge, MA: NBER.

Bernhardt, T. and W. Milberg (2011). "Does economic upgrading generate social upgrading? Insights from the Horticulture, Apparel, Mobile Phones and Tourism Sectors", Capturing the Gains Working Paper, No. 2011/07.

Bernasconi-Osterwalder, N. (2012). "Analysis of the European Commission's Draft Text on Investor–State Dispute Settlement for EU Agreements", Investment Treaty News, 19 July, International Institute for Sustainable Development.

Bosworth, B., Collins, S.M. and G. Chodorow-Reich (2007). "Returns on FDI: Does the U.S. really do better?", NBER Working Paper, No. 13313. Cambridge, MA: NBER.

Braunstein, E. (2012). "Neoliberal Development Macroeconomics. A Consideration of its Gendered Employment Effects", UNRISD Research Paper 2012–1, Geneva: United Nations

Buckley, P.J. and M.C. Casson (2009). “The internalisation theory of the multinational enterprise: A review of the progress of a research agenda after 30 years”, Journal of International Business Studies, 40:1563–1580.

CARIM (2010). Caribbean Trade and Investment Report 2010: Strategies for recovery, renewal and reform. Kingston: Caribbean Community Secretariat.

Cantwell, J. and R. Mudambi (2005). “MNE competence-creating subsidiary mandates.” Strategic Management Journal 26(12): 1109-1128.

Cattaneo, O., G. Gereffi and C. Staritz (2010). Global Value Chains in a Postcrisis World: A Development Perspective. Washington D.C.: World Bank.

Central Bank of Trinidad and Tobago (2013). Economic Bulletin, January 2013, Volume XV, No. 1.

Christian, M., G. Ahmed, K. Fernandez-Stark and G. Gereffi (2011).”The Tourism Global Value Chain: Economic Upgrading and Workforce Development”, in Skills for Upgrading: Workforce Development and Global Value Chains in Developing Countries, Durham: Duke University, Center on Globalization, Governance and Competitiveness.

Comisión Chilena del Cobre (2013). “Anuario de Estadísticas del cobre y otros minerales, 1993-2012”. Santiago: Comisión Chilena del Cobre

Cooke, J.A. (2010). “From Bean to Cup: How Starbucks transformed its supply chain”. Supply Chain Quarterly, Quarter 4.

Cooke, J.A. (2012). “From many to one: IBM’s unified supply chain”, Supply Chain Quarterly, Quarter 4.

Curcurua, S., C.P. Thomas and F.E. Warnock (2013). “On returns differentials”, International Finance Discussion Papers, No. 1077 (April). Washington, D.C.: Board of Governors of the Federal Reserve System.

Dedrick, J., K. Kraemer and G. Linden (2009). “Who profits from innovation in global value chains?: a study of the iPod and notebook PCs”, Industrial and Corporate Change, 19: 81–116.

Dinc, S. and I. Erel (2012). “Economic Nationalism in Mergers and Acquisitions”. Charles A. Dice Center Working Paper, No. 2009-24.

Douglas, Z. (2009). The International Law of Investment Claims. Cambridge: Cambridge University Press.

Dussel Peters, E. (2009). “Don’t expect apples from a pear tree: foreign direct investment and innovation in Mexico”, Discussion Paper, No. 28, November. Working Group on Development and Environment in the Americas.

Dunning, J. and S. Lundan (2008). Multinational Enterprises and the Global Economy, second edition. Cheltenham: Edward Elgar.

Duval, Y. and C. Utokhtam (2009). “Behind the Border Trade Facilitation in Asia-Pacific: Cost of Trade, Credit Information, Contract Enforcement and Regulatory Coherence”. Trade and Investment Division Staff Working Paper Series, No. 02/2009. ESCAP: United Nations.

ECLAC (2013). La inversión extranjera directa en América Latina y el Caribe 2012. Santiago: United Nations.

Engel. B (2011). “10 best practices you should be doing now”, Supply Chain Quarterly, Quarter 1.

Fally, T. (2011). “On the Fragmentation of Production in the US”, University of Colorado-Boulder, July.

Fernandez-Stark, K., S. Frederick and G. Gereffi (2011). The apparel global value chain: economic upgrading and workforce development. Durham: Duke University.

Fessehaie, J. (2012). “What determines the breadth and depth of Zambia’s backward linkages to copper mining? The role of public policy and value chain dynamics”, Resources Policy, 37: 443–51.

Flamm K. and J. Grunwald (1985). The Global Factory: Foreign Assembly in International Trade. Washington, D.C.: Brookings Institute.

Frederick, S. and G. Gereffi (2011). “Upgrading and restructuring in the global apparel value chain: why China and Asia are outperforming Mexico and Central America”, International Journal of Technological Learning, Innovation, and Development, 4: 67–95.

Gaukrodger, D and K. Gordon (2012). “Investor-state dispute settlement: a scoping paper for the investment policy community”, OECD Working Papers on International Investment, No. 2012/3, Paris: OECD,

Gentile-Lüdecke, S. and A. Giroud (2012). "Knowledge Transfer from TNCs and Upgrading of Domestic Firms: The Polish Automotive Sector." World Development 40(4): 796–807.

Gereffi, G. and S. Frederick (2010)."The global apparel value chain, trade and the crisis - challenges and opportunities for developing countries", in Global Value Chains in a Postcrisis World: A Development Perspective. Washington, D.C.: World Bank.

Gereffi, G. and O. Memedovic (2003). The Global Apparel Value Chain: What Prospects for Upgrading by Developing Countries? Vienna: UNIDO.

Gereffi, G., J. Humphrey, R. Kaplinsky and T. Sturgeon (2001). "Introduction: Globalisation, Value Chains and Development", IDS Bulletin, No 32.3. Brighton: Institute for Development Studies.

Gereffi, G., J. Humphrey and T. Sturgeon (2005). "The governance of global value chains", Review of International Political Economy, 12: 78–104.

Gereffi, G. (2009). "Chains for Change: Third Max Havelaar Lectures". Paper presented at Rotterdam School of Management, Erasmus University, Rotterdam, 9 November.

Gereffi, G., K. Fernandez-Stark and P. Psilos (2011). Skills for upgrading: Workforce Development and Global Value Chains in Developing Countries. Durham: Center on Globalization, Governance & Competitiveness, Duke University.

Giroud, A., B. Jindra and P. Marek (2012). "Heterogeneous FDI in transition economies – a novel approach to assess the developmental impact of backward linkages", World Development, 40: 2206–2220.

Giuliani, E., C. Pietrobelli and R. Rabellotti (2005). "Upgrading in Global Value Chains: Lessons from Latin American Clusters", World Development, 33: 549–573.

Gourevitch, P., R. Bohn and D. McKendrick (2000). "Globalization of Production: Insights from the Hard Disk Drive Industry", World Development, 28: 301–317.

Government of the Republic of Trinidad and Tobago (2013). Review of the Economy 2012, Stimulating Growth, Generating Prosperity. Port of Spain: Government of Trinidad and Tobago.

Griffith, R., R. Craigwell and K. White (2008). "The Significance of Foreign Direct Investment to Caribbean Development", Journal of Public Sector Policy Analysis, 2: 50.

Haakonsson, S.J. (2009). "'Learning by importing' in global value chains: upgrading and South-South strategies in the Ugandan pharmaceutical industry", Development Southern Africa, 26: 499–516.

Hanlin, R. and C. Hanlin (2012). "The view from below: 'lock-in' and local procurement in the African gold mining sector", Resources Policy, 37: 468-474.

Harlé, N., K. Cool and P. Ombregt (2012). "Merger Control and Practice in the BRIC Countries vs. The EU and the US: Review Thresholds", INSEAD Working Paper, No. 2012/100/ST. Paris: INSEAD.

Havranek, T., and Z. Irsova (2011). "Estimating vertical spillovers from FDI: Why results vary and what the true effect is". Journal of International Economics, 85(2): 234–244.

Heinemann, A. (2012). "Government Control of Cross-Border M&A: Legitimate Regulation or Protectionism?" Journal of International Economic Law, 15(3): 843–870. Oxford: Oxford University Press.

Henderson, J., N. Coe, P. Dicken, M. Hess and H. W-C. Yeung (2002). "Global production networks and the analysis of economic development", Review of International Political Economy, 9: 436–464.

Hummels, D., J. Ishii and K.-M. Yi (2001). "The nature and growth of vertical specialization in world trade", Journal of International Economics, 54(1): 75–96

Humphrey, J. (2003). "Globalisation and supply chain networks: the auto industry in brazil and india", Global Networks, 3: 121-41.

Humphrey, J., and O. Memedovic (2003). "The global automotive industry value chain: what prospects for upgrading by developing countries", UNIDO Sectorial Studies Series Working Paper. Vienna: UNIDO.

Humphrey, J. and H. Schmitz (2002). "How does insertion in global value chains affect upgrading in industrial clusters?", Regional Studies, 36:1017–1027.

ILO (2012). Value Chain Development: The role of Cooperatives and Business Associations in Value Chain Development. Geneva: ILO.

IMF (2012a). "Economic Prospects and Policy Challenges for the GCC Countries." Paper presented at Annual Meeting of Ministers of Finance and Central Bank Governors, October 5-6, Saudi Arabia. Washington D.C.: IMF.

IMF (2012b). Trinidad and Tobago: Selected issues, IMF Country Report No. 12/128. Washington, D.C.: IMF.

IMF (2013). World Economic Outlook April 2013, Hopes, Realities, Risks, World Economic and Financial Surveys. Washington, D.C.: IMF

Ivarsson, I. and C.G. Alvstam (2009). "Local Technology Linkages and Supplier Upgrading in Global Value Chains: The Case of Swedish Engineering TNCs in Emerging Markets", Competition and Change, 13: 368–388.

Ivarsson, I. and C.G. Alvstam (2010). "Supplier Upgrading in the Home-furnishing Value Chain: An Empirical Study of IKEA's Sourcing in China and South East Asia", World Development, 38:1575-87.

ISCID (2004). "Possible Improvements of the Framework for ICSID Arbitration", ISCID Discussion paper. Washington D.C.: ISCID.

Japan, Ministry of International Trade and Industry (2003). Dai 34-kai Wagakuni Kigyo no Kaigai Jigyo Katsudo. Tokyo: Ministry of Finance Printing Bureau.

Japan, Ministry of Economy, Trade and Industry (2013). Dai 42-kai Wagakuni Kigyo no Kaigai Jigyo Katsudo. Tokyo: Ministry of Finance Printing Bureau.

Jenkins, B., A. Akhalkatsi, B. Roberts and A. Gardiner (2007). Business Linkages: Lessons, Opportunities, and Challenges. Washington D.C.: IFC, International Business Leaders Forum and the Kennedy School of Government, Harvard University.

Johnson, R.C. and G. Noguera (2012). "Accounting for intermediates: Production

sharing and trade in value-added", Journal of International Economics, 86(2), 224–236.

Kaplinsky, R., M. Morris and J. Readman (2002). "The Globalization of Product Markets and Immiserizing Growth: Lessons From the South African Furniture Industry", World Development, 30: 1159–1177.

Kaplinsky, R. (2010). The Role Of Standards in Global Value Chains. Washington, D.C. : World Bank.

Kaplinsky, R., A. Terheggen and J. Tijaja (2011). "China as a Final Market: The Gabon Timber and Thai Cassava Value Chains", World Development, 39: 1177–1190.

Kelegama, S. (2009). "Ready-made garment exports from Sri Lanka." Journal of Contemporary Asia, 39(4): 579–596.

Koopman, R., W. Powers, Z. Wang and S.-J. Wei (2011). "Give credit to where credit is due: tracing value added in global production chains", NBER Working Paper, No. 16426. Cambridge, MA: NBER.

Kuznetsov, A. (2012). "Inward FDI in Russia and its policy context, 2012", Columbia FDI Profiles, Vale Columbia Center on Sustainable International Investment.

Lall, S. (2000). "The Technological Structure of Performance of Developing Country Manufactured Exports, 1985-1998", QEH Working Paper Series, No.44.

Lall, S. (2002). "Implications of cross-border mergers and acquisitions by TNCs in developing countries: a beginner's guide", QEH Working Paper Number, No. 88. Oxford: University of Oxford.

Limão, N. and A.J Venables (2001). "Infrastructure, geographical disadvantage, transport costs, and trade", World Bank Economic Review,15(3): 451-479.

Madina, A., A. Bulic and G. Muchaidze (2011). Turkish Automotive Cluster. Cambridge, MA: Harvard Business School.

Mayer, F. and W. Milberg (2013). "Aid for Trade in a world of global value chains: chain power, the distribution of rents, and implications for the form of aid", Duke Sanford School of Public Policy Working Paper. Durham: Duke University.

Mayer, T. and G.I.P. Ottaviano (2007). "The happy few: the internationalisation of european firms. new facts based on firm-level evidence", Bruegel Blueprint Series, Volume 3.

Mckinsey (2012). "The rise of the African consumer". A report from McKinsey's Africa Consumer Insights Center.

Meyer, K.E. and E. Sinani (2009). "When and where does foreign direct investment generate positive spillovers? A meta-analysis". Journal of International Business Studies, 40(7): 1075–1094.

MIDA (2012). "Malaysia: The Global Outsourcing Hub for High Technology Manufacturing", presentation to MIDA Seminar and Networking Session (B2B), Kuala Lumpur, 19–20 June.

Milberg, W., G. Gereffi and X. Jiang (2013, forthcoming). "Industrial policy in the era of vertically specialized industrialization" in Industrial Policy for Economic Development: Lessons from Country Experiences. Geneva: UNCTAD-ILO.

Milberg, W. and D. Winkler (2013). Outsourcing Economics: Global Value Chains in Capitalist Development. New York: Cambridge University Press.

Ministerio de Energia y Minas de Perú (2012). Boletin Estadistico de Mineria, October. Lima: Ministerio de Energia y Minas de Perú.

Moreno-Brid, J., J. Santamaria and J.C.R. Valdivia (2006). "Mexico: economic growth, exports and industrial performance after NAFTA." Serie Estudios y Perspectivas, Economic Development Unit. Mexico: CEPAL.

Morris, M., D. Kaplin and R. Kaplinsky (2012). ""One thing leads to another" – Commodities, linkages and industrial development", Resources Policy, 37: 408–416.

Morris, M. and N. Dunne (2004). "Driving environmental certification: its impact on the furniture and timber products value chain in South Africa", Geoforum, 35: 251-266.

Murphy, J.T. (2007). "The Challenge of Upgrading in African Industries: Socio-Spatial Factors and the Urban Environment in Mwanza, Tanzania", World Development, 35(10): 1754–1778.

Narula, R. and N. Driffield (2012). "Does FDI cause development? The ambiguity of the evidence and why it matters", European Journal of Development Research, 24: 1–7.

Navas-Alemán, L. (2011). "The impact of operating in multiple value chains for upgrading: the case of the brazilian furniture and footwear industries", World Development, 39: 1386-1397.

Nadvi, K. (2004). "Globalization and poverty: How can global value chain research inform the policy debate?", IDS Bulletin, 35: 20-30.

Ocampo, J.L. (2012). "The Development Implications of External Integration in Latin America", WIDER Working Paper, Volume 2012/48. Helsinki: UNU-WIDER.

OECD (2012). "Government perspectives on investor-state dispute settlement: a progress report". Paper presented at Freedom of Investment Roundtable, 14 December. Paris: OECD.

Olivet, C. and P. Eberhardt (2012). Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom. Brussels and Amsterdam: Corporate Europe Observatory and Transnational Institute.

Ottaviano, G. and T. Mayer (2007). "Happy few: the internationalisation of European fi rms. New facts based on fi rm-level evidence". Open Access publications from Sciences Po, hdl: 2441/10147, Sciences Po.

Pavlínek, P. (2007). "Regional restructuring of the Skoda auto supplier network in Czech Republic", European Urban and Regional Studies, 14: 133–155.

Pavlínek, P. (2012). "The internationalization of corporate R&D and the automotive industry R&D of East-Central Europe", Economic Geography, 88: 279–310.

Perez, D. (2013). "Supply chain strategies: Which one hits the mark?", Supply Chain Quarterly, Quarter 1.

Pickles, J. (2012). "Economic and social upgrading in apparel global value chains: Public governance and trade policy", Capturing the Gains Working Paper, No 13.

Pietrobelli, C. and R. Rabellotti (2011). "Global Value Chains Meet Innovation Systems: Are There Learning Opportunities for Developing Countries?", World Development, 39: 1261–1269.

Raghu, M.R. (2012). "GCC demographic shift, Intergenerational risk-transfer at play". Kuwait Financial Center "Markaz" Research, June.

Read, R. and N. Driffield (2004). "Foreign Direct Investment and the Creation of Local Linkages in Pacific Island Economies". Paper presented at Islands of the World VIII International Conference, Taipei, 1–7 November.

Rossi, A. (2011). Economic and social upgrading in global production networks: the case of the garment industry in Morocco. Doctoral thesis, University of Sussex.

Rugraff, E. (2010). "Foreign direct investment and supplier-oriented upgrading in the Czech motor vehicle industry", Regional Studies, 44: 627–638.

Saliola, F. and A. Zanfei (2009). "Multinational firms, global value chains and the organization of knowledge transfer", Research Policy, 38: 369.

Santiso, J. (ed.) (2012) Sovereign Wealth Funds 2012. Barcelona: ESEAD.

Sauvant, K.P., L.E. Sachs and P.F.S.J Wouter (eds.) (2012). Sovereign Investment: Concerns and Policy Reactions. Oxford: Oxford University Press.

Schreuer, C. (2008). "Preliminary rulings in investment arbitration", in Karl Sauvant (ed.), Appeals Mechanism in International Investment Disputes, Oxford: Oxford University Press.

Seville, D., A. Buxton and B. Vorley (2011). Under what conditions are value chains effective tools for pro-poor development?, London: International Institute for Environment and Development.

Sinnott, E., A. de la Torre and J. Nash (2010). "Natural Resources in Latin America and the Caribbean, Beyond boom and busts?", World Bank Latin American and Caribbean Studies. Washington, D.C.: World Bank.

Staritz, C. (2011). Making the Cut? Low-Income Countries and the Global Clothing Value Chain in a Post-Quota and Post-Crisis World. Washington, D.C.: World Bank.

Staritz, C. and J.G. Reis (eds.) (2013). Global Value Chains, Economic Upgrading, and Gender. Case Studies of the horticulture, Tourism and Call Center Industries. Washington, D.C.: World Bank.

Stein, P., T. Goland and R. Schiff (2010). „Two trillion and counting: Assessing the credit gap for micro, small, and medium-size enterprises in the developing world", McKinsey & Company and International Finance Corporation.

Sturgeon, T. and J.-R. Lee (2004). "Industry Co-Evolution: A Comparison of Taiwan and North America's Electronics Contract Manufacturers", ITEC Research Paper Series, No 04-03. Kyoto: Doshisha University.

Sturgeon, T. and O. Memedovic (2011). Mapping Global Value Chains: Intermediate Goods Trade and Structural Change in the World Economy. Vienna: UNIDO.

Suzuki, A., L. Jarvis and R. Sexton (2011). "Partial Vertical Integration, Risk Shifting, and Product Rejection in the High-Value Export Supply Chain: The Ghana Pineapple Sector", World Development, 39:1611–1123.

Tams, C. (2006)."An appealing option? A debate about an ICSID appellate structure", Essays in Transnational Economic Law, No.57.

Tejani, S. and W. Milberg (2010). Global defeminization? Industrial Upgrading, Occupational Segmentation And Manufacturing Employment in Middle-Income Countries. New York: Schwartz Centre for Economic Policy Analysis.

Tejani, S. (2011). "The gender dimension of special economic zones", in Special Economic Zones: Progress, Emerging Challenges, and Future Directions. Washington D.C: World Bank.

UNCTAD (1993) – WIR93. World Investment Report 1993: Transnational corporations and integrated international production. New York and Geneva: United Nations.

UNCTAD (1998) – WIR98. World Investment Report 1998: Trends and Determinants, New York and Geneva: United Nations.

UNCTAD (1999). Transfer Pricing: UNCTAD Series on Issues in International Investment Agreements, Geneva and New York: United Nations.

UNCTAD (2000) – WIR00. World Investment Report 2000: Cross-border Mergers and Acquisitions and Development. New York and Geneva: United Nations.

UNCTAD (2001) – WIR01. World Investment Report 2001: Promoting Linkages, New York and Geneva: United Nations.

UNCTAD (2003). FDI in Landlocked Developing Countries at a Glance. New York and Geneva: United Nations.

UNCTAD (2007) – WIR07. World Investment Report 2007: Transnational Corporations, Extractive Industries and Development, New York and Geneva: United Nations.

UNCTAD (2008) – WIR08. World Investment Report 2008: Transnational Corporations and the Infrastructure Challenge. New York and Geneva: United Nations.

UNCTAD (2009a). Investment Guide to the Silk Road. New York and Geneva: United Nations.

UNCTAD (2009b): Non-Tariff Measures: Evidence From Selected Developing Countries and Future Research Agenda. New York and Geneva: United Nations.

UNCTAD (2010a). Integrating Developing Countries' SMEs into Global Value Chains, New York and Geneva: United Nations.

UNCTAD (2010b). "Investor-State Disputes: Prevention and Alternatives to Arbitration" Series on International Investment Policies for Development. New York and Geneva: United Nations.

UNCTAD (2010c) – WIR10. World Investment Report 2010: Investing in a Low-Carbon Economy. New York and Geneva: United Nations

UNCTAD (2011a). "How to Prevent and Manage Investor-State Disputes: Lessons from Peru", Best Practices in Investment for Development Series. New York and Geneva: United Nations.

UNCTAD (2011b). "Interpretation of IIAs: What States Can Do", IIA Issues Note, No.3, New York and Geneva: United Nations.

UNCTAD (2011c). "Promoting standards for responsible investment in value chains": Item 1. Report to the High-Level Development Working Group, September. New York and Geneva: United Nations.

UNCTAD (2011d) – WIR11. World Investment Report 2011: Non-Equity Modes of International Production and Development. New York and Geneva: United Nations.

UNCTAD (2011e). Information Economy Report: ICTs as an Enabler for Private Sector Development. New York and Geneva: United Nations.

UNCTAD (2012a). Investment Policy Framework for Sustainable Development: towards a new generation of investment policies. Geneva and New York: United Nations.

UNCTAD (2012b). "Report of the Multi-year Expert Meeting on International Cooperation: South–South Cooperation and Regional Integration on its fourth session (Geneva, 24-25 October 2012)." Geneva: United Nations.

UNCTAD (2012c). "Transparency – A Sequel", Series on Issues in IIAs II. New York and Geneva: United Nations.

UNCTAD (2012d) – WIR12. World Investment Report 2012: Towards a New Generation of Investment Policies. New York and Geneva: United Nations.

UNCTAD (2013a). FDI in Infrastructure, Report prepared as part of the IAWG G20 report on Long-Term Investment Financing for Growth and Development. New York and Geneva: United Nations.

UNCTAD (2013b). Global Value Chains and Development: Investment and Value Added Trade in the Global Economy. New York and Geneva: United Nations.

UNCTAD (2013c). "Latest Developments in Investor–State Dispute Settlement", IIA Issues Note, No. 1, New York and Geneva: United Nations.

UNCTAD (2013d). "The rise of BRICS FDI and Africa", Global Investment Trends Monitor, Special Edition, 25 March. New York and Geneva: United Nations.

UNDESA (2011). World Population Prospects, the 2010 Revision. Available at: http://esa.un.org/unpd/wpp/index.htm.

Van Dijk, M. P. and J. Trienekens (eds.) (2012). Global Value Chains: Linking Local Producers from Developing Countries to International Markets. Amsterdam:Amsterdam University Press.

Van Harten, G. (2008). "A Case for International Investment Court". Paper presented at Inaugural Conference of the Society for International Economic Law, 16 July.

Vermeulen, S. and L. Cotula (2010). Making the Most of Agricultural Investment: A Survey of Business Models that Provide Opportunities for Smallholders. London, Rome, Bern:IIED/FAO/IFAD/SDS.

Waibel, M., C. Balchin, K-H. Chung and A. Kaushal (eds.) (2010). The Backlash against Investment Arbitration: Perceptions and Reality. Alphen aan den Rijn: Kluwer Law International.

White House (2012). National Strategy for Global Supply Chain Security. Washington, D.C.: U.S. Department of Homeland Security.

Whittaker, D.H., T. Okita, T. Sturgeon, M.H. Tsai and T. Zhu (2010). "Compressed development", Studies in Comparative International Development, 45:439-67.

Wijayasiri, J. and J. Dissanayake. (2008). "Case study 3: the ending of the Multi-Fiber Agreement and innovation in Sri Lankan textile and clothing industry", Working Paper, No. 75. Paris: OECD.

World Trade Organization (2010). Time Series on International Trade Report. Geneva: WTO.

Zanfei, A. (2012a). "Effects, not externalities", European Journal of Development Research, 24: 8–14.

Zhao, Y. (2012). "The puzzle of foreign divestments: risks should not be closely observed", China Foreign Exchange, September 2012.

ANNEX TABLES

Table 1. FDI flows, by region and economy, 2007–2012 213

Table 2. FDI stock, by region and economy, 1990, 2000, 2012 217

Table 3. Value of cross-border M&As, by region/economy of seller/purchaser, 2006–2012 221

Table 4. Value of cross-border M&As, by sector/industry, 2006–2012 224

Table 5. Cross-border M&A deals worth over $3 billion completed in 2012 225

Table 6. Value of greenfield FDI projects, by source/destination, 2006–2012 226

Table III.1 Selected aspects of IIAs signed in 2012 229

Table III.2 List of IIAs as of end 2012 230

List of annex tables available on the UNCTAD site, www.unctad.org/wir, and on the CD-ROM

1. FDI inflows, by region and economy, 1990–2012
2. FDI outflows, by region and economy, 1990–2012
3. FDI inward stock, by region and economy, 1990–2012
4. FDI outward stock, by region and economy, 1990–2012
5. FDI inflows as a percentage of gross fixed capital formation, 1990–2012
6. FDI outflows as a percentage of gross fixed capital formation, 1990–2012
7. FDI inward stock as percentage of gross domestic products, by region and economy, 1990–2012
8. FDI outward stock as percentage of gross domestic products, by region and economy, 1990–2012
9. Value of cross-border M&A sales, by region/economy of seller, 1990–2012
10. Value of cross-border M&A purchases, by region/economy of purchaser, 1990–2012
11. Number of cross-border M&A sales, by region/economy of seller, 1990–2012
12. Number of cross-border M&A purchases, by region/economy of purchaser, 1990–2012
13. Value of cross-border M&A sales, by sector/industry, 1990–2012
14. Value of cross-border M&A purchases, by sector/industry, 1990–2012
15. Number of cross-border M&A sales, by sector/industry, 1990–2012
16. Number of cross-border M&A purchases, by sector/industry, 1990–2012
17. Cross-border M&A deals worth over $1 billion completed in 2012
18. Value of greenfield FDI projects, by source, 2003–2012
19. Value of greenfield FDI projects, by destination, 2003–2012
20. Value of greenfield FDI projects, by sector/industry, 2003–2012
21. Number of greenfield FDI projects, by source, 2003–2012
22. Number of greenfield FDI projects, by destination, 2003–2012
23. Number of greenfield FDI projects, by sector/industry, 2003–2012
24. Estimated world inward FDI stock, by sector and industry, 1990 and 2011
25. Estimated world outward FDI stock, by sector and industry, 1990 and 2011
26. Estimated world inward FDI flows, by sector and industry, 1990–1992 and 2009–2011
27. Estimated world outward FDI flows, by sector and industry, 1990–1992 and 2009–2011
28. The world's top 100 non-financial TNCs, ranked by foreign assets, 2012
29. The top 100 non-financial TNCs from developing and transition economies, ranked by foreign assets, 2012

Annex table 1. FDI flows, by region and economy, 2007-2012
(Millions of dollars)

Region/economy	FDI inflows						FDI outflows					
	2007	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011	2012
World	2 002 695	1 816 398	1 216 475	1 408 537	1 651 511	1 350 926	2 272 049	2 005 332	1 149 776	1 504 928	1 678 035	1 390 956
Developed economies	1 319 893	1 026 531	613 436	696 418	820 008	560 718	1 890 420	1 600 707	828 006	1 029 837	1 183 089	909 383
Europe	906 531	571 797	404 791	429 230	472 852	275 580	1 329 455	1 043 564	429 790	598 007	609 201	384 973
European Union	859 118	545 325	359 000	379 444	441 557	258 514	1 257 890	982 036	381 955	497 801	536 499	323 131
Austria	31 154	6 858	9 303	840	11 378	6 315	39 025	29 452	10 006	9 994	24 782	16 648
Belgium	93 429	193 950	60 963	85 676	103 280	- 1 614	80 127	221 023	7 525	43 894	82 492	14 668
Bulgaria	12 389	9 855	3 385	1 525	1 827	1 899	282	765	- 95	230	161	227
Cyprus	2 226	1 414	3 472	766	1 372	849	1 240	2 717	383	679	846	- 1 929
Czech Republic	10 444	6 451	2 927	6 141	2 318	10 592	1 620	4 323	949	1 167	- 327	1 341
Denmark	11 812	1 824	3 917	- 11 540	12 685	2 883	20 574	13 240	6 305	- 107	13 299	7 596
Estonia	2 717	1 731	1 840	1 599	257	1 470	1 747	1 114	1 547	142	- 1 458	886
Finland	12 451	- 1 144	718	7 359	2 668	- 1 806	7 203	9 297	5 681	10 167	4 878	4 533
France	96 221	64 184	24 219	33 627	38 547	25 093	164 310	155 047	107 130	64 575	59 553	37 197
Germany	80 208	8 109	22 460	57 428	48 937	6 565	170 617	72 758	69 643	121 525	52 168	66 926
Greece	2 111	4 499	2 436	330	1 143	2 945	5 246	2 418	2 055	1 558	1 772	- 39
Hungary	3 951	6 325	1 995	2 163	5 757	13 469	3 621	2 234	1 883	1 135	4 693	10 578
Ireland	24 707	- 16 453	25 715	42 804	11 467	29 318	21 146	18 949	26 616	22 348	- 4 290	18 966
Italy	43 849	- 10 835	20 077	9 178	34 324	9 625	96 231	67 000	21 275	32 655	53 629	30 397
Latvia	2 322	1 261	94	380	1 466	988	369	243	- 62	19	62	190
Lithuania	2 015	1 965	- 14	800	1 448	835	597	336	198	- 6	55	402
Luxembourg	- 28 260	16 853	19 946	34 753	22 166	27 878	73 350	14 809	1 522	21 435	9 169	17 273
Malta	762	794	372	980	413	157	7	297	65	87	20	- 89
Netherlands	119 383	4 549	38 610	- 7 366	17 179	- 244	55 606	68 334	34 471	68 332	40 900	- 3 509
Poland	23 561	14 839	12 932	13 876	18 911	3 356	5 405	4 414	4 699	7 226	7 211	- 894
Portugal	3 063	4 665	2 706	2 646	11 150	8 916	5 493	2 741	816	- 7 493	14 905	1 915
Romania	9 921	13 909	4 844	2 940	2 523	2 242	279	274	- 88	- 20	- 33	42
Slovakia	4 017	4 868	- 6	1 770	2 143	2 826	673	550	904	946	490	- 73
Slovenia	1 514	1 947	- 653	359	999	145	1 802	1 468	260	- 211	112	- 94
Spain	64 264	76 993	10 407	39 873	26 816	27 750	137 052	74 717	13 070	37 844	36 578	- 4 869
Sweden	28 846	36 888	10 033	- 64	9 246	13 711	38 841	30 363	25 908	20 178	28 158	33 428
United Kingdom	200 039	89 026	76 301	50 604	51 137	62 351	325 426	183 153	39 287	39 502	106 673	71 415
Other developed Europe	47 414	26 471	45 791	49 785	31 296	17 066	71 564	61 528	47 835	100 206	72 702	61 842
Gibraltar	165[a]	159[a]	172[a]	165[a]	166[a]	168[a]	-	-	-	-	-	-
Iceland	6 825	917	86	246	1 108	511	10 109	- 4 209	2 292	- 2 357	23	- 3 318
Norway	7 988	10 251	16 641	16 824	18 205	12 775	10 436	20 404	19 165	23 274	25 362	20 847
Switzerland	32 435	15 144	28 891	32 550	11 817	3 613	51 020	45 333	26 378	79 290	47 316	44 313
North America	332 772	367 919	166 304	226 991	268 323	212 995	458 145	387 573	306 556	339 122	446 505	382 808
Canada	116 820	61 553	22 700	29 086	41 386	45 375	64 627	79 277	39 601	34 723	49 849	53 939
United States	215 952	306 366	143 604	197 905	226 937	167 620	393 518	308 296	266 955	304 399	396 656	328 869
Other developed countries	80 590	86 815	42 342	40 197	78 833	72 143	102 820	169 571	91 660	92 707	127 383	141 602
Australia	45 535	47 010	26 701	35 242	65 297	56 959	16 857	33 618	16 233	27 271	14 285	16 141
Bermuda	617	172	- 71	249	- 109	128	105	323	11	- 14	- 337	222
Israel	8 798	10 875	4 607	5 510	11 081	10 414	8 605	7 210	1 751	8 656	3 309	3 178
Japan	22 550	24 426	11 939	- 1 251	- 1 755	1 731	73 548	128 019	74 699	56 263	107 601	122 551
New Zealand	3 090	4 334	- 834	448	4 320	2 911	3 706	401	- 1 035	530	2 525	- 489
Developing economies	589 430	668 439	530 289	637 063	735 212	702 826	330 033	344 034	273 401	413 220	422 067	426 082
Africa	51 274	58 894	52 964	43 582	47 598	50 041	11 081	10 080	6 281	9 311	5 376	14 296
North Africa	23 936	23 114	18 224	15 709	8 496	11 502	5 560	8 752	2 588	4 847	1 582	3 134
Algeria	1 662	2 593	2 746	2 264	2 571	1 484	295	318	215	220	534	- 41
Egypt	11 578	9 495	6 712	6 386	- 483	2 798	665	1 920	571	1 176	626	211
Libya	3 850	3 180	3 310	1 909	-	-	3 947	5 888	1 165	2 722	131	2 509
Morocco	2 805	2 487	1 952	1 574	2 568	2 836	622	485	470	589	179	361
Sudan	2 426	2 601	1 816	2 064	2 692	2 466[a]	11	98	89	66[a]	84[a]	80
Tunisia	1 616	2 759	1 688	1 513	1 148	1 918	20	42	77	74	28	13
Other Africa	27 337	35 780	34 741	27 873	39 102	38 539	5 522	1 328	3 693	4 464	3 793	11 162
West Africa	9 554	12 479	14 709	11 977	17 705	16 817	1 274	1 704	2 119	1 292	1 472	3 026
Benin	255	170	134	177	161	159	- 6	- 4	31	- 18	60	- 63
Burkina Faso	344	106	101	35	42	40	0	- 0	8	- 4	1	1
Cape Verde	190	209	119	112	93	71	0	0	- 0	0	1	- 1
Côte d' Ivoire	427	446	377	339	286	478	-	-	- 9	25	15	26
Gambia	76	70	40	37	36	79[a]	-	-	-	-	-	-
Ghana	855	1 220	2 897	2 527	3 248	3 295	-	8	7	-	25	1
Guinea	386	382	141	101	956	744[a]	-	126	-	-	1	3
Guinea-Bissau	19	5	17	33	25	16	- 0	- 1	- 0	6	1	1
Liberia	132	284	218	450	508	1 354	363	382	364	369	372	1 354
Mali	73	180	748	406	556	310	7	1	- 1	7	4	4
Mauritania	139	343	- 3	131	589	1 204[a]	4[a]	4[a]	4[a]	4[a]	4[a]	4
Niger	129	340	791	940	1 066	793	8	24	59	- 60	9	7
Nigeria	6 087	8 249	8 650	6 099	8 915	7 029	875	1 058	1 542	923	824	1 539

/...

Annex table 1. FDI flows, by region and economy, 2007-2012 (continued)
(Millions of dollars)

Region/economy	FDI inflows						FDI outflows					
	2007	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011	2012
Saint Helena	0	-	-	-	-	-	-	-	-	-	-	-
Senegal	297	398	320	266	338	338	25	126	77	2	47	47
Sierra Leone	95	53	110	238	715	740[a]	- 1	- 5	- 0	- 0	-	-
Togo	49	24	49	86	171	166	- 1	- 16	37	37	106	103
Central Africa	5 639	5 022	6 028	9 389	8 120	9 999	81	149	53	590	323	699
Burundi	1	4	0	1	3	1	0	1	-	-	-	-
Cameroon	189	21	740	538	243[a]	507[a]	- 8	- 2	- 69	503	144[a]	193
Central African Republic	57	117	42	62	37	71	-	-	-	-	-	-
Chad	- 322[a]	466[a]	376[a]	313[a]	282[a]	323[a]	-	-	-	-	-	-
Congo	2 275	2 526[a]	1 862[a]	2 211[a]	3 056[a]	2 758[a]	-	-	-	-	-	-
Congo, Democratic Republic of	1 808	1 727	664	2 939	1 687	3 312	14	54	35	7	91	421
Equatorial Guinea	1 243	- 794	1 636	2 734[a]	1 975[a]	2 115[a]	-	-	-	-	-	-
Gabon	269	773[a]	573[a]	499[a]	696[a]	702[a]	59[a]	96[a]	87[a]	81[a]	88[a]	85
Rwanda	82	103	119	42	106	160	13	-	-	-	-	-
São Tomé and Principe	36	79	16	51	35	50[a]	3	0	0	0	0	1
East Africa	4 027	4 358	3 875	4 460	4 555	6 324	112	109	89	132	106	109
Comoros	8	5	14	8	23	17[a]	-	-	-	-	-	-
Djibouti	195	229	100	27	78	100	-	-	-	-	-	-
Eritrea	7[a]	39[a]	91[a]	91[a]	39[a]	74[a]	-	-	-	-	-	-
Ethiopia	222	109	221	288	627	970[a]	-	-	-	-	-	-
Kenya	729	96	115	178	335	259	36	44	46	2	9	16
Madagascar	773	1 169	1 066	808	810	895[a]	-	-	-	-	-	-
Mauritius	339	383	248	430	273	361	58	52	37	129	89	89
Mayotte	-	-	-	-	-	-	-	-	-	-	-	-
Seychelles	239	130	118	160	144	114	18	13	5	6	8	4
Somalia	141[a]	87[a]	108[a]	112[a]	102[a]	107[a]	-	-	-	-	-	-
Uganda	792	729	842	544	894	1 721	-	-	-	- 4	-	-
United Republic of Tanzania	582	1 383	953	1 813	1 229	1 706	-	-	-	-	-	-
Southern Africa	8 117	13 921	10 129	2 047	8 722	5 400	4 055	- 634	1 432	2 449	1 893	7 328
Angola	- 893	1 679	2 205	- 3 227	- 3 024	- 6 898	912	2 570	7	1 340	2 093	2 741
Botswana	495	521	129	- 6	414	293	51	- 91	6	1	- 11	- 10
Lesotho	106	112	100	114	132	172	- 2	- 2	- 2	- 2	- 4	- 37
Malawi	124	195	49	97	129	129	14	19	- 1	42	50	50
Mozambique	427	592	893	1 018	2 663	5 218	- 0	- 0	- 3	1	- 3	- 9
Namibia	733	720	522	793	816	357	3	5	- 3	5	5	- 5
South Africa	5 695	9 006	5 365	1 228	6 004	4 572	2 966	- 3 134	1 151	- 76	- 257	4 369
Swaziland	37	106	66	136	93	90	23	- 8	7	- 1	9	6
Zambia	1 324	939	695	1 729	1 108	1 066	86	-	270	1 095	- 2	177
Zimbabwe	69	52	105	166	387	400	3	8	-	43	14	46
Asia	364 899	396 152	324 688	400 687	436 150	406 770	238 544	235 090	211 525	283 972	310 612	308 159
East and South-East Asia	250 744	245 997	210 332	312 502	342 862	326 140	186 772	175 763	177 127	254 191	271 476	275 000
East Asia	165 104	195 454	162 523	214 604	233 818	214 804	127 132	143 509	137 783	206 777	212 519	214 408
China	83 521	108 312	95 000	114 734	123 985	121 080	26 510	55 910	56 530	68 811	74 654	84 220
Hong Kong, China	62 110	67 035	54 274	82 708	96 125	74 584	67 872	57 099	57 940	98 414	95 885	83 985
Korea, Democratic People's Republic of	67[a]	44[a]	2[a]	38[a]	56[a]	79[a]	-	-	-	-	-	-
Korea, Republic of	8 961	11 195	8 961	10 110	10 247	9 904	21 607	20 289	17 392	28 357	28 999	32 978
Macao, China	2 305	2 591	858	2 831	647	1 500[a]	23	- 83	- 11	- 441	120	150
Mongolia	373	845	624	1 691	4 715	4 452	13	6	54	62	94	44
Taiwan Province of China	7 769	5 432	2 805	2 492	- 1 957	3 205	11 107	10 287	5 877	11 574	12 766	13 031
South-East Asia	85 640	50 543	47 810	97 898	109 044	111 336	59 640	32 255	39 345	47 414	58 957	60 592
Brunei Darussalam	260	330	371	626	1 208	850[a]	- 7	16	9	6	10	8
Cambodia	867	815	539	783	902	1 557	1	20	19	21	29	31
Indonesia	6 928	9 318	4 877	13 771	19 241	19 853	4 675	5 900	2 249	2 664	7 713	5 423
Lao People's Democratic Republic	324	228	190	279	301	294	37[a]	- 75[a]	1[a]	- 1[a]	0[a]	- 21
Malaysia	8 595	7 172	1 453	9 060	12 198	10 074	11 314	14 965	7 784	13 399	15 249	17 115
Myanmar	710	863	973	1 285	2 200	2 243	-	-	-	-	-	-
Philippines	2 916	1 544	1 963	1 298	1 816	2 797	3 536	259	359	616	539	1 845
Singapore	46 972	12 200	24 939	53 623	55 923	56 651	36 897	6 812	24 051	25 341	26 249	23 080
Thailand	11 359	8 455	4 854	9 147	7 779	8 607	3 003	4 057	4 172	4 467	8 217	11 911
Timor-Leste	9	40	50	29	47	42[a]	-	-	-	-	-	-
Viet Nam	6 700	9 579	7 600	8 000	7 430	8 368	184	300	700	900	950	1 200
South Asia	34 545	56 608	42 438	28 726	44 231	33 511	17 709	21 647	16 507	16 383	12 952	9 219
Afghanistan	189	94	76	211	83	94	-	-	-	-	-	-
Bangladesh	666	1 086	700	913	1 136	990[a]	21	9	29	15	13	53
Bhutan	3	7	18	26	10	16[a]	-	-	-	-	-	-
India	25 350	47 139	35 657	21 125	36 190	25 543	17 234	21 147	16 031	15 933	12 456	8 583
Iran, Islamic Republic of	2 005	1 909	3 048	3 648	4 150	4 870	302[a]	380[a]	356[a]	346[a]	360[a]	430

/...

Annex table 1. FDI flows, by region and economy, 2007-2012 (continued)
(Millions of dollars)

Region/economy	FDI inflows 2007	2008	2009	2010	2011	2012	FDI outflows 2007	2008	2009	2010	2011	2012
Maldives	132	181	158	216	256	284	-	-	-	-	-	-
Nepal	6	1	39	87	95	92	-	-	-	-	-	-
Pakistan	5 590	5 438	2 338	2 022	1 327	847	98	49	71	47	62	73
Sri Lanka	603	752	404	478	981	776[a]	55	62	20	43	60	80
West Asia	79 609	93 546	71 919	59 459	49 058	47 119	34 063	37 680	17 890	13 398	26 184	23 941
Bahrain	1 756	1 794	257	156	781	891	1 669	1 620	- 1 791	334	894	922
Iraq	972	1 856	1 598	1 396	2 082	2 549[a]	8	34	72	125	366	549
Jordan	2 622	2 826	2 413	1 651	1 474	1 403	48	13	72	28	31	5
Kuwait	111	- 6	1 114	456	855	1 851	9 778	8 858	8 584	1 530	8 896	7 562
Lebanon	3 376	4 333	4 804	4 280	3 485	3 787[a]	848	987	1 126	487	754	611
Oman	3 332	2 952	1 485	1 243	739	1 514	- 36	585	109	1 498	1 220	1 371
Palestinian Territory	28	52	301	180	214	244	- 8	- 8	- 15	77	- 37	- 2
Qatar	4 700	3 779	8 125	4 670	- 87	327	5 160	3 658	3 215	1 863	6 027	1 840
Saudi Arabia	24 319	39 456	36 458	29 233	16 308	12 182	- 135	3 498	2 177	3 907	3 430	4 402
Syrian Arab Republic	1 242	1 467	2 570	1 469	-	-	2	2	-	-	-	-
Turkey	22 047	19 760	8 663	9 036	16 047	12 419	2 106	2 549	1 553	1 464	2 349	4 073
United Arab Emirates	14 187	13 724	4 003	5 500	7 679	9 602	14 568	15 820	2 723	2 015	2 178	2 536
Yemen	917	1 555	129	189	- 518	349	54[a]	66[a]	66[a]	70[a]	77[a]	71
Latin America and the Caribbean	171 929	210 679	150 150	189 855	249 432	243 861	80 257	97 773	55 512	119 236	105 154	103 045
South and Central America	110 479	128 981	77 908	119 834	159 330	166 136	26 571	39 080	13 845	46 493	41 893	49 072
South America	71 672	93 384	56 719	92 134	129 423	144 402	14 538	35 863	3 920	30 948	27 993	21 533
Argentina	6 473	9 726	4 017	7 848	9 882	12 551	1 504	1 391	712	965	1 488	1 089
Bolivia, Plurinational State of	366	513	423	643	859	1 060	4	5	- 3	- 29	-	-
Brazil	34 585	45 058	25 949	48 506	66 660	65 272	7 067	20 457	- 10 084	11 588	- 1 029	- 2 821
Chile	12 572	15 518	12 887	15 373	22 931	30 323	4 852	9 151	7 233	9 461	20 373	21 090
Colombia	9 049	10 596	7 137	6 758	13 438	15 823	913	2 486	3 348	6 842	8 280	- 248
Ecuador	194	1 057	306	163	639	587	- 7[a]	41[a]	43[a]	143[a]	- 81[a]	17
Falkland Islands (Malvinas)	-	-	-	-	-	-	-	-	-	-	-	-
Guyana	152	168	208	270	215[a]	231[a]	-	-	-	-	-	-
Paraguay	202	209	95	228	215	320[a]	7	8	8	- 4	-	-
Peru	5 491	6 924	6 431	8 455	8 233	12 240	66	736	411	266	113	- 57
Suriname	- 247	- 231	- 93	- 248	70	70	-	-	-	-	- 3	1
Uruguay	1 329	2 106	1 529	2 289	2 505	2 710	89	- 11	16	- 60	- 7	2
Venezuela, Bolivarian Republic of	1 505	1 741	- 2 169	1 849	3 778	3 216	43	1 598	2 236	1 776	- 1 141	2 460
Central America	38 808	35 597	21 188	27 700	29 907	21 733	12 033	3 217	9 925	15 546	13 900	27 540
Belize	150	180	113	100	99	198	7	10	4	3	5	2
Costa Rica	1 896	2 078	1 347	1 466	2 156	2 265	263	6	7	25	58	426
El Salvador	1 551	903	366	117	386	516	- 95	- 80	-	-	-	-
Guatemala	745	754	600	806	1 026	1 207	25	16	26	24	17	39
Honduras	928	1 006	509	969	1 014	1 059	1	- 1	4	- 1	18	6
Mexico	31 380	27 853	16 561	21 372	21 504	12 659	8 256	1 157	8 464	15 045	12 139	25 597
Nicaragua	382	626	434	508	968	810	-	-	-	-	-	-
Panama	1 777	2 196	1 259	2 363	2 755	3 020	3 575[a]	2 108[a]	1 419[a]	451[a]	1 664[a]	1 469
Caribbean	61 450	81 699	72 243	70 021	90 102	77 725	53 686	58 693	41 668	72 742	63 261	53 972
Anguilla	120	101	44	11	38	18	1	2	0	0	0	-
Antigua and Barbuda	341	161	85	101	68	74	2	2	4	5	3	3
Aruba	- 474	15	- 32	158	468	- 140	40	3	1	3	3	3
Bahamas	1 623	1 512	873	1 148	1 533	1 094	459	410	216	149	524	367
Barbados	476	464	247	290	532	356[a]	82	- 6	- 56	- 54	- 29	- 46
British Virgin Islands	31 764[a]	51 722[a]	46 503[a]	49 058[a]	62 725[a]	64 896[a]	43 668[a]	44 118[a]	35 143[a]	58 717[a]	52 233[a]	42 394
Cayman Islands	23 218[a]	19 634[a]	20 426[a]	15 875[a]	19 836[a]	4 234[a]	9 303[a]	13 377[a]	6 311[a]	13 857[a]	9 436[a]	9 938
Curaçao	106	147	55	89	69	94	- 7	- 1	5	15	- 30	- 14
Dominica	48	57	43	25	14	20	7	0	1	1	0	0
Dominican Republic	1 667	2 870	2 165	1 896	2 275	3 610	- 17	- 19	- 32	- 23	- 25	- 27
Grenada	172	141	104	64	45	33	16	6	1	3	3	2
Haiti	75	30	38	150	181	179	-	-	-	-	-	-
Jamaica	867	1 437	541	228	218	362	115	76	61	58	75	17
Montserrat	7	13	3	4	2	3	0	0	0	0	0	0
Netherlands Antilles[b]	-	-	-	-	-	-	-	-	-	-	-	-
Saint Kitts and Nevis	141	184	136	119	112	101	6	6	5	3	2	0
Saint Lucia	277	166	152	127	116	113	6	5	6	5	4	3
Saint Vincent and the Grenadines	121	159	111	97	86	126	2	0	1	0	0	0
Sint Maarten	72	86	40	33	- 48	26	4	16	1	3	1	- 2
Trinidad and Tobago	830	2 801	709	549	1 831	2 527	0	700	-	-	1 060	1 332
Oceania	1 329	2 713	2 486	2 939	2 032	2 154	151	1 090	84	701	925	582
Cook Islands	3[a]	-	- 6[a]	-	-	-	103[a]	963[a]	13[a]	540[a]	809[a]	454
Fiji	376	354	142	355	417	268	- 6	- 8	3	6	1	2
French Polynesia	58	14	22	115	123	87[a]	14	30	8	89	28	42
Kiribati	1	3	3	- 7	- 2	- 2[a]	0	1	- 1	- 0	-	-

/...

Annex table 1. FDI flows, by region and economy, 2007-2012 (concluded)
(Millions of dollars)

Region/economy	FDI inflows						FDI outflows					
	2007	2008	2009	2010	2011	2012	2007	2008	2009	2010	2011	2012
Marshall Islands	189[a]	422[a]	555[a]	275[a]	-142[a]	38[a]	7[a]	29[a]	-7[a]	-15[a]	41[a]	13
Micronesia, Federated States of	17[a]	-5[a]	1[a]	1[a]	1[a]	1[a]	-	-	-	-	-	-
Nauru	3[a]	1[a]	1[a]	-	-	-	-	-	-	-	-	-
New Caledonia	417	1 746	1 182	1 863	1 702	1 588[a]	7	64	58	76	40	58
Niue	-	-	-	-	-	-	4[a]	4[a]	-0[a]	-	-1[a]	-
Palau	4[a]	6[a]	1[a]	7[a]	6[a]	5[a]	-	0[a]	-	-	-	-
Papua New Guinea	96	-30	423	29	-309	29[a]	8	-0	4	0	1	-
Samoa	7	49	10	1	12	22	-	-	1	-	1	9
Solomon Islands	64	95	120	238	146	69	12	4	3	2	4	3
Tonga	29	4	-0	7	19	7[a]	2	2	0	2	1	1
Vanuatu	57	44	32	41	58	38	1	1	1	1	1	1
Transition economies	93 371	121 429	72 750	75 056	96 290	87 382	51 596	60 591	48 369	61 872	72 880	55 491
South-East Europe	13 187	13 257	8 577	4 592	7 202	4 235	1 500	1 955	1 297	205	282	53
Albania	659	974	996	1 051	1 036	957	24	81	36	6	42	23
Bosnia and Herzegovina	1 818	1 025	149	324	380	633	65	39	-95	78	2	36
Croatia	5 041	6 220	3 339	432	1 502	1 251	295	1 421	1 233	-146	30	-99
Serbia	3 439	2 955	1 959	1 329	2 709	352	947	283	52	189	170	54
Montenegro	934	960	1 527	760	558	610	157	108	46	29	17	27
The FYR of Macedonia	693	586	201	212	468	135	-1	-14	11	2	-0	-8
CIS	78 434	106 608	63 514	69 650	88 040	82 281	50 020	58 489	47 090	61 532	72 451	55 174
Armenia	699	935	778	570	525	489	-2	10	53	8	78	16
Azerbaijan	-4 749	14	473	563	1 467	2 005	286	556	326	232	554	1 194
Belarus	1 807	2 188	1 877	1 393	4 002	1 442	15	31	102	51	126	99
Kazakhstan	11 119	14 322	13 243	11 551	13 903	14 022	3 153	1 204	3 159	7 885	4 630	1 582
Kyrgyzstan	208	377	189	438	694	372	-1	-0	-0	0	0	-0
Moldova, Republic of	541	711	145	197	281	159	17	16	7	4	21	20
Russian Federation	56 996	74 783	36 583	43 168	55 084	51 416	45 879	55 663	43 281	52 616	66 851	51 058
Tajikistan	360	376	16	16	11	290[a]	-	-	-	-	-	-
Turkmenistan	856[a]	1 277[a]	4 553[a]	3 631[a]	3 399[a]	3 159[a]	-	-	-	-	-	-
Ukraine	9 891	10 913	4 816	6 495	7 207	7 833	673	1 010	162	736	192	1 206
Uzbekistan	705[a]	711[a]	842[a]	1 628[a]	1 467[a]	1 094[a]	-	-	-	-	-	-
Georgia	1 750	1 564	659	814	1 048	866	76	147	-19	135	147	263
Memorandum												
Least developed countries (LDCs)[c]	15 029	18 834	17 586	18 751	21 443	25 703	1 575	3 405	1 095	2 999	3 038	5 030
Landlocked developing countries (LLDCs)[d]	15 427	25 284	26 287	26 836	34 369	34 592	3 715	1 667	3 962	9 279	5 447	3 071
Small island developing states (SIDS)[e]	6 691	9 051	5 011	4 699	5 636	6 217	799	1 293	287	301	1 789	1 799

Source: UNCTAD, FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics).

[a] Estimates.

[b] This economy dissolved on 10 October 2010.

[c] Least developed countries include: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Yemen and Zambia.

[d] Landlocked developing countries include: Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Lesotho, The FYR of Macedonia, Malawi, Mali, Republic of Moldova, Mongolia, Nepal, Niger, Paraguay, Rwanda, South Sudan, Swaziland, Republic of Tajikistan, Turkmenistan, Uganda, Uzbekistan, Zambia and Zimbabwe.

[e] Small island developing countries include: Antigua and Barbuda, Bahamas, Barbados, Cape Verde, Comoros, Dominica, Fiji, Grenada, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Principe, Seychelles, Solomon Islands, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu and Vanuatu.

Annex table 2. FDI stock, by region and economy, 1990, 2000, 2012
(Millions of dollars)

Region/economy	FDI inward stock			FDI outward stock		
	1990	2000	2012	1990	2000	2012
World	2 078 267	7 511 311	22 812 680	2 091 496	8 025 834	23 592 739
Developed economies	1 563 939	5 679 001	14 220 303	1 946 832	7 099 240	18 672 623
Europe	808 866	2 468 223	8 676 610	885 707	3 775 476	11 192 494
European Union	761 821	2 350 014	7 805 297	808 660	3 508 626	9 836 857
Austria	10 972	31 165	158 109[a]	4 747	24 821	215 364[a]
Belgium	-	-	1 010 967	-	-	1 037 782
Belgium and Luxembourg	58 388	195 219	-	40 636	179 773	-
Bulgaria	112	2 704	49 871	124	67	1 867
Cyprus	..[a,b]	2 846[a]	20 962	8	557[a]	7 120
Czech Republic	1 363	21 644	136 442	0	738	15 176
Denmark	9 192	73 574	147 672[a]	7 342	73 100	229 470[a]
Estonia	-	2 645	18 826	-	259	5 791
Finland	5 132	24 273	89 992	11 227	52 109	142 313
France	97 814	390 953	1 094 961	112 441	925 925	1 496 795
Germany	111 231	271 613	716 344[a]	151 581	541 866	1 547 185[a]
Greece	5 681	14 113	37 801	2 882	6 094	43 728
Hungary	570	22 870	103 557	159	1 280	34 741
Ireland	37 989	127 089	298 088	14 942	27 925	357 626
Italy	59 998	122 533	356 887	60 184	169 957	565 085
Latvia	-	2 084	13 254	-	23	1 104
Lithuania	-	2 334	15 796	-	29	2 521
Luxembourg	-	-	121 621	-	-	171 468
Malta	465	2 263	15 811[a]	0	193	1 526[a]
Netherlands	68 701	243 733	572 986	105 088	305 461	975 552
Poland	109	34 227	230 604	95	1 018	57 525
Portugal	10 571	32 043	117 161	900	19 794	71 261
Romania	0	6 953	74 171	66	136	1 417
Slovakia	282	6 970	55 816	0	555	4 413
Slovenia	1 643	2 893	15 526	560	768	7 796
Spain	65 916	156 348	634 539	15 652	129 194	627 212
Sweden	12 636	93 791	376 181	50 720	123 618	406 851
United Kingdom	203 905	463 134	1 321 352	229 307	923 367	1 808 167
Other developed Europe	47 045	118 209	871 313	77 047	266 850	1 355 637
Gibraltar	263[a]	642[a]	2 236[a]	-	-	-
Iceland	147	497	12 378	75	663	10 178
Norway	12 391	30 265	191 103[a]	10 884	34 026	216 083[a]
Switzerland	34 245	86 804	665 596	66 087	232 161	1 129 376
North America	652 444	2 995 951	4 568 948	816 569	2 931 653	5 906 169
Canada	112 843	212 716	636 972	84 807	237 639	715 053
United States	539 601	2 783 235	3 931 976	731 762	2 694 014	5 191 116
Other developed countries	102 629	214 827	974 744	244 556	392 111	1 573 959
Australia	80 364	118 858	610 517	37 505	95 979	424 450
Bermuda	-	265[a]	1 494	-	108[a]	784
Israel	4 476	20 426	75 944	1 188	9 091	74 746
Japan	9 850	50 322	205 361	201 441	278 442	1 054 928
New Zealand	7 938	24 957	81 429	4 422	8 491	19 052
Developing economies	514 319	1 771 481	7 744 523	144 664	905 229	4 459 356
Africa	60 675	153 742	629 632	20 229	43 851	144 735
North Africa	23 962	45 590	227 186	1 836	3 199	30 402
Algeria	1 561[a]	3 379[a]	23 264[a]	183[a]	205[a]	2 133[a]
Egypt	11 043[a]	19 955	75 410	163[a]	655	6 285
Libya	678[a]	471	16 334	1 321[a]	1 903	19 255
Morocco	3 011[a]	8 842[a]	48 176[a]	155[a]	402[a]	2 423[a]
Sudan	55[a]	1 398[a]	30 368[a]	-	-	-
Tunisia	7 615	11 545	33 634	15	33	306
Other Africa	36 712	108 153	402 446	18 393	40 652	114 333
West Africa	14 013	33 010	130 945	2 202	6 376	14 230
Benin	..[a,b]	213	912	2[a]	11	13
Burkina Faso	39[a]	28	431	4[a]	0	9
Cape Verde	4[a]	192[a]	1 298	-	-	- 2
Côte d'Ivoire	975[a]	2 483	7 653	6[a]	9	72
Gambia	157	216	782[a]	-	-	-
Ghana	319[a]	1 554[a]	16 622	-	-	109
Guinea	69[a]	263[a]	3 416[a]	-	7[a]	143[a]
Guinea-Bissau	8[a]	38[a]	102	-	-	6
Liberia	2 732[a]	3 247[a]	7 221	846[a]	2 188[a]	5 699
Mali	229[a]	132	2 786	22[a]	1	26
Mauritania	59[a]	146[a]	4 155[a]	3[a]	4[a]	39[a]
Niger	286[a]	45	4 049	54[a]	1	25
Nigeria	8 539[a]	23 786[a]	76 369	1 219[a]	4 144[a]	7 407

/...

Annex table 2. FDI stock, by region and economy, 1990, 2000, 2012 (continued)
(Millions of dollars)

Region/economy	FDI inward stock			FDI outward stock		
	1990	2000	2012	1990	2000	2012
Senegal	258[a]	295	2 346	47[a]	22	353
Sierra Leone	243[a]	284[a]	1 913[a]	-	-	-
Togo	268[a]	87	892	-	- 10	331
Central Africa	3 808	5 732	54 424	372	681	2 716
Burundi	30[a]	47[a]	9[a]	0[a]	2[a]	1[a]
Cameroon	1 044[a]	1 600[a]	5 238[a]	150[a]	254[a]	1 015[a]
Central African Republic	95[a]	104[a]	619	18[a]	43[a]	43[a]
Chad	250[a]	576[a]	4 200[a]	37[a]	70[a]	70[a]
Congo	575[a]	1 889[a]	21 012[a]	-	-	-
Congo, Democratic Republic of	546[a]	617	4 488	-	34[a]	736[a]
Equatorial Guinea	25[a]	1 060[a]	13 503[a]	0[a]	..[a,b]	3[a]
Gabon	1 208[a]	..[a,b]	4 269[a]	167[a]	280[a]	836[a]
Rwanda	33[a]	55	743	-	-	13[a]
São Tomé and Principe	0[a]	11[a]	344[a]	-	-	-
East Africa	1 701	7 202	41 177	165	387	1 262
Comoros	17[a]	21[a]	100[a]	-	-	-
Djibouti	13[a]	40	1 056	-	-	-
Eritrea	-	337[a]	779[a]	-	-	-
Ethiopia	124[a]	941[a]	5 803[a]	-	-	-
Kenya	668[a]	932[a]	2 876[a]	99[a]	115[a]	316[a]
Madagascar	107[a]	141	5 809[a]	1[a]	10[a]	6[a]
Mauritius	168[a]	683[a]	2 944[a]	1[a]	132[a]	681[a]
Seychelles	213	515	1 859[a]	64	130	259[a]
Somalia	..[a,b]	4[a]	776[a]	-	-	-
Uganda	6[a]	807	8 191	-	-	-
United Republic of Tanzania	388[a]	2 781	10 984	-	-	-
Southern Africa	17 191	62 209	175 900	15 653	33 208	96 125
Angola	1 024[a]	7 978[a]	1 937	1[a]	2[a]	9 877
Botswana	1 309	1 827	1 318	447	517	585
Lesotho	83[a]	330	839[a]	0[a]	2	15[a]
Malawi	228[a]	358	1 167	-	..[b]	72
Mozambique	25	1 249	12 632	2	1	15
Namibia	2 047	1 276	3 491	80	45	47
South Africa	9 207	43 451	138 964[a]	15 004	32 325	82 367[a]
Swaziland	336	536	958	38	87	85[a]
Zambia	2 655[a]	3 966[a]	11 994	-	-	2 706
Zimbabwe	277[a]	1 238[a]	2 601[a]	80[a]	234[a]	356[a]
Asia	340 270	1 108 173	4 779 316	67 010	653 364	3 159 803
East and South-East Asia	302 281	1 009 804	3 812 439	58 504	636 451	2 839 459
East Asia	240 645	752 559	2 492 960	49 032	551 714	2 243 384
China	20 691[a]	193 348	832 882[a]	4 455[a]	27 768[a]	509 001[a]
Hong Kong, China	201 653[a]	491 923	1 422 375	11 920[a]	435 791	1 309 849
Korea, Democratic People's Republic of	572[a]	1 044[a]	1 610[a]	-	-	-
Korea, Republic of	5 186	43 740	147 230	2 301[a]	21 500	196 410
Macao, China	2 809[a]	2 801[a]	16 353[a]	-	-	822[a]
Mongolia	0[a]	182[a]	13 151	-	-	1 210
Taiwan Province of China	9 735[a]	19 521	59 359[a]	30 356[a]	66 655	226 093[a]
South-East Asia	61 636	257 244	1 319 479	9 471	84 736	596 075
Brunei Darussalam	33[a]	3 868	13 302[a]	0[a]	512	699[a]
Cambodia	38[a]	1 580	8 413	0[a]	193	423
Indonesia	8 732[a]	25 060[a]	205 656[a]	86[a]	6 940[a]	11 627[a]
Lao People's Democratic Republic	13[a]	588[a]	2 483[a]	1[a]	20[a]	- 9[a]
Malaysia	10 318	52 747[a]	132 400	753	15 878[a]	120 396
Myanmar	281[a]	3 211	11 910[a]	-	-	-
Philippines	3 268[a]	13 762[a]	31 027[a]	405[a]	1 032[a]	8 953[a]
Singapore	30 468	110 570	682 396[a]	7 808	56 755	401 426[a]
Thailand	8 242	31 118	159 125[a]	418	3 406	52 561[a]
Timor-Leste	-	-	237[a]	-	-	-
Viet Nam	243[a]	14 739[a]	72 530[a]	-	-	-
South Asia	6 795	29 834	306 660	422	2 949	123 715
Afghanistan	12[a]	17[a]	1 569[a]	-	-	-
Bangladesh	477[a]	2 162	7 156[a]	45[a]	69	159[a]
Bhutan	2[a]	4[a]	23[a]	-	-	-
India	1 657[a]	16 339	226 345	124[a]	1 733	118 167
Iran, Islamic Republic of	2 039[a]	2 597[a]	37 313	-	572[a]	3 345[a]
Maldives	25[a]	128[a]	1 655[a]	-	-	-
Nepal	12[a]	72[a]	440[a]	-	-	-
Pakistan	1 892[a]	6 919	25 395	245[a]	489	1 524
Sri Lanka	679[a]	1 596	6 765[a]	8[a]	86	520[a]

/...

Annex table 2. FDI stock, by region and economy, 1990, 2000, 2012 (continued)
(Millions of dollars)

Region/economy	FDI inward stock			FDI outward stock		
	1990	2000	2012	1990	2000	2012
West Asia	31 194	68 535	660 217	8 084	13 964	196 628
Bahrain	552	5 906	16 826	719	1 752	9 699
Iraq	..[a,b]	..[a,b]	12 616[a]	-	-	1 547[a]
Jordan	1 368[a]	3 135	24 775	158[a]	44	509
Kuwait	37[a]	608[a]	12 767	3 662[a]	1 428[a]	24 501
Lebanon	53[a]	14 233	52 885[a]	43[a]	352	8 197[a]
Oman	1 723[a]	2 577[a]	17 240	-	-	5 387
Palestinian Territory	-	647[a]	2 572[a]	-	..[a,b]	191[a]
Qatar	63[a]	1 912	30 804[a]	-	74	20 413[a]
Saudi Arabia	15 193[a]	17 577	199 032[a]	2 328[a]	5 285[a]	34 360[a]
Syrian Arab Republic	154[a]	1 244	9 939[a]	4[a]	107[a]	421[a]
Turkey	11 150[a]	18 812	181 066	1 150[a]	3 668	30 471
United Arab Emirates	751[a]	1 069[a]	95 008	14[a]	1 938[a]	60 274
Yemen	180[a]	843	4 688[a]	5[a]	12[a]	660[a]
Latin America and the Caribbean	111 373	507 346	2 310 630	57 357	207 747	1 150 092
South and Central America	103 311	428 931	1 687 384	55 726	117 626	598 149
South America	74 815	308 951	1 290 092	49 346	96 045	420 453
Argentina	9 085[a]	67 601	110 704	6 057[a]	21 141	32 914
Bolivia, Plurinational State of	1 026	5 188	8 809	7[a]	29	8[a]
Brazil	37 143	122 250	702 208	41 044[a]	51 946	232 848
Chile	16 107[a]	45 753	206 594	154[a]	11 154	97 141
Colombia	3 500	11 157	111 924	402	2 989	31 633
Ecuador	1 626	6 337	13 079	18[a]	251[a]	480[a]
Falkland Islands (Malvinas)	0[a]	58[a]	75[a]	-	-	-
Guyana	45[a]	756[a]	2 335[a]	-	1[a]	2[a]
Paraguay	418[a]	1 221	3 936	134[a]	214	238
Peru	1 330	11 062	63 448	122	505	3 986
Uruguay	671[a]	2 088	17 900[a]	186[a]	138	334[a]
Venezuela, Bolivarian Republic of	3 865	35 480	49 079	1 221	7 676	20 870
Central America	28 496	119 980	397 292	6 381	21 580	177 696
Belize	89[a]	301	1 660	20[a]	43	170
Costa Rica	1 324[a]	2 709	18 713	44[a]	86	1 570
El Salvador	212	1 973	8 635	56[a]	104	6
Guatemala	1 734	3 420	8 914	0	93	438
Honduras	293	1 392	9 024	-	-	81
Mexico	22 424	101 996	314 968[a]	2 672[a]	8 273	137 684[a]
Nicaragua	145[a]	1 414	6 476	-	-	-
Panama	2 275[a]	6 775[a]	28 903[a]	3 588[a]	12 981[a]	37 747[a]
Caribbean	8 062	78 415	623 245	1 630	90 121	551 943
Anguilla	11[a]	231[a]	1 024[a]	-	5[a]	31[a]
Antigua and Barbuda	290[a]	619[a]	2 514[a]	-	5[a]	98[a]
Aruba	145[a]	1 161	4 124	-	675	685
Bahamas	586[a]	3 278[a]	16 065[a]	-	452[a]	3 428[a]
Barbados	171	308	4 100[a]	23	41	886[a]
British Virgin Islands	126[a]	32 093[a]	362 891[a]	875[a]	67 132[a]	433 588[a]
Cayman Islands	1 749[a]	25 585[a]	164 699[a]	648[a]	20 788[a]	108 030[a]
Curaçao	-	-	690	-	-	75
Dominica	66[a]	275[a]	644[a]	-	3[a]	33[a]
Dominican Republic	572	1 673	24 728[a]	-	-	-
Grenada	70[a]	348[a]	1 351[a]	-	2[a]	50[a]
Haiti	149[a]	95	963	0[a]	2[a]	2[a]
Jamaica	790[a]	3 317[a]	11 581	42[a]	709[a]	397
Montserrat	40[a]	83[a]	131[a]	-	0[a]	1[a]
Netherlands Antilles[c]	408[a]	277	-	21[a]	6	-
Saint Kitts and Nevis	160[a]	487[a]	1 810[a]	-	3[a]	53[a]
Saint Lucia	316[a]	807[a]	2 391[a]	-	4[a]	60[a]
Saint Vincent and the Grenadines	48[a]	499[a]	1 526[a]	-	0[a]	5[a]
Sint Maarten	-	-	234[a]	-	-	7[a]
Trinidad and Tobago	2 365[a]	7 280[a]	21 782[a]	21[a]	293[a]	4 512[a]
Oceania	2 001	2 220	24 945	68	267	4 727
Cook Islands	1[a]	218[a]	2 171[a]	-	..[a,b]	3 293[a]
Fiji	284	356	3 264	25[a]	39	50
French Polynesia	69[a]	139[a]	653[a]	-	-	266[a]
Kiribati	-	-	2[a]	-	-	2[a]
Marshall Islands	1[a]	218[a]	2 171[a]	-	..[a,b]	145[a]
Nauru	..[a,b]	..[a,b]	..[a,b]	18[a]	22[a]	22[a]
New Caledonia	70[a]	67[a]	9 613[a]	-	-	-
Niue	-	6[a]	..[a,b]	-	10[a]	22[a]
Palau	2[a]	4[a]	34[a]	-	-	-

/...

Annex table 2. FDI stock, by region and economy, 1990, 2000, 2012 (concluded)
(Millions of dollars)

Region/economy	FDI inward stock			FDI outward stock		
	1990	2000	2012	1990	2000	2012
Papua New Guinea	1 582	935	4 596[a]	26[a]	210[a]	226[a]
Samoa	9[a]	77	260	-	-	21
Solomon Islands	-	106[a]	1 401	-	-	655
Tonga	1[a]	15[a]	110[a]	-	-	-
Vanuatu	-	61[a]	576	-	-	24
Transition economies	9	60 829	847 854	0	21 366	460 760
South-East Europe	0	5 682	82 785	0	840	7 877
Albania	-	247	4 885[a]	0	-	206[a]
Bosnia and Herzegovina	-	1 083[a]	7 771[a]	-	-	286[a]
Croatia	0	2 796	31 609	0	824	4 506
Serbia	-	1 017[a]	25 451	-	-	2 204
Montenegro	-	-	4 882[a]	-	-	414[a]
The FYR of Macedonia	0	540	4 959	-	16	105
CIS	9	54 375	754 453	0	20 408	451 688
Armenia	9[a]	513	5 063	-	0	169
Azerbaijan	-	3 735	11 118[a]	-	1	7 517[a]
Belarus	0	1 306	14 426	0	24	403
Kazakhstan	-	10 078	106 920	-	16	20 979
Kyrgyzstan	-	432	2 758	-	33	2
Moldova, Republic of	-	449	3 339	-	23	108
Russian Federation	-	32 204	508 890[a]	-	20 141	413 159[a]
Tajikistan	0	136	1 282[a]	-	-	-
Turkmenistan	-	949[a]	19 999[a]	-	-	-
Ukraine	0	3 875	72 804	0	170	9 351
Uzbekistan	-	698[a]	7 855[a]	-	-	-
Georgia	0	771	10 615	-	118	1 195
Memorandum						
Least developed countries (LDCs)[d]	11 051	36 631	185 463	1 089	2 678	22 138
Landlocked developing countries (LLDCs)[e]	7 471	35 792	239 409	844	1 305	34 334
Small island developing states (SIDS)[f]	7 136	20 511	84 597	220	2 033	11 606

Source: UNCTAD, FDI-TNC-GVC Information System, FDI database (www.unctad.org/fdistatistics)..

[a] Estimates.

[b] Negative stock value. However, this value is included in the regional and global total.

[c] This economy dissolved on 10 October 2010.

[d] Least developed countries include: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, Sao Tome and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, United Republic of Tanzania, Vanuatu, Yemen and Zambia.

[e] Landlocked developing countries include: Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Lesotho, The FYR of Macedonia, Malawi, Mali, Republic of Moldova, Mongolia, Nepal, Niger, Paraguay, Rwanda, South Sudan, Swaziland, Republic of Tajikistan, Turkmenistan, Uganda, Uzbekistan, Zambia and Zimbabwe.

[f] Small island developing countries include: Antigua and Barbuda, Bahamas, Barbados, Cape Verde, Comoros, Dominica, Fiji, Grenada, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Principe, Seychelles, Solomon Islands, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu and Vanuatu.

Annex table 3. Value of cross-border M&As, by region/economy of seller/purchaser, 2006–2012
(Millions of dollars)

Region / economy	Net sales[a]							Net purchases[b]						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
World	625 320	1 022 725	706 543	249 732	344 029	555 173	308 055	625 320	1 022 725	706 543	249 732	344 029	555 173	308 055
Developed economies	527 152	891 896	581 394	203 530	257 152	433 839	260 282	497 324	841 714	568 041	160 785	223 726	428 075	175 555
Europe	350 740	559 082	273 301	133 871	124 973	213 442	137 930	300 382	568 988	358 981	102 709	41 943	168 379	24 917
European Union	333 337	527 718	251 169	116 226	115 974	185 299	122 309	260 680	537 890	306 734	89 694	25 960	137 124	- 1 470
Austria	1 145	9 661	1 327	1 797	432	7 002	1 687	6 985	4 720	3 049	3 345	1 523	3 702	1 835
Belgium	1 794	961	2 491	12 089	9 444	3 945	1 790	3 640	8 258	30 146	- 9 638	222	8 820	- 1 362
Bulgaria	807	971	227	151	24	- 96	31	-	5	7	2	19	-	-
Cyprus	294	1 343	- 909	52	680	780	51	1 274	775	1 725	1 395	- 39	4 048	5 019
Czech Republic	1 154	107	5 169	2 669	- 457	842	32	812	846	34	1 608	14	26	474
Denmark	11 235	5 761	6 095	1 651	1 448	7 921	3 604	2 078	3 226	2 841	3 198	- 3 427	- 21	674
Estonia	3	- 57	110	28	3	239	58	179	-	4	- 0	4	- 1	1
Finland	1 321	8 313	1 153	508	324	973	1 950	2 169	- 1 128	13 179	653	391	3 355	4 164
France	19 423	28 207	4 590	724	3 837	23 161	11 985	41 030	78 451	56 806	41 565	6 117	33 982	- 5 221
Germany	41 388	44 091	31 911	12 790	8 507	13 386	7 726	16 427	58 795	61 340	24 313	6 848	4 706	15 453
Greece	7 309	723	6 903	477	- 819	1 205	35	5 238	1 495	2 697	386	520	- 148	- 1 561
Hungary	2 337	721	1 559	1 853	213	1 714	96	1 522	1	41	0	799	17	- 7
Ireland	2 731	811	2 892	1 712	2 127	1 934	12 096	10 176	6 677	3 693	- 526	5 101	- 5 649	774
Italy	25 760	23 630	- 2 377	1 109	6 329	15 095	2 156	6 887	55 880	21 358	17 505	- 6 193	3 902	- 1 680
Latvia	11	47	195	109	72	1	1	-	4	3	- 30	40	- 3	-
Lithuania	97	35	98	20	462	386	39	-	30	31	-	4	4	- 3
Luxembourg	35 005	7 339	- 3 570	444	5 446	9 504	6 461	15 539	22 631	8 109	3 382	431	1 119	- 6 321
Malta	517	- 86	-	13	315	-	96	115	-	- 25	-	235	- 16	25
Netherlands	25 560	162 770	- 8 156	17 988	4 113	14 076	17 051	51 304	- 3 268	53 668	- 3 273	20 112	- 4 253	- 2 937
Poland	773	728	966	776	1 063	10 098	815	194	128	432	117	292	511	3 399
Portugal	537	1 715	- 1 279	504	2 208	911	8 334	644	4 023	1 164	1 236	- 8 965	1 642	- 4 741
Romania	5 324	1 926	993	314	148	88	125	-	-	4	7	24	-	-
Slovakia	194	50	136	13	-	0	15	- 142	-	-	-	-	- 18	- 30
Slovenia	15	57	418	-	332	51	330	29	74	320	251	- 50	- 10	-
Spain	7 951	51 686	33 708	32 173	8 669	17 738	5 252	71 481	40 893	- 14 654	- 1 278	1 367	14 644	- 1 280
Sweden	15 228	4 563	18 770	1 098	221	7 626	4 638	3 199	32 390	6 108	9 024	796	- 3 353	794
United Kingdom	125 421	171 646	147 748	25 164	60 833	46 720	35 852	19 900	222 984	54 653	- 3 546	- 227	70 120	- 8 941
Other developed Europe	17 403	31 363	22 132	17 645	8 999	28 143	15 621	39 702	31 099	52 247	13 015	15 983	31 255	26 387
Andorra	1 174	-	-	-	-	-	12	-	-	-	-	-	166	-
Faeroe Islands	-	-	0	-	85	-	-	-	-	-	-	-	-	13
Gibraltar	-	50	212	-	-	-	19	404	116	1	253	8	1 757	23
Guernsey	-	31	17	260	171	25	1 294	1 424	1 144	556	4 001	8 246	- 1 230	1 968
Iceland	39	- 227	-	-	14	-	-	2 171	4 664	737	- 317	- 221	- 446	- 2 547
Isle of Man	-	221	35	66	157	- 217	55	990	720	319	136	850	- 736	- 162
Jersey	254	816	251	414	81	88	133	96	814	- 829	844	1 244	5 197	3 564
Liechtenstein	-	-	-	-	-	-	-	154	270	-	1	-	-	3 753
Monaco	-	437	-	-	-	30	-	- 13	-	-	100	100	16	-
Norway	4 289	7 831	14 997	1 630	7 171	8 574	5 474	9 465	10 641	6 102	611	- 3 940	5 822	3 522
Switzerland	11 647	22 206	6 620	15 275	1 321	19 644	8 635	25 010	12 729	45 362	7 385	9 696	20 708	16 254
North America	165 591	265 866	262 698	51 475	97 914	176 541	95 438	138 576	226 646	114 314	40 477	118 147	174 661	119 359
Canada	37 841	100 888	35 253	11 389	14 917	32 666	29 325	20 848	46 751	44 141	16 718	30 794	38 086	39 474
United States	127 750	164 978	227 445	40 085	82 996	143 876	66 113	117 729	179 895	70 173	23 760	87 353	136 574	79 885
Other developed countries	10 821	66 948	45 395	18 185	34 265	43 855	26 913	58 366	46 080	94 747	17 598	63 636	85 035	31 279
Australia	10 508	44 222	33 530	22 206	26 866	34 603	23 087	31 949	43 439	18 454	- 2 981	15 851	6 395	- 5 102
Bermuda	1 083	1 424	850	820	- 405	121	905	503	- 40 691	4 507	3 248	5 701	2 360	2 734
Israel	8 061	684	1 363	803	1 147	3 663	942	9 747	8 408	11 316	167	5 863	8 525	- 2 132
Japan	- 11 683	16 538	9 251	- 5 771	6 895	4 672	1 282	16 966	30 346	56 379	17 440	31 183	62 692	35 666
New Zealand	2 853	4 081	401	126	- 238	797	697	- 799	4 578	4 092	- 275	5 037	5 063	113
Developing economies	89 163	100 381	104 812	39 077	82 378	88 519	49 342	114 922	144 830	105 849	73 975	98 149	108 296	113 055
Africa	11 181	8 076	21 193	5 140	8 072	8 592	- 1 195	15 913	9 891	8 216	2 702	3 309	4 378	611
North Africa	6 773	2 182	16 283	1 475	1 141	1 353	- 388	5 633	1 401	4 665	1 004	1 471	17	85
Algeria	18	-	82	-	-	-	-	-	- 47	-	-	-	-	-
Egypt	2 976	1 713	15 895	993	195	609	- 705	5 633	1 448	4 613	76	1 092	-	- 16
Libya	1	200	307	145	91	20	-	-	-	51	601	377	-	-
Morocco	133	269	- 125	333	846	274	296	-	-	-	324	-	17	101
Sudan	1 332	-	-	-	-	450	-	-	-	-	-	-	-	-
Tunisia	2 313	-	122	4	9	-	21	-	-	-	3	2	-	-
Other Africa	4 408	5 894	4 910	3 665	6 931	7 240	- 807	10 279	8 490	3 551	1 697	1 838	4 361	525
Angola	1	-	- 475	- 471	1 300	-	-	-	- 60	-	-	-	-	69
Botswana	57	1	-	50	-	6	7	-	-	3	-	-	- 14	10
Burkina Faso	289	-	20	-	-	-	1	-	-	-	-	-	-	-
Cameroon	-	-	1	-	-	0	-	-	-	-	-	-	-	-
Cape Verde	-	-	4	-	-	-	-	-	-	-	-	-	-	-
Congo	20	-	435	-	-	-	7	-	-	-	-	-	-	-
Congo, Democratic Republic of	-	-	-	5	175	-	-	-	- 45	-	-	-	-	19
Côte d'Ivoire	-	-	-	-	-	-	0	-	-	-	-	-	-	-
Equatorial Guinea	-	-	- 2 200	-	-	-	-	-	-	-	-	-	-	-
Eritrea	-	-	-	-	12	- 254	- 54	-	-	-	-	-	-	-
Ethiopia	-	-	-	-	-	146	366	-	-	-	-	-	-	-
Gabon	-	82	-	-	-	-	-	-	- 16	-	-	-	-	-
Ghana	3	122	900	0	-	- 3	-	-	-	-	-	1	-	-
Guinea	2	-	-	-	-	-	-	-	-	-	-	-	-	-
Kenya	2	396	-	-	9	19	86	-	-	18	-	-	- 3	-
Liberia	-	-	-	-	587	-	-	-	-	-	-	-	-	-
Madagascar	1	-	-	-	-	-	-	-	-	-	-	-	-	-
Malawi	-	5	-	0	0	-	-	-	-	-	-	-	-	-

/…

Annex table 3. Value of cross-border M&As, by region/economy of seller/purchaser, 2006–2012 (continued)
(Millions of dollars)

Region / economy	Net sales[a]							Net purchases[b]						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
Mali	1	-	-	-	-	-	-	-	-	-	-	-	-	-
Mauritania	-	375	-	-	-	-	-	-	-	-	-	-	-	-
Mauritius	268	-	26	27	203	6	13	232	89	206	191	- 50	- 173	- 432
Mozambique	34	2	-	-	35	27	3	-	-	-	-	-	-	-
Namibia	181	2	15	59	104	40	15	-	-	-	-	-	-	-
Niger	-	-	-	-	-	-	-	-	-	-	-	-	-	- 185
Nigeria	4 883	490	- 597	- 241	664	539	- 159	-	-	418	-	-	1	40
Rwanda	-	-	6	-	-	-	69	-	-	-	-	-	-	-
Senegal	-	-	-	-	- 457	-	-	-	-	-	-	-	-	-
Seychelles	-	89	49	-	19	-	-	-	0	66	-	5	- 78	189
Sierra Leone	-	31	40	-	13	52	-	-	-	-	-	-	-	-
South Africa	- 1 336	4 301	6 676	4 215	3 934	6 632	- 879	10 046	8 541	2 817	1 491	1 600	4 276	821
Swaziland	-	-	-	-	-	-	-	-	-	-	-	6	-	-
Togo	-	-	-	-	-	-	-	-	-	20	-	-	353	- 5
Uganda	-	-	1	-	-	-	-	-	-	-	-	257	-	-
United Republic of Tanzania	-	-	-	2	60	0	18	-	-	-	-	18	-	-
Zambia	4	-	1	11	272	-	6	-	25	-	16	2	-	-
Zimbabwe	-	0	7	6	-	27	- 305	1	- 44	1	-	-	-	-
Asia	65 250	71 423	68 909	38 291	36 873	59 805	29 483	70 792	94 469	94 398	67 310	79 013	85 203	79 782
East and South-East Asia	34 936	43 451	39 968	28 654	26 417	35 513	22 550	28 696	25 270	58 810	40 176	67 609	72 458	69 357
East Asia	25 456	23 390	17 226	15 741	16 972	14 448	12 171	21 163	- 667	39 888	35 851	53 879	54 272	52 833
China	11 298	9 332	5 375	10 898	6 306	11 839	9 995	12 090	- 2 282	37 941	21 490	29 578	36 554	37 111
Hong Kong, China	9 106	7 102	8 707	3 028	12 182	2 177	2 787	8 003	- 7 980	- 1 048	7 461	14 806	12 952	8 016
Korea, Republic of	- 161	46	1 194	1 956	- 2 012	2 526	- 1 648	1 057	8 646	3 882	6 951	9 949	4 520	5 508
Macao, China	413	133	593	- 57	33	34	30	-	-	0	- 580	52	-	10
Mongolia	2	7	-	344	65	88	82	-	-	106	- 24	-	-	-
Taiwan Province of China	4 798	6 770	1 356	- 429	399	- 2 216	925	14	949	- 993	552	- 506	247	2 189
South-East Asia	9 480	20 061	22 743	12 913	9 445	21 065	10 379	7 533	25 936	18 922	4 325	13 730	18 185	16 523
Brunei Darussalam	0	0	-	3	-	-	-	112	-	-	10	-	-	-
Cambodia	9	6	30	- 336	5	50	- 100	-	-	-	-	-	0	-
Indonesia	388	1 706	2 070	1 332	1 672	6 826	483	- 85	826	913	- 2 590	256	409	315
Lao People's Democratic Republic	-	-	-	-	110	6	-	-	-	-	-	-	-	-
Malaysia	2 509	6 976	2 781	354	3 443	4 570	721	2 664	3 654	9 751	3 277	2 432	4 138	9 292
Myanmar	-	- 1	-	- 0	-	-	-	- 1 010	-	-	-	-	-	-
Philippines	- 134	1 165	2 621	1 291	- 270	2 586	411	190	- 2 514	- 174	- 7	19	479	683
Singapore	2 908	7 426	14 240	9 693	3 941	4 947	8 028	5 566	23 916	6 992	2 762	8 233	8 163	770
Thailand	3 771	2 372	142	346	443	954	- 72	88	54	1 416	872	2 731	4 996	5 460
Viet Nam	29	412	859	230	101	1 126	908	8	-	25	-	59	-	3
South Asia	7 883	5 371	12 654	6 094	5 569	13 181	2 637	6 745	29 096	13 488	291	26 682	6 143	2 651
Bangladesh	330	4	-	9	10	-	-	-	-	-	-	1	-	-
India	4 424	4 405	10 427	6 049	5 550	12 886	2 474	6 715	29 083	13 482	291	26 698	6 137	2 650
Iran, Islamic Republic of	-	-	695	-	-	-	16	-	-	-	-	-	-	-
Maldives	-	-	3	-	-	-	-	-	-	-	-	- 3	-	-
Nepal	- 15	-	13	-	-	4	-	-	-	-	-	-	-	-
Pakistan	3 139	956	1 147	-	- 0	247	-	30	-	-	-	- 13	-	-
Sri Lanka	4	6	370	36	9	44	148	-	12	6	-	-	6	1
West Asia	22 431	22 602	16 287	3 543	4 887	11 111	4 295	35 350	40 103	22 099	26 843	- 15 278	6 603	7 775
Bahrain	- 410	190	178	-	452	30	-	4 275	1 002	4 497	323	- 3 362	- 2 695	527
Iraq	-	-	34	-	-	717	224	-	33	-	-	-	-	- 14
Jordan	750	440	773	108	- 103	181	22	4	45	322	-	- 34	37	- 2
Kuwait	13	3 963	496	- 55	463	16	377	1 345	1 416	2 147	124	- 10 810	2 033	376
Lebanon	5 948	- 153	108	-	642	-	317	716	210	- 233	283	0	836	80
Oman	1	621	10	-	386	-	- 714	5	79	601	893	- 529	222	354
Qatar	-	-	124	298	13	28	92	127	5 160	6 029	10 266	590	- 790	4 614
Saudi Arabia	21	125	102	42	164	653	1 029	5 405	15 780	1 442	121	706	107	201
Syrian Arab Republic	-	-	-	-	41	-	-	-	-	-	-	-	-	-
Turkey	15 340	16 415	13 238	2 849	2 053	8 930	2 690	356	767	1 313	-	- 38	908	2 012
United Arab Emirates	53	856	1 225	300	756	556	216	23 117	15 611	5 983	14 831	- 1 803	5 944	- 373
Yemen	716	144	-	-	20	-	44	-	-	-	-	-	-	-
Latin America and the Caribbean	12 768	20 648	15 452	- 4 358	28 414	20 098	21 070	28 064	40 195	2 466	3 740	15 831	18 750	32 647
South America	4 503	13 697	8 121	- 5 342	17 045	15 578	18 571	19 923	13 152	4 765	3 104	12 900	10 321	23 305
Argentina	344	877	- 3 283	111	3 458	- 268	430	160	569	274	- 77	499	102	2 799
Bolivia, Plurinational State of	- 39	- 77	24	-	- 18	-	1	-	-	-	-	-	-	2
Brazil	2 637	6 539	7 568	- 1 369	8 857	15 119	16 359	18 629	10 785	5 243	2 501	8 465	5 541	7 427
Chile	447	1 480	3 234	829	353	514	- 113	431	466	- 88	55	642	628	9 764
Colombia	1 319	4 303	- 57	- 1 633	- 1 255	- 1 216	1 978	697	1 384	16	211	3 210	5 094	3 007
Ecuador	21	29	0	6	357	167	140	-	-	0	-	-	40	-
Guyana	-	3	1	1	-	3	-	-	-	-	-	-	0	3
Paraguay	-	10	4	- 60	- 1	0	-	-	-	-	-	-	-	-
Peru	53	1 135	293	38	687	512	- 67	6	195	679	416	77	171	319
Suriname	-	-	-	-	-	-	3	-	-	-	-	-	-	-
Uruguay	164	157	8	3	448	747	89	-	-	-	-	7	13	0
Venezuela, Bolivarian Republic of	- 443	- 760	329	- 3 268	4 158	-	- 249	-	- 248	- 1 358	- 2	-	- 1 268	- 16
Central America	2 898	4 889	2 899	153	8 854	1 319	571	3 699	17 452	- 1 053	3 434	2 909	4 736	6 214
Belize	-	-	0	-	1	-	60	4	- 43	-	2	-	-	-
Costa Rica	294	- 34	405	-	5	17	120	97	642	-	-	-	-	354
El Salvador	173	835	-	30	43	103	- 1	370	-	-	-	-	-	12
Guatemala	- 2	5	145	-	650	100	- 216	317	140	-	-	-	-	-
Honduras	-	140	-	-	1	23	-	-	-	-	-	-	-	-

/…

Annex table 3. Value of cross-border M&As, by region/economy of seller/purchaser, 2006–2012 (concluded)
(Millions of dollars)

Region / economy	Net sales[a]							Net purchases[b]						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
Mexico	874	3 717	2 304	104	7 990	1 231	330	2 750	18 226	- 463	3 247	2 892	4 274	5 830
Nicaragua	2	-	-	- 1	-	71	0	-	-	-	-	-	-	-
Panama	1 557	226	44	20	164	- 226	278	160	- 1 512	- 591	185	17	462	18
Caribbean	5 367	2 061	4 432	832	2 516	3 201	1 928	4 442	9 592	- 1 245	- 2 799	22	3 693	3 127
Anguilla	-	-	-	-	-	-	-	- 1	-	30	-	- 10	3	-
Antigua and Barbuda	85	1	-	-	-	-	-	-	-	-	-	-	-	-
Aruba	468	-	-	-	-	-	-	-	-	-	-	-	-	-
Bahamas	3 027	-	41	-	82	212	145	- 411	2 693	537	11	112	- 350	228
Barbados	999	1	207	-	328	-	-	-	3	3	-	-	-	-
British Virgin Islands	19	559	980	242	432	631	9	2 900	5 017	- 1 635	- 1 579	- 774	1 476	2 028
Cayman Islands	49	-	969	-	84	- 112	130	1 563	2 047	2 079	- 1 237	743	1 175	909
Dominican Republic	427	42	-	0	1	39	1 264	-	93	- 25	-	31	-	-
Haiti	-	-	-	1	59	-	-	-	-	-	-	-	-	-
Jamaica	67	595	-	-	-	9	-	158	3	13	28	1	-	-
Netherlands Antilles[c]	10	-	-	2	19	235	276	350	-	-	- 30	- 156	52	- 158
Puerto Rico	216	862	-	587	1 037	1 214	88	- 216	- 261	- 2 454	§	77	202	120
Saint Kitts and Nevis	-	-	-	-	-	-	-	-	-	-	-	- 0	-	-
Trinidad and Tobago	-	-	2 236	-	-	973	16	97	- 2	207	- 10	-	- 15	-
Turks and Caicos Islands	-	-	-	-	-	-	-	0	-	-	-	-	-	-
US Virgin Islands	-	-	-	-	473	-	-	-	-	-	4	-	1 150	-
Oceania	- 36	234	- 742	4	9 019	23	- 15	154	275	770	224	- 4	- 35	15
American Samoa	-	-	-	-	-	-	11	-	-	-	-	-	-	- 29
Cook Islands	-	-	-	-	-	-	-	-	-	-	50	-	-	-
Fiji	-	12	2	-	1	-	-	-	-	-	-	-	-	-
French Polynesia	-	-	-	-	-	-	-	-	-	-	1	-	-	44
Guam	72	-	-	-	-	-	-	-	-	-	-	-	-	-
Marshall Islands	-	45	-	-	-	-	-	-	-	-	0	-	- 35	-
Nauru	-	-	-	-	-	-	-	-	-	-	172	-	-	-
New Caledonia	- 100	-	-	-	-	-	-	-	-	-	-	-	-	-
Norfolk Island	-	-	-	-	-	-	-	90	-	-	-	-	-	0
Papua New Guinea	7	160	- 758	0	9 018	5	- 26	-	275	1 051	-	- 4	-	-
Samoa	- 18	3	13	-	-	-	-	64	-	- 324	-	-	-	-
Solomon Islands	-	14	-	-	-	19	-	-	-	-	-	-	-	-
Tuvalu	-	-	-	-	-	-	-	-	-	43	-	-	-	-
Vanuatu	3	-	-	4	-	-	-	-	-	-	-	-	-	-
Transition economies	9 005	30 448	20 337	7 125	4 499	32 815	- 1 569	2 940	21 729	20 167	7 432	5 693	11 692	8 651
South-East Europe	3 942	2 192	767	529	266	1 460	84	- 2 092	1 039	- 4	- 167	325	51	2
Albania	41	164	3	146	-	-	-	-	-	-	-	-	-	-
Bosnia and Herzegovina	79	1 022	2	8	-	-	1	-	-	-	-	-	-	1
Croatia	2 530	674	204	-	201	92	81	3	-	2	8	325	-	-
Montenegro	7	0	-	362	-	-	-	-	4	-	-	-	-	-
Serbia	582	280	501	10	19	1 340	2	- 1 898	860	- 7	- 174	-	51	1
Serbia and Montenegro	419	-	-	3	-	-	-	-	-	-	-	-	-	-
The FYR of Macedonia	280	53	57	-	46	27	-	-	-	-	-	-	-	-
Yugoslavia (former)	5	-	-	-	-	-	-	- 198	175	-	-	-	-	-
CIS	4 949	28 203	19 466	6 581	4 203	31 356	- 1 654	5 032	20 691	20 171	7 599	5 368	11 453	8 649
Armenia	-	423	204	30	-	26	23	-	-	-	-	-	-	0
Azerbaijan	-	-	2	-	0	-	-	-	-	519	-	-	2	598
Belarus	-	2 500	16	-	649	10	-	-	-	-	-	-	-	-
Kazakhstan	- 1 751	727	- 242	1 322	101	293	- 2 350	1 503	1 833	2 047	-	1 462	8 088	- 32
Kyrgyzstan	-	179	-	-	44	72	- 5	-	-	-	-	-	-	-
Moldova, Republic of	10	24	4	-	-	- 9	-	-	-	-	-	-	-	-
Russian Federation	6 319	22 529	13 507	5 079	3 085	29 550	245	3 507	18 598	16 634	7 599	3 866	3 260	7 807
Tajikistan	-	5	-	-	-	14	-	-	-	-	-	-	-	-
Ukraine	261	1 816	5 933	147	322	1 400	434	23	260	972	-	40	103	276
Uzbekistan	110	-	42	4	1	-	-	-	-	-	-	-	-	-
Georgia	115	53	104	14	30	-	1	-	-	-	-	- 0	188	-
Unspecified	-	-	-	-	-	-	-	10 134	14 452	12 486	7 540	16 461	7 110	10 795
Memorandum														
Least developed countries (LDCs)[d]	2 688	584	- 2 552	- 774	2 201	501	354	- 946	- 80	- 261	16	277	353	- 102
Landlocked developing countries[e]	- 1 052	1 357	144	1 708	621	700	- 2 105	1 504	1 814	2 676	- 8	1 727	8 076	394
Small island developing states (SIDS)[f]	4 438	920	1 824	31	9 650	1 223	148	141	3 061	1 803	393	60	- 651	- 16

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

[a] Net sales by the region/economy of the immediate acquired company.

[b] Net purchases by region/economy of the ultimate acquiring company.

[c] This economy dissolved on 10 October 2010.

[d] Least developed countries include: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, São Tomé and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia.

[e] Landlocked developing countries include: Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, the Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, the Lao People's Democratic Republic, Lesotho, the former Yugoslav Republic of Macedonia, Malawi, Mali, the Republic of Moldova, Mongolia, Nepal, Niger, Paraguay, Rwanda, South Sudan, Swaziland, the Republic of Tajikistan, Turkmenistan, Uganda, Uzbekistan, Zambia and Zimbabwe.

[f] Small island developing countries include: Antigua and Barbuda, the Bahamas, Barbados, Cape Verde, the Comoros, Dominica, Fiji, Grenada, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Principe, Seychelles, Solomon Islands, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu and Vanuatu.

Note: Cross-border M&A sales and purchases are calculated on a net basis as follows: Net cross-border M&A sales in a host economy = Sales of companies in the host economy to foreign TNCs (-) Sales of foreign affiliates in the host economy; net cross-border M&A purchases by a home economy = Purchases of companies abroad by home-based TNCs (-) Sales of foreign affiliates of home-based TNCs. The data cover only those deals that involved an acquisition of an equity stake of more than 10 per cent.

Annex table 4. Value of cross-border M&As, by sector/industry, 2006–2012
(Millions of dollars)

Sector/industry	Net sales[a]							Net purchases[b]						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
Total	625 320	1 022 725	706 543	249 732	344 029	555 173	308 055	625 320	1 022 725	706 543	249 732	344 029	555 173	308 055
Primary	43 093	74 013	90 201	48 092	76 475	136 808	46 691	32 650	95 021	53 131	29 097	61 717	79 429	11 314
Agriculture, hunting, forestry and fisheries	- 152	2 422	2 898	1 033	5 576	1 808	7 886	2 856	887	4 240	1 476	514	- 8	- 1 251
Mining, quarrying and petroleum	43 245	71 591	87 303	47 059	70 899	135 000	38 805	29 794	94 134	48 891	27 622	61 203	79 437	12 564
Manufacturing	212 998	336 584	326 114	76 080	131 843	204 624	136 960	163 847	218 661	244 667	37 632	121 031	225 591	143 166
Food, beverages and tobacco	6 736	49 950	131 855	9 636	37 911	45 452	32 446	3 124	36 280	54 667	- 804	33 964	31 590	35 171
Textiles, clothing and leather	1 799	8 494	2 112	410	976	2 130	3 761	809	- 1 220	- 189	537	3 708	2 691	2 477
Wood and wood products	1 922	5 568	3 166	821	- 248	2 406	4 636	1 660	4 728	- 251	536	8 457	3 685	3 555
Publishing and printing	24 386	5 543	4 658	66	4 977	1 866	8	7 783	843	8 228	- 130	519	3 119	4 164
Coke, petroleum products and nuclear fuel	2 005	2 663	3 086	2 214	2 584	- 704	- 120	5 429	7 691	- 3 244	- 1 096	- 6 967	- 1 930	- 3 770
Chemicals and chemical products	48 035	116 736	73 563	32 559	31 774	76 616	33 822	35 192	89 397	71 293	28 861	43 987	88 908	43 287
Rubber and plastic products	6 577	7 281	1 200	15	5 974	2 341	2 078	5 409	658	- 235	- 197	169	1 369	566
Non-metallic mineral products	6 166	37 800	28 944	118	3 575	1 522	2 323	6 370	16 613	23 053	- 260	4 766	1 332	755
Metals and metal products	46 312	69 740	14 215	- 2 953	2 668	7 082	11 537	47 613	44 241	20 695	1 433	2 777	19 811	9 798
Machinery and equipment	17 664	20 108	15 060	2 431	7 933	14 865	15 091	14 890	- 37 504	7 868	2 635	6 027	14 539	12 447
Electrical and electronic equipment	35 305	24 483	14 151	17 763	13 592	27 392	21 874	27 908	33 644	32 401	1 880	6 096	29 928	18 838
Precision instruments	7 064	- 17 184	23 059	4 105	12 121	11 343	6 701	9 118	19 339	19 176	4 428	10 180	17 098	10 233
Motor vehicles and other transport equipment	7 475	3 099	11 608	8 753	7 437	5 370	2 440	- 2 031	3 795	10 254	- 480	6 808	10 946	4 898
Other manufacturing	1 552	2 305	- 565	141	570	6 945	362	574	158	951	290	539	2 505	746
Services	369 228	612 128	290 228	125 561	135 711	213 741	124 404	428 822	709 043	408 746	183 003	161 282	250 154	153 575
Electricity, gas and water	1 402	103 005	48 969	61 627	- 1 577	26 227	14 102	- 18 197	50 150	25 270	47 613	- 18 352	14 248	337
Construction	9 955	12 994	2 452	10 391	7 034	1 857	861	3 372	10 222	- 5 220	- 1 704	- 1 361	- 1 506	2 597
Trade	11 512	41 307	17 458	3 658	14 042	20 991	14 041	4 241	7 422	19 766	3 360	8 410	6 643	21 629
Hotels and restaurants	14 476	9 438	3 499	1 422	5 367	4 220	1 613	- 164	- 8 357	3 702	673	988	684	- 1 848
Transport, storage and communications	113 915	66 328	34 325	15 912	15 345	34 888	24 390	87 466	45 574	48 088	12 187	14 629	25 179	12 030
Finance	107 951	249 314	73 630	9 535	31 285	38 425	16 174	316 920	548 901	311 409	110 555	126 066	165 490	106 729
Business services	80 978	102 231	100 701	17 167	45 591	56 416	36 464	47 087	50 893	57 088	17 652	27 104	33 066	21 059
Public administration and defense	- 111	29	30	110	63	604	- 97	- 15 477	- 17 058	- 46 337	- 8 202	- 1 293	- 159	- 2 271
Education	- 429	860	1 048	559	1 676	857	524	122	42	155	51	111	386	317
Health and social services	10 624	8 140	2 222	1 123	9 238	3 391	5 388	506	9 493	- 176	40	3 824	656	890
Community, social and personal service activities	17 060	15 625	1 002	3 434	5 566	6 935	11 574	1 798	9 263	- 5 270	87	7 009	1 430	- 47
Other services	1 896	2 856	4 893	624	2 080	18 929	- 630	1 148	2 497	270	692	- 5 853	4 037	- 7 847

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

[a] Net sales in the industry of the acquired company.

[b] Net purchases by the industry of the acquiring company.

Note: Cross-border M&A sales and purchases are calculated on a net basis as follows: Net Cross-border M&As sales by sector/industry = Sales of companies in the industry of the acquired company to foreign TNCs (-) Sales of foreign affiliates in the industry of the acquired company; net cross-border M&A purchases by sector/industry = Purchases of companies abroad by home-based TNCs, in the industry of the acquiring company (-) Sales of foreign affiliates of home-based TNCs, in the industry of the acquiring company. The data cover only those deals that involved an acquisition of an equity stake of more than 10 per cent.

Annex table 5. Cross-border M&A deals worth over $3 billion completed in 2012

Rank	Value ($ billion)	Acquired company	Host economy[a]	Industry of the acquired company	Acquiring company	Home economy[a]	Industry of the acquiring company	Shares acquired
1	12.9	International Power PLC	United Kingdom	Electric services	Electrabel SA	Belgium	Electric services	41
2	11.9	Pfizer Nutrition	United States	Dry, condensed, and evaporated dairy products	Nestle SA	Switzerland	Chocolate and cocoa products	100
3	11.5	Cooper Industries PLC	Ireland	Current-carrying wiring devices	Eaton Corp	United States	Fluid power cylinders and actuators	100
4	8.9	ING Direct USA	United States	Functions related to depository banking, nec	Capital One Financial Corp	United States	National commercial banks	100
5	8.3	Tyco International Ltd	United States	Security systems services	Shareholders	United States	Investors, nec	100
6	6.7	Alliance Boots GmbH	Switzerland	Drug stores and proprietary stores	Walgreen Co	United States	Drug stores and proprietary stores	45
7	6.6	Cequel Communications LLC	United States	Cable and other pay television services	Investor Group	Canada	Investors, nec	100
8	6.1	Viterra Inc	Canada	Crop harvesting, primarily by machine	Glencore International PLC	Switzerland	Metals service centers and offices	100
9	6.0	Actavis Group	Switzerland	Pharmaceutical preparations	Watson Pharmaceuticals Inc	United States	Pharmaceutical preparations	100
10	5.6	Ageas NV	Netherlands	Life insurance	Ageas SA/NV	Belgium	Life insurance	100
11	5.6	BP PLC	United States	Oil and gas field exploration services	Plains Exploration & Production Co	United States	Crude petroleum and natural gas	100
12	5.4	Progress Energy Resources Corp	Canada	Crude petroleum and natural gas	Petronas Carigali Canada Ltd	Canada	Crude petroleum and natural gas	100
13	5.2	De Beers SA	Luxembourg	Miscellaneous nonmetallic minerals, except fuels	Anglo American PLC	United Kingdom	Gold ores	40
14	5.2	OAO "MegaFon"	Russian Federation	Radiotelephone communications	Investor Group	Cyprus	Investors, nec	25
15	5.1	Annington Homes Ltd	United Kingdom	Operators of apartment buildings	Terra Firma Capital Partners Ltd	United Kingdom	Investors, nec	100
16	5.0	NDS Group Ltd	United Kingdom	Prepackaged Software	Cisco Systems Inc	United States	Computer peripheral equipment, nec	100
17	5.0	Exxon Mobil	Japan	Petroleum and petroleum products wholesalers, nec	TonenGeneral Sekiyu KK	Japan	Petroleum refining	99
18	4.9	Tyco Flow Control	United States	Industrial valves	Pentair Inc	United States	Service industry machines, nec	100
19	4.8	Viviti Technologies Ltd	United States	Computer storage devices	Western Digital Corp	United States	Computer storage devices	100
20	4.8	Petrogal Brasil Ltda	Brazil	Crude petroleum and natural gas	Sinopec International Petroleum Exploration & Production Corp	China	Investors, nec	30
21	4.5	Ariba Inc	United States	Prepackaged Software	SAP America Inc	United States	Prepackaged Software	100
22	4.3	Asia Pacific Breweries Ltd	Singapore	Malt beverages	Heineken International BV	Netherlands	Malt beverages	40
23	4.1	Open Grid Europe GmbH	Germany	Natural gas transmission	Investor Group	Canada	Investors, nec	100
24	3.9	Thomas & Betts Corp	United States	Current-carrying wiring devices	ABB Ltd	Switzerland	Switchgear,switchboard equip	100
25	3.9	Denizbank AS	Turkey	Banks	OAO "Sberbank Rossii"	Russian Federation	Banks	100
26	3.8	VimpelCom Ltd	Netherlands	Radiotelephone communications	Altimo Cooperatief UA	Netherlands	Investors, nec	16
27	3.7	Inoxum AG	Germany	Steel works, blast furnaces, and rolling mills	Outokumpu Oyj	Finland	Steel works, blast furnaces, and rolling mills	100
28	3.7	Goodman Global Group Inc	United States	Heating equipment	Daikin Industries Ltd	Japan	Refrigeration and heating equipment	100
29	3.7	Lincare Holdings Inc	United States	Home health care services	Linde AG	Germany	Industrial gases	100
30	3.7	SuccessFactors Inc	United States	Prepackaged Software	SAP America Inc	United States	Prepackaged Software	100
31	3.5	Starbev Management Services	Czech Republic	Malt beverages	Molson Coors Brewing Co	United States	Malt beverages	100
32	3.5	Energias de Portugal SA	Portugal	Electric services	China Three Gorges International (Europe) SA	Luxembourg	Investors, nec	21
33	3.5	Korea Exchange Bank	Korea, Republic of	Banks	Hana Financial Group Inc	Korea, Republic of	Banks	51
34	3.5	RBC Bank	United States	National commercial banks	PNC Financial Services Group Inc	United States	National commercial banks	100
35	3.5	Milton Roy Co	United States	Measuring and dispensing pumps	Hamilton Sundstrand Corp SPV	United Kingdom	Investment offices, nec	100
36	3.4	TAM SA	Brazil	Air transportation, scheduled	LAN Airlines SA	Chile	Air transportation, scheduled	100
37	3.4	Koninklijke KPN NV	Netherlands	Telephone communications, except radiotelephone	AMOV Europa BV	Netherlands	Investment offices, nec	23
38	3.3	Quadra FNX Mining Ltd	Canada	Copper ores	KGHM Polska Miedz SA	Poland	Copper ores	100
39	3.3	Roy Hill Holdings Pty Ltd	Australia	Iron ores	Investor Group	Korea, Republic of	Investors, nec	25
40	3.3	OAO "Telekominvest"	Russian Federation	Radiotelephone communications	AF Telecom Holding	Cyprus	Investors, nec	26
41	3.2	Forsakrings AB Skandia	Sweden	Life insurance	Livforsakrings AB Skandia	Sweden	Life insurance	100
42	3.2	JPLSPE Empreendimentos e Participacoes SA	Brazil	Hospital and medical service plans	UnitedHealth Group Inc	United States	Hospital and medical service plans	86
43	3.2	ING Bank of Canada	Canada	Banks	Bank of Nova Scotia	Canada	Security brokers, dealers, and flotation companies	100
44	3.1	Logica PLC	United Kingdom	Prepackaged Software	CGI Holdings Europe Ltd	United Kingdom	Investors, nec	100
45	3.1	Medicis Pharmaceutical Corp	United States	Pharmaceutical preparations	Valeant Pharmaceuticals International Inc	Canada	Pharmaceutical preparations	100
46	3.0	MGN Gas Networks(UK)Ltd	United Kingdom	Natural gas transmission	Investor Group	Hong Kong, China	Investors, nec	100
47	3.0	Karachaganak Petroleum Operating BV	Kazakhstan	Crude petroleum and natural gas	AO Natsionalnaya Kompaniya "KazMunaiGaz"	Kazakhstan	Crude petroleum and natural gas	10

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

[a] The economy wher ethe immediate acquired/immediate acquiring compnay is located.

Note: As long as the ultimate host economy is different from the ultimate home economy, M&A deals that were undertaken within the same economy are still considered cross-border M&As.

Annex table 6. Value of greenfield FDI projects, by source/destination, 2006–2012
(Millions of dollars)

Partner region/economy	World as destination							World as source						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
	By source							By destination						
World	910 601	943 950	1 582 134	1 041 927	901 152	913 828	612 155	910 601	943 950	1 582 134	1 041 927	901 152	913 828	612 155
Developed countries	658 289	662 006	1 118 178	749 530	641 353	643 354	404 307	331 020	320 810	462 741	318 200	301 090	294 560	225 537
Europe	370 912	430 235	651 104	452 067	387 271	361 926	224 284	227 933	230 679	338 580	200 112	169 504	173 498	129 606
European Union	342 134	390 319	600 407	418 898	355 494	334 108	207 933	224 048	224 928	328 669	194 062	162 855	169 645	126 467
Austria	18 330	14 783	24 293	10 057	9 309	8 307	4 458	2 096	3 144	3 028	1 717	2 289	4 134	1 579
Belgium	3 854	7 332	14 360	8 872	5 736	5 912	3 685	4 936	10 346	10 797	3 796	6 067	3 351	2 635
Bulgaria	84	81	286	30	147	121	81	19 326	7 695	11 422	4 780	4 780	5 300	2 756
Cyprus	368	393	249	856	543	4 379	1 562	390	465	629	249	720	385	204
Czech Republic	1 599	5 158	4 615	1 729	2 298	2 109	2 184	7 644	7 491	5 684	4 575	7 733	4 909	2 706
Denmark	4 575	7 327	14 861	10 172	4 521	8 150	6 629	1 697	2 001	1 968	2 195	457	794	850
Estonia	1 131	2 654	556	188	1 088	352	182	954	840	1 481	1 260	947	883	997
Finland	9 831	13 189	11 071	3 628	4 351	5 878	4 776	1 797	1 269	2 415	1 208	1 698	2 223	1 016
France	50 275	57 531	92 471	65 976	52 028	49 563	27 272	18 436	19 367	24 114	11 367	9 104	10 515	7 017
Germany	74 440	79 114	104 663	75 703	71 923	71 319	49 479	15 509	18 562	36 871	19 976	17 081	17 854	8 477
Greece	2 309	1 700	4 416	1 802	1 300	1 450	1 573	1 706	5 096	5 278	2 090	1 123	2 377	1 553
Hungary	1 067	2 914	4 956	3 389	431	1 245	1 055	8 784	9 550	9 031	3 739	7 541	3 213	2 502
Ireland	9 655	7 728	18 768	14 322	5 743	4 696	5 641	6 575	4 679	8 215	4 932	4 453	6 973	5 022
Italy	16 338	23 086	43 827	29 799	23 628	23 269	21 387	11 710	11 760	14 511	10 501	11 365	5 692	4 013
Latvia	1 001	284	660	761	821	279	75	3 209	717	2 550	828	965	717	1 042
Lithuania	3 387	303	723	305	252	158	640	1 306	1 485	1 518	1 232	1 558	7 285	1 222
Luxembourg	11 847	11 466	14 029	10 837	7 398	9 418	5 699	228	695	431	759	731	290	270
Malta	7	68	212	773	12	566	68	852	299	395	467	300	174	269
Netherlands	34 144	25 810	40 875	32 805	19 565	17 602	9 149	4 942	5 840	9 438	9 459	10 966	5 604	4 026
Poland	1 292	3 052	2 726	1 246	2 238	833	1 408	15 651	22 767	34 074	14 085	11 437	12 490	11 533
Portugal	1 816	4 522	11 159	7 180	5 015	2 120	2 035	4 381	7 198	7 763	4 932	2 665	1 732	1 102
Romania	152	108	4 257	131	708	129	127	19 139	21 942	31 458	15 019	7 764	16 156	9 888
Slovakia	296	474	135	393	1 314	277	356	11 557	5 485	3 350	5 382	4 239	5 664	1 420
Slovenia	1 811	683	1 658	586	536	346	335	657	1 037	612	282	748	692	469
Spain	21 752	32 198	48 452	41 694	40 333	29 352	17 379	21 153	23 529	31 572	15 984	16 371	11 386	11 367
Sweden	12 159	11 875	21 448	15 502	14 925	13 819	5 694	7 037	4 372	2 930	2 827	2 364	3 160	1 354
United Kingdom	58 613	76 486	114 683	80 163	79 329	72 459	35 005	32 377	27 293	67 135	50 423	27 389	35 689	41 177
Other developed Europe	28 778	39 916	50 697	33 169	31 777	27 818	16 351	3 885	5 751	9 911	6 050	6 649	3 853	3 139
Iceland	3 980	1 545	568	123	633	433	39	186	53	1 077	-	705	203	136
Liechtenstein	101	74	110	136	111	133	92	-	131	8	-	9	-	-
Norway	4 437	10 792	12 061	10 619	5 433	6 660	3 404	915	794	3 200	2 334	2 243	830	583
Switzerland	20 256	27 499	37 930	22 227	25 407	20 326	12 700	2 747	4 703	5 391	3 654	3 655	2 698	2 382
North America	173 568	156 166	317 911	203 053	166 591	185 329	121 746	54 160	56 906	79 928	85 957	82 067	99 981	71 190
Canada	15 351	16 651	50 513	30 930	20 006	28 507	18 940	15 507	8 630	15 763	14 084	18 951	27 256	8 422
United States	158 217	139 514	267 398	172 123	146 585	156 822	102 806	38 653	48 277	64 164	71 873	63 116	72 725	62 768
Other developed countries	113 808	75 605	149 164	94 410	87 492	96 098	58 277	48 927	33 225	44 233	32 131	49 519	21 082	24 741
Australia	17 168	17 191	31 952	18 421	12 441	14 486	10 449	39 143	22 814	30 062	19 990	41 246	12 248	16 488
Bermuda	1 166	3 937	3 440	8 108	1 573	1 198	844	23	15	-	1	165	6	14
Greenland	-	214	35	-	-	-	-	-	-	-	-	457	-	-
Israel	10 250	4 347	14 526	2 755	6 655	3 408	2 754	914	457	853	3 333	856	696	1 692
Japan	84 553	49 378	98 600	64 123	65 962	75 922	42 725	7 085	7 768	11 287	8 240	6 407	6 165	5 235
New Zealand	671	537	611	1 004	860	1 085	1 504	1 762	2 171	2 030	568	388	1 967	1 312
Developing economies	232 156	257 314	432 298	273 131	238 178	252 483	197 806	529 356	542 680	994 787	665 340	544 258	559 722	346 088
Africa	7 347	8 664	16 487	15 386	16 689	35 428	7 447	85 564	92 685	223 645	95 274	88 946	82 939	46 985
North Africa	3 799	4 439	7 109	2 396	3 295	746	2 735	50 554	53 701	107 057	41 499	26 542	13 750	15 673
Algeria	30	60	2 522	16	-	130	200	10 020	12 571	21 507	2 380	1 716	1 204	2 370
Egypt	3 534	3 680	3 498	1 828	3 190	76	2 523	11 677	13 480	20 456	20 678	14 161	6 247	10 205
Libya	-	-	-	19	-	-	-	20 992	4 061	23 056	1 689	1 858	49	98
Morocco	81	50	619	393	58	87	12	5 514	5 113	18 925	6 189	4 217	4 354	1 125
South Sudan	-	-	-	-	-	-	-	578	19	1 181	54	139	235	382
Sudan	9	42	-	-	-	432	-	639	-	1 612	2 025	2 440	58	66
Tunisia	144	609	471	140	47	21	-	1 132	18 458	20 321	8 484	2 010	1 602	1 426
Other Africa	3 548	4 225	9 377	12 990	13 394	34 682	4 712	35 011	38 984	116 588	53 774	62 405	69 189	31 312
Angola	-	39	78	15	494	-	362	2 676	8 138	11 204	5 542	1 148	312	3 031
Benin	-	-	-	-	-	-	-	-	-	9	-	14	46	17
Botswana	108	-	-	11	9	138	70	909	344	2 220	349	660	492	148
Burkina Faso	-	-	-	-	-	-	-	-	9	281	272	479	165	1
Burundi	-	-	-	-	-	-	12	-	-	19	47	25	41	19
Cameroon	-	-	-	19	-	-	-	799	2 460	351	1 155	5 289	4 272	566
Cape Verde	-	-	-	-	-	-	-	-	9	128	-	38	62	-
Central African Republic	-	-	-	-	-	-	-	-	361	-	-	-	-	59
Chad	-	-	-	-	-	-	-	-	-	1 819	402	-	135	101
Comoros	-	-	-	-	-	-	-	-	9	9	-	-	7	138
Congo	-	-	-	-	-	-	-	-	198	9	1 281	-	37	119
Congo, Democratic Republic of	-	-	161	-	7	-	-	1 880	1 238	3 294	43	1 238	2 242	517
Côte d' Ivoire	9	-	13	10	19	-	48	359	71	372	131	261	937	1 038
Djibouti	-	-	-	-	-	-	-	521	5	1 555	1 245	1 255	-	25
Equatorial Guinea	-	-	-	-	-	-	-	110	-	6	3 119	9	1 881	2
Eritrea	-	-	3	-	-	-	-	30	-	-	-	-	-	-
Ethiopia	-	-	18	12	-	-	54	1 508	2 389	762	321	290	630	441
Gabon	-	-	-	-	-	9	-	1 727	328	5 118	927	1 231	219	267
Gambia	-	-	-	-	-	-	-	83	9	31	31	405	26	200
Ghana	-	-	-	7	15	51	51	1 240	129	4 918	7 059	2 661	6 431	1 319
Guinea	-	-	-	-	-	-	-	304	-	-	61	1 411	548	33
Guinea-Bissau	-	-	-	-	-	-	-	-	361	-	19	-	-	-

/...

Annex table 6. Value of greenfield FDI projects, by source/destination, 2006–2012 (continued)
(Millions of dollars)

Partner region/economy	World as destination							World as source						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
	By source							By destination						
Kenya	82	198	616	314	3 920	421	835	174	332	549	3 716	1 382	2 855	988
Lesotho	-	-	-	-	-	-	-	-	51	16	28	51	710	10
Liberia	-	-	-	-	-	-	-	-	-	2 600	821	4 591	287	53
Madagascar	27	-	-	-	-	-	-	246	3 335	1 325	365	-	140	363
Malawi	-	-	9	9	-	-	2	-	-	19	713	314	454	24
Mali	-	-	19	10	19	9	-	399	-	172	59	13	0	794
Mauritania	-	-	-	-	-	-	9	579	37	272	-	59	279	361
Mauritius	-	38	307	1 809	2 642	3 287	149	15	481	317	147	71	1 749	142
Mozambique	-	-	-	-	-	-	59	637	2 100	12 100	1 539	3 278	9 971	3 456
Namibia	23	-	23	-	-	-	18	32	473	1 907	1 519	390	832	777
Niger	-	-	-	-	-	-	-	1	-	3 319	-	100	277	-
Nigeria	465	190	2 517	659	1 020	1 046	723	11 074	4 213	36 134	7 978	14 080	4 543	4 142
Reunion	-	-	-	-	-	-	-	13	-	-	-	-	-	-
Rwanda	-	-	-	26	-	-	19	-	283	252	312	1 839	779	110
São Tomé and Principe	-	-	-	-	-	-	-	-	2	351	-	-	-	-
Senegal	-	-	-	-	-	10	8	1 262	3 008	1 281	548	883	69	1 238
Seychelles	-	-	-	-	-	-	-	-	1 425	130	1	121	9	43
Sierra Leone	-	-	-	-	-	-	-	280	-	73	260	230	212	119
Somalia	-	-	-	-	-	-	-	351	-	361	-	59	-	44
South Africa	2 834	3 693	4 841	9 820	5 146	29 469	2 082	5 085	5 247	13 533	7 695	6 819	12 413	4 571
Swaziland	-	-	-	-	-	-	-	-	-	23	12	-	646	7
Togo	-	49	94	142	34	214	19	323	351	146	26	-	-	411
Uganda	-	9	40	28	9	-	-	373	291	3 057	2 147	8 505	2 476	569
United Republic of Tanzania	-	9	9	57	49	27	24	294	317	2 492	623	1 077	3 806	1 137
Zambia	-	-	-	9	-	-	168	1 596	422	3 076	2 375	1 376	2 366	840
Zimbabwe	-	-	629	34	10	-	-	133	557	979	889	754	5 834	3 074
Asia	215 064	235 131	392 100	239 783	199 738	195 931	181 285	377 555	378 625	619 265	447 345	332 917	334 965	232 111
East and South-East Asia	92 053	142 728	168 043	126 896	143 088	115 133	118 476	208 426	264 209	338 093	264 779	212 668	206 049	147 608
East Asia	65 095	95 299	114 596	86 457	106 884	86 154	79 535	143 634	134 634	155 649	135 605	118 130	119 965	93 125
China	17 490	32 765	51 477	26 496	32 892	40 148	19 052	127 284	110 398	130 518	116 828	97 243	100 676	73 833
Hong Kong, China	12 390	19 814	16 986	17 468	8 238	13 036	12 034	5 168	4 742	7 164	9 073	8 217	7 127	7 950
Korea, Democratic People's Republic of	-	-	-	-	-	-	-	236	560	533	228	-	59	-
Korea, Republic of	24 935	25 928	34 753	30 619	37 457	20 846	38 724	7 314	9 108	11 828	4 583	3 601	7 087	6 279
Macao, China	-	-	2	-	-	-	-	126	4 899	909	310	282	430	2 382
Mongolia	-	-	-	-	150	-	-	216	448	330	302	1 608	183	122
Taiwan Province of China	10 280	16 792	11 377	11 875	28 147	12 124	9 726	3 291	4 477	4 367	4 280	7 179	4 403	2 558
South-East Asia	26 958	47 430	53 447	40 438	36 203	28 979	38 941	64 792	129 575	182 444	129 174	94 538	86 083	54 483
Brunei Darussalam	-	-	77	-	-	2	-	-	722	435	470	156	5 969	77
Cambodia	-	-	51	149	-	-	-	1 240	261	3 581	3 895	1 759	2 365	1 625
Indonesia	800	1 824	393	1 043	415	5 037	734	14 351	20 512	41 929	31 271	13 740	24 152	16 764
Lao People's Democratic Republic	-	-	192	-	-	-	-	567	1 371	1 151	2 118	335	980	589
Malaysia	5 806	26 806	19 988	14 904	21 319	4 140	18 422	5 242	10 318	24 057	13 753	15 541	13 694	6 827
Myanmar	-	20	-	-	-	84	-	299	1 378	1 434	1 889	449	712	1 920
Philippines	367	1 541	563	1 410	1 790	324	629	5 322	19 509	15 800	9 719	4 645	2 902	4 263
Singapore	12 125	13 432	21 444	12 985	8 631	13 308	16 537	14 160	24 944	13 995	12 940	16 992	20 554	9 838
Thailand	3 092	3 159	7 936	8 298	3 128	4 443	2 413	5 592	7 427	15 122	7 678	8 641	4 121	6 203
Timor-Leste	-	-	-	-	-	-	-	-	-	-	-	1 000	-	116
Viet Nam	4 768	647	2 804	1 651	920	1 643	205	18 018	43 133	64 942	45 442	31 280	10 634	6 259
South Asia	33 949	31 856	43 644	30 196	21 115	35 627	27 714	84 812	58 632	96 044	77 147	62 919	58 669	39 525
Afghanistan	5	-	-	-	-	8	6	36	6	269	2 978	634	305	245
Bangladesh	56	-	72	37	103	109	144	703	53	860	645	2 720	490	2 361
Bhutan	-	-	-	-	-	-	-	74	-	-	135	83	86	39
India	31 636	25 649	40 792	24 308	20 250	34 655	24 884	76 798	44 445	79 090	57 170	51 977	48 921	30 947
Iran, Islamic Republic of	889	6 137	1 531	5 743	535	515	1 578	1 100	8 217	6 911	9 133	3 034	1 812	-
Maldives	-	-	-	-	-	-	-	1 029	206	462	453	2 162	1 012	329
Nepal	-	-	2	-	6	31	125	110	3	740	295	340	128	-
Pakistan	130	40	1 220	42	153	227	106	4 086	5 049	6 390	3 955	1 255	2 399	4 315
Sri Lanka	1 234	29	27	66	68	82	871	875	652	1 323	2 383	714	3 517	1 290
West Asia	89 061	60 547	180 414	82 691	35 535	45 171	35 095	84 317	55 785	185 128	105 419	57 329	70 248	44 978
Bahrain	21 934	8 995	20 987	14 740	1 070	912	1 145	5 911	820	8 050	2 036	1 997	3 931	3 535
Iraq	-	42	-	20	-	48	-	8 334	474	23 982	12 849	5 486	10 597	976
Jordan	164	244	2 627	1 650	591	52	1 037	4 770	1 250	12 882	2 506	2 824	3 250	1 713
Kuwait	17 519	2 936	16 108	4 585	2 850	4 502	1 331	1 922	373	2 256	987	673	494	1 051
Lebanon	5 493	596	6 706	639	246	301	393	2 060	428	1 292	1 772	1 336	531	201
Oman	-	87	84	3 110	39	165	101	3 209	1 794	10 954	5 608	4 255	8 043	4 970
Palestinian Territory	300	-	-	-	-	-	15	76	52	1 050	16	15	-	-
Qatar	1 682	972	10 072	13 663	2 891	13 044	8 749	5 395	1 368	19 021	21 519	5 434	4 362	2 172
Saudi Arabia	5 717	2 089	13 980	6 105	1 441	5 027	2 389	20 205	14 630	42 318	14 860	10 339	15 766	8 390
Syrian Arab Republic	-	-	326	59	-	193	0	2 535	1 854	6 052	3 379	2 165	1 315	10
Turkey	1 941	2 399	4 464	4 068	4 031	4 975	3 216	14 242	14 655	17 120	23 859	8 917	10 323	9 540
United Arab Emirates	34 312	42 187	105 010	34 053	22 374	15 954	16 711	15 327	17 740	36 218	15 067	12 869	11 623	12 053
Yemen	-	-	49	-	2	-	9	332	347	3 933	961	1 019	11	366
Latin America and the Caribbean	9 128	13 519	23 636	17 942	21 736	20 773	9 074	65 652	67 137	145 581	120 542	120 116	138 531	65 728
South America	7 103	9 906	20 896	14 540	18 692	10 517	6 555	42 334	43 214	97 209	83 909	92 510	104 518	50 010
Argentina	918	625	470	1 118	1 284	905	1 369	4 665	6 402	7 193	9 217	7 112	12 000	6 004
Bolivia, Plurinational State of	-	-	-	-	-	-	-	2 444	1 449	789	1 947	797	305	10
Brazil	3 632	5 772	15 773	10 236	10 413	4 613	3 186	15 459	18 976	48 278	40 304	44 010	62 950	26 373
Chile	476	2 239	855	1 758	2 564	1 578	1 013	3 375	3 093	9 360	12 888	8 374	13 814	10 233
Colombia	53	139	500	102	3 390	1 020	884	2 458	3 982	9 781	2 945	10 614	8 616	2 848

/…

Annex table 6. Value of greenfield FDI projects, by source/destination, 2006–2012 (concluded)
(Millions of dollars)

Partner region/economy	World as destination							World as source						
	2006	2007	2008	2009	2010	2011	2012	2006	2007	2008	2009	2010	2011	2012
	By source							By destination						
Ecuador	34	89	67	330	166	60	38	1 065	518	511	348	132	648	603
Guyana	-	-	-	-	-	-	-	412	10	1 000	12	160	15	302
Paraguay	-	-	-	-	-	-	-	-	607	378	83	3 873	108	287
Peru	8	315	17	108	25	380	12	6 908	2 974	11 259	14 331	11 956	4 074	2 184
Suriname	-	-	-	-	-	-	-	-	-	101	-	-	384	34
Uruguay	-	25	3	49	3	5	-	2 413	2 910	4 381	504	750	1 030	720
Venezuela, Bolivarian Republic of	1 983	701	3 211	840	847	1 956	53	3 135	2 293	4 179	1 331	4 732	574	413
Central America	1 757	2 880	1 196	2 459	2 869	9 820	2 196	19 231	21 405	41 333	32 910	19 895	25 567	13 289
Belize	-	-	-	-	-	5	-	-	-	-	3	5	-	43
Costa Rica	-	95	6	45	63	11	1	796	2 157	582	2 427	1 981	3 364	476
El Salvador	-	102	-	281	147	20	-	765	356	562	716	276	462	4
Guatemala	-	79	58	131	86	125	43	67	979	905	1 330	963	209	53
Honduras	57	61	-	-	-	-	-	59	951	1 089	126	226	551	43
Mexico	1 682	2 444	990	1 923	2 101	9 498	2 147	16 863	13 652	34 896	25 040	14 679	18 694	11 838
Nicaragua	-	54	67	-	251	-	-	163	62	185	877	280	274	135
Panama	18	47	75	80	220	161	5	518	3 249	3 114	2 391	1 485	2 013	697
Caribbean	267	733	1 544	944	175	436	323	4 088	2 519	7 039	3 723	7 712	8 445	2 429
Antigua and Barbuda	-	-	-	-	-	-	-	-	-	82	-	-	-	-
Aruba	-	-	-	-	-	-	-	-	-	64	-	6	25	70
Bahamas	5	19	18	42	-	2	7	-	18	61	5	64	333	24
Barbados	-	2	-	-	5	26	19	-	-	-	29	137	303	16
Cayman Islands	57	166	554	853	52	243	297	66	36	326	104	253	349	351
Cuba	-	-	77	-	-	21	-	450	127	2 703	1 015	6 067	465	223
Dominican Republic	-	498	-	30	25	-	-	827	749	2 044	1 399	330	5 143	584
Grenada	-	-	-	-	-	-	-	-	3	-	-	5	5	-
Guadeloupe	-	-	-	-	-	-	-	25	-	267	-	-	25	-
Haiti	-	-	-	-	9	-	-	164	-	2	110	59	376	2
Jamaica	205	2	889	17	33	127	-	369	29	317	41	23	491	27
Martinique	-	-	-	-	13	-	-	25	35	-	6	-	-	23
Puerto Rico	-	20	6	4	36	18	-	621	713	739	716	570	752	926
Saint Kitts and Nevis	-	-	-	-	-	-	-	-	-	-	-	-	-	64
Saint Lucia	-	-	-	-	-	-	-	-	12	-	3	144	64	-
Trinidad and Tobago	1	26	-	-	3	-	-	1 542	797	372	296	22	114	119
Turks and Caicos Islands	-	-	-	-	-	-	-	-	-	64	-	34	-	-
Oceania	618	-	76	20	16	351	-	584	4 234	6 296	2 179	2 279	3 287	1 265
Fiji	-	-	-	2	8	-	-	228	206	117	339	-	179	41
French Polynesia	-	-	-	10	-	-	-	-	-	-	-	108	-	-
Micronesia, Federated States of	18	-	-	-	-	-	-	98	-	-	-	-	-	156
New Caledonia	-	-	-	-	-	202	-	-	3 800	3 200	22	-	8	-
Papua New Guinea	-	-	73	-	8	149	-	259	228	2 438	1 786	1 944	3 050	1 068
Samoa	600	-	2	-	-	-	-	-	-	500	-	-	-	-
Solomon Islands	-	-	-	8	-	-	-	-	-	42	32	228	51	-
Transition economies	20 157	24 630	31 658	19 267	21 621	17 991	10 042	50 225	80 460	124 606	58 388	55 805	59 546	40 529
South-East Europe	486	2 940	3 920	472	1 556	307	256	8 662	14 294	21 362	8 178	7 638	9 260	8 708
Albania	-	-	-	-	105	-	-	2 346	4 454	3 505	124	68	525	288
Bosnia and Herzegovina	-	-	7	-	16	2	8	643	2 623	1 993	1 368	283	1 253	1 287
Croatia	314	2 909	3 261	146	1 071	105	174	600	1 795	3 194	1 707	2 397	1 798	1 141
Montenegro	-	-	-	-	7	-	-	344	1 794	851	120	380	436	355
Serbia	173	31	651	314	356	150	74	3 270	3 131	9 197	4 095	4 040	4 292	4 459
The FYR of Macedonia	-	-	-	12	1	49	-	1 460	497	2 622	763	470	956	1 179
CIS	19 670	21 690	27 657	18 746	20 009	17 509	9 501	40 584	64 832	100 429	45 811	47 149	48 306	31 397
Armenia	2	-	51	-	9	83	171	366	2 134	690	1 003	265	805	434
Azerbaijan	75	4 307	1 223	3 779	580	435	3 246	953	1 999	2 921	1 939	711	1 289	1 573
Belarus	157	76	1 323	391	2 091	127	91	923	487	2 477	1 134	1 888	1 268	787
Kazakhstan	230	109	411	706	636	383	138	4 176	4 251	20 344	1 949	2 536	7 816	1 191
Kyrgyzstan	-	-	60	30	-	-	-	81	3 362	539	50	-	358	83
Moldova, Republic of	-	-	557	-	-	0	-	130	162	163	488	301	320	118
Russian Federation	16 134	15 357	21 295	13 055	15 476	15 527	4 900	28 194	42 858	60 308	31 268	34 519	22 795	18 537
Tajikistan	-	-	82	10	-	-	-	43	327	226	570	3	1 076	669
Turkmenistan	-	-	-	-	-	-	-	11	1 051	3 974	1 433	458	1 926	8
Ukraine	3 073	1 842	2 656	776	1 218	954	954	4 972	7 185	7 686	4 561	4 061	3 094	3 192
Uzbekistan	-	-	-	-	-	-	0	734	1 016	1 101	1 418	2 408	7 560	4 806
Georgia	-	-	82	49	56	174	285	980	1 334	2 816	4 398	1 017	1 980	424
Memorandum														
Least developed countries (LDCs)[a]	697	168	798	502	732	923	1 020	18 194	26 152	65 204	36 054	39 854	33 654	21 824
Landlocked developing countries(LLDCs)[b]	420	4 425	3 290	4 675	1 429	1 137	4 011	16 899	23 410	53 430	25 449	29 366	39 438	17 931
Small island developing states (SIDS)[c]	829	87	1 290	1 877	2 698	3 591	175	3 539	3 425	5 325	3 132	5 957	7 429	2 283

Source: UNCTAD FDI-TNC-GVC Information System, cross-border M&A database (www.unctad.org/fdistatistics).

[a] Least developed countries include: Afghanistan, Angola, Bangladesh, Benin, Bhutan, Burkina Faso, Burundi, Cambodia, the Central African Republic, Chad, the Comoros, the Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, the Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, the Lao People's Democratic Republic, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mozambique, Myanmar, Nepal, Niger, Rwanda, Samoa, São Tomé and Principe, Senegal, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sudan, Timor-Leste, Togo, Tuvalu, Uganda, the United Republic of Tanzania, Vanuatu, Yemen and Zambia.

[b] Landlocked developing countries include: Afghanistan, Armenia, Azerbaijan, Bhutan, Bolivia, Botswana, Burkina Faso, Burundi, the Central African Republic, Chad, Ethiopia, Kazakhstan, Kyrgyzstan, the Lao People's Democratic Republic, Lesotho, the former Yugoslav Republic of Macedonia, Malawi, Mali, the Republic of Moldova, Mongolia, Nepal, Niger, Paraguay, Rwanda, South Sudan, Swaziland, the Republic of Tajikistan, Turkmenistan, Uganda, Uzbekistan, Zambia and Zimbabwe.

[c] Small island developing countries include: Antigua and Barbuda, the Bahamas, Barbados, Cape Verde, the Comoros, Dominica, Fiji, Grenada, Jamaica, Kiribati, Maldives, Marshall Islands, Mauritius, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, São Tomé and Principe, Seychelles, Solomon Islands, Timor-Leste, Tonga, Trinidad and Tobago, Tuvalu and Vanuatu.

Note: Data refer to estimated amounts of capital investment.

Annex table III.1. Selected aspects of IIAs signed in 2012

Select aspects of IIAs commonly found in IIAs, in order of appearance	Policy Objectives: Sustainable development enhancing features	Policy Objectives: Focus on investments conducive to development	Policy Objectives: Preserve the right to regulate in the public interest	Policy Objectives: Avoid over-exposure to litigation	Policy Objectives: Stimulate responsible business practices	Pakistan–Turkey BIT	Nicaragua–Russian Federation BIT	Morocco–Viet Nam BIT	Japan–Kuwait BIT	Iraq–Japan BIT	Gabon–Turkey BIT	The FYR of Macedonia–Kazakhstan BIT	EU–Columbia–Peru FTA	EU–Central America Association Agreement	EU–Iraq Partnership and Cooperation Agreement	Chile–Hong Kong, China FTA	China–Republic of Korea–Japan TIA	Canada–China BIT	Cameroon–Turkey BIT	Bangladesh–Turkey BIT	Australia–Malaysia FTA	Albania–Azerbaijan BIT
References to the protection of health and safety, labour rights, environment or sustainable development in the treaty preamble	X	X	X		X	X			X	X	X		X	X	X	X	X	X	X	X		X
Refined definition of investment (exclusion of portfolio investment, sovereign debt obligations, or claims to money arising solely from commercial contracts)		X		X		X	X					X		X	X				X		X	
A carve-out for prudential measures in the financial services sector			X	X					X	X			X	X		X	X	X				
Fair and equitable standard equated to the minimum standard of treatment of aliens under customary international law			X	X		X		X			X							X	X	X	X	
Clarification of what does and does not constitute an indirect expropriation			X	X		X					X						X	X	X	X	X	
Detailed exceptions from the free-transfer-of-funds obligation, including balance-of-payments difficulties and/or enforcement of national laws			X	X		X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Omission of the so-called “umbrella” clause				X		X	X	X			X	X	X	X	X			X	X	X	X	X
General exceptions, e.g. for the protection of human, animal or plant life or health; or the conservation of exhaustible natural resources	X		X	X		X			X		X		X	X	X	X		X	X	X	X	
Explicit recognition that parties should not relax health, safety or environmental standards to attract investment	X	X			X				X	X			X	X		X	X	X		X		
Promotion of Corporate Social Responsibility standards by incorporating a separate provision into the IIA or as a general reference in the treaty preamble	X												X				X					
Limiting access to ISDS (e.g. limiting treaty provisions subject to ISDS, excluding policy areas from ISDS, granting consent to arbitration on a case-by-case basis, limiting the time period to submit claims, no ISDS mechanism)			X	X		X			X	X	X		X	X	X	X	X	X	X	X	X	X

Source: UNCTAD.

Note: This table is based on those 17 IIAs concluded in 2012, for which a text was available. The table does not include three “framework agreements” (GCC–Peru, GCC–United States and EU–Viet Nam), for which texts are available but which do not include substantive investment provisions.

Annex table III.2. List of IIAs at end 2012[a]

	BITs	Other IIAs[b]	Total
Afghanistan	3	3	6
Albania	43	6	49
Algeria	47	6	53
Angola	8	7	15
Anguilla	-	1	1
Antigua and Barbuda	2	10	12
Argentina	58	16	74
Armenia	38	2	40
Aruba	-	1	1
Australia	23	18	41
Austria	64	65	129
Azerbaijan	45	3	48
Bahamas	1	7	8
Bahrain	30	14	44
Bangladesh	29	4	33
Barbados	10	10	20
Belarus	59	3	62
Belgium [c]	93	65	158
Belize	7	9	16
Benin	14	6	20
Bermuda	-	1	1
Bhutan	-	2	2
Bolivia, Plurinational State of	19	14	33
Bosnia and Herzegovina	39	4	43
Botswana	8	6	14
Brazil	14	17	31
British Virgin Islands	-	1	1
Brunei Darussalam	8	19	27
Bulgaria	68	63	131
Burkina Faso	14	7	21
Burundi	7	8	15
Cambodia	21	16	37
Cameroon	15	5	20
Canada	31	21	52
Cape Verde	9	5	14
Cayman islands	-	2	2
Central African Republic	4	4	8
Chad	14	4	18
Chile	51	28	79
China	128	17	145
Colombia	7	19	26
Comoros	6	8	14
Congo	12	5	17
Congo, Democratic Republic of	15	8	23
Cook Islands	-	2	2
Costa Rica	21	14	35
Côte d' Ivoire	10	6	16
Croatia	58	5	63
Cuba	58	3	61
Cyprus	27	62	89
Czech Republic	79	65	144
Denmark	55	65	120
Djibouti	8	9	17

/...

Annex table III.2. List of IIAs at end 2012[a] (continued)

	BITs	Other IIAs[b]	Total
Dominica	2	10	12
Dominican Republic	15	6	21
Ecuador	18	11	29
Egypt	100	15	115
El Salvador	22	10	32
Equatorial Guinea	8	4	12
Eritrea	4	4	8
Estonia	27	64	91
Ethiopia	29	5	34
Fiji	-	3	3
Finland	71	65	136
France	102	65	167
Gabon	13	6	19
Gambia	13	6	19
Georgia	31	4	35
Germany	136	65	201
Ghana	26	6	32
Greece	43	65	108
Grenada	2	9	11
Guatemala	17	12	29
Guinea	19	6	25
Guinea-Bissau	2	7	9
Guyana	8	10	18
Haiti	7	4	11
Honduras	11	10	21
Hong Kong, China	15	5	20
Hungary	58	65	123
Iceland	9	32	41
India	83	14	97
Indonesia	63	17	80
Iran, Islamic Republic of	61	1	62
Iraq	7	7	14
Ireland	-	65	65
Israel	37	5	42
Italy	93	65	158
Jamaica	17	10	27
Japan	19	21	40
Jordan	53	10	63
Kazakhstan	42	5	47
Kenya	12	8	20
Kiribati	-	2	2
Korea, Democratic People’s Republic of	24	-	24
Korea, Republic of	90	17	107
Kuwait	61	15	76
Kyrgyzstan	29	5	34
Lao People’s Democratic Republic	23	14	37
Latvia	44	63	107
Lebanon	50	8	58
Lesotho	3	7	10
Liberia	4	6	10
Libya	32	10	42
Liechtenstein	-	26	26
Lithuania	52	63	115

/...

Annex table III.2. List of IIAs at end 2012[a] (continued)

	BITs	Other IIAs[b]	Total
Luxembourg [c]	93	65	158
Macao, China	2	2	4
Madagascar	9	8	17
Malawi	6	8	14
Malaysia	67	23	90
Maldives	-	3	3
Mali	17	7	24
Malta	22	62	84
Mauritania	19	5	24
Mauritius	36	9	45
Mexico	28	20	48
Moldova, Republic of	39	2	41
Monaco	1	-	1
Mongolia	43	3	46
Montenegro	17	3	20
Montserrat	-	5	5
Morocco	62	7	69
Mozambique	24	6	30
Myanmar	6	12	18
Namibia	13	6	19
Nauru	-	2	2
Nepal	6	3	9
Netherlands	96	65	161
New Caledonia	-	1	1
New Zealand	5	15	20
Nicaragua	18	11	29
Niger	5	7	12
Nigeria	22	6	28
Norway	15	30	45
Oman	34	13	47
Pakistan	46	7	53
Palestinian Territory	3	6	9
Panama	23	9	32
Papua New Guinea	6	4	10
Paraguay	24	15	39
Peru	32	30	62
Philippines	35	16	51
Poland	62	65	127
Portugal	55	65	120
Qatar	49	13	62
Romania	82	64	146
Russian Federation	71	4	75
Rwanda	6	8	14
Saint Kitts and Nevis	-	10	10
Saint Lucia	2	10	12
Saint Vincent and the Grenadines	2	10	12
Samoa	-	2	2
San Marino	8	-	8
São Tomé and Principe	1	3	4
Saudi Arabia	22	14	36
Senegal	24	7	31
Serbia	49	3	52
Seychelles	7	8	15

/...

Annex table III.2. List of IIAs at end 2012[a] (concluded)

	BITs	Other IIAs[b]	Total
Sierra Leone	3	6	9
Singapore	41	29	70
Slovakia	54	65	119
Slovenia	38	63	101
Solomon Islands	-	2	2
Somalia	2	6	8
South Africa	46	9	55
Spain	84	65	149
Sri Lanka	28	5	33
Sudan	27	11	38
Suriname	3	7	10
Swaziland	5	9	14
Sweden	69	65	134
Switzerland	118	32	150
Syrian Arab Republic	41	6	47
Taiwan Province of China	23	4	27
Tajikistan	32	5	37
Thailand	39	23	62
The FYR of Macedonia	37	5	42
Timor-Leste	3	-	3
Togo	4	6	10
Tonga	1	2	3
Trinidad and Tobago	12	10	22
Tunisia	54	9	63
Turkey	84	21	105
Turkmenistan	24	5	29
Tuvalu	-	2	2
Uganda	15	9	24
Ukraine	67	5	72
United Arab Emirates	40	13	53
United Kingdom	104	65	169
United Republic of Tanzania	16	7	23
United States	46	64	110
Uruguay	30	17	47
Uzbekistan	49	4	53
Vanuatu	2	2	4
Venezuela, Bolivarian Republic of	28	7	35
Viet Nam	60	21	81
Yemen	37	7	44
Zambia	12	9	21
Zimbabwe	30	9	39

Source: UNCTAD, IIA database.

[a] Note that the numbers of BITs and "other IIAs" in this table do not add up to the total number of BITs and "other IIAs" as stated in the text, because some economies/territories have concluded agreements with entities that are not listed in this table. Note also that because of ongoing reporting by member States and the resulting retroactive adjustments to the UNCTAD database, the data differ from those reported in WIR12

[b] These numbers include agreements concluded by economies as members of a regional integration organization.

[c] BITs concluded by the Belgo-Luxembourg Economic Union.

WORLD INVESTMENT REPORT PAST ISSUES

WIR 2012: Towards a New Generation of Investment Policies

WIR 2011: Non-Equity Modes of International Production and Development

WIR 2010: Investing in a Low-carbon Economy

WIR 2009: Transnational Corporations, Agricultural Production and Development

WIR 2008: Transnational Corporations and the Infrastructure Challenge

WIR 2007: Transnational Corporations, Extractive Industries and Development

WIR 2006: FDI from Developing and Transition Economies: Implications for Development

WIR 2005: Transnational Corporations and the Internationalization of R&D

WIR 2004: The Shift Towards Services

WIR 2003: FDI Policies for Development: National and International Perspectives

WIR 2002: Transnational Corporations and Export Competitiveness

WIR 2001: Promoting Linkages

WIR 2000: Cross-border Mergers and Acquisitions and Development

WIR 1999: Foreign Direct Investment and the Challenge of Development

WIR 1998: Trends and Determinants

WIR 1997: Transnational Corporations, Market Structure and Competition Policy

WIR 1996: Investment, Trade and International Policy Arrangements

WIR 1995: Transnational Corporations and Competitiveness

WIR 1994: Transnational Corporations, Employment and the Workplace

WIR 1993: Transnational Corporations and Integrated International Production

WIR 1992: Transnational Corporations as Engines of Growth

WIR 1991: The Triad in Foreign Direct Investment

All downloadable at www.unctad.org/wir

SELECTED UNCTAD PUBLICATION SERIES ON TNCs AND FDI

World Investment Report
www.unctad.org/wir

FDI Statistics
www.unctad.org/fdistatistics

World Investment Prospects Survey
www.unctad.org/wips

Global Investment Trends Monitor
www.unctad.org/diae

Investment Policy Monitor
www.unctad.org/iia

Issues in International Investment Agreements: I and II (Sequels)
www.unctad.org/iia

International Investment Policies for Development
www.unctad.org/iia

Investment Advisory Series A and B
www.unctad.org/diae

Investment Policy Reviews
www.unctad.org/ipr

Current Series on FDI and Development
www.unctad.org/diae

Transnational Corporations Journal
www.unctad.org/tnc

HOW TO OBTAIN THE PUBLICATIONS

The sales publications may be purchased from distributors of United Nations publications throughout the world. They may also be obtained by contacting:

United Nations Publications Customer Service
c/o National Book Network
15200 NBN Way
PO Box 190
Blue Ridge Summit, PA 17214
email: unpublications@nbnbooks.com

https://unp.un.org/

For further information on the work on foreign direct investment and transnational corporations, please address inquiries to:

Division on Investment and Enterprise
United Nations Conference on Trade and Development
Palais des Nations, Room E-10052
CH-1211 Geneva 10 Switzerland

Telephone: +41 22 917 4533
Fax: +41 22 917 0498
web: www.unctad.org/diae

ANNEX 8

中文简体 | 中文繁体 | 邮箱 | 搜索 本网站搜索 搜索

中华人民共和国中央人民政府
The Central People's Government of the People's Republic of China

网站首页 | 今日中国 | 中国概况 | 法律法规 | 公文公报 | 政务互动 | 政府建设 | 工作动态 | 人事任免 | 新闻发布

当前位置： 首页>> 公文公报>> 国务院文件>> 国务院令

中央政府门户网站 www.gov.cn 2007年04月24日 来源：国务院办公厅

【字体：大 中 小】 打印本页 关闭窗口

中华人民共和国国务院令

第492号

《中华人民共和国政府信息公开条例》已经2007年1月17日国务院第165次常务会议通过，现予公布，自2008年5月1日起施行。

总　理　温家宝

二〇〇七年四月五日

中华人民共和国政府信息公开条例

第一章　总　则

第一条　为了保障公民、法人和其他组织依法获取政府信息，提高政府工作的透明度，促进依法行政，充分发挥政府信息对人民群众生产、生活和经济社会活动的服务作用，制定本条例。

第二条　本条例所称政府信息，是指行政机关在履行职责过程中制作或者获取的，以一定形式记录、保存的信息。

第三条　各级人民政府应当加强对政府信息公开工作的组织领导。

国务院办公厅是全国政府信息公开工作的主管部门，负责推进、指导、协调、监督全国的政府信息公开工作。

县级以上地方人民政府办公厅（室）或者县级以上地方人民政府确定的其他政府信息公开工作主管部门负责推进、指导、协调、监督本行政区域的政府信息公开工作。

第四条　各级人民政府及县级以上人民政府部门应当建立健全本行政机关的政府信息公开工作制度，并指定机构（以下统称政府信息公开工作机构）负责本行政机关政府信息公开的日常工作。

政府信息公开工作机构的具体职责是：

（一）具体承办本行政机关的政府信息公开事宜；

（二）维护和更新本行政机关公开的政府信息；

（三）组织编制本行政机关的政府信息公开指南、政府信息公开目录和政府信息公开工作年度报告；

开工作年度报告；

（四）对拟公开的政府信息进行保密审查；

（五）本行政机关规定的与政府信息公开有关的其他职责。

第五条　行政机关公开政府信息，应当遵循公正、公平、便民的原则。

第六条　行政机关应当及时、准确地公开政府信息。行政机关发现影响或者可能影响社会稳定、扰乱社会管理秩序的虚假或者不完整信息的，应当在其职责范围内发布准确的政府信息予以澄清。

第七条　行政机关应当建立健全政府信息发布协调机制。行政机关发布政府信息涉及其他行政机关的，应当与有关行政机关进行沟通、确认，保证行政机关发布的政府信息准确一致。

行政机关发布政府信息依照国家有关规定需要批准的，未经批准不得发布。

第八条　行政机关公开政府信息，不得危及国家安全、公共安全、经济安全和社会稳定。

第二章　公开的范围

第九条　行政机关对符合下列基本要求之一的政府信息应当主动公开：

（一）涉及公民、法人或者其他组织切身利益的；

（二）需要社会公众广泛知晓或者参与的；

（三）反映本行政机关机构设置、职能、办事程序等情况的；

（四）其他依照法律、法规和国家有关规定应当主动公开的。

第十条　县级以上各级人民政府及其部门应当依照本条例第九条的规定，在各自职责范围内确定主动公开的政府信息的具体内容，并重点公开下列政府信息：

（一）行政法规、规章和规范性文件；

（二）国民经济和社会发展规划、专项规划、区域规划及相关政策；

（三）国民经济和社会发展统计信息；

（四）财政预算、决算报告；

（五）行政事业性收费的项目、依据、标准；

（六）政府集中采购项目的目录、标准及实施情况；

（七）行政许可的事项、依据、条件、数量、程序、期限以及申请行政许可需要提交的全部材料目录及办理情况；

（八）重大建设项目的批准和实施情况；

（九）扶贫、教育、医疗、社会保障、促进就业等方面的政策、措施及其实施情况；

（十）突发公共事件的应急预案、预警信息及应对情况；

（十一）环境保护、公共卫生、安全生产、食品药品、产品质量的监督检查情况。

第十一条　设区的市级人民政府、县级人民政府及其部门重点公开的政府信息还应当包括下列内容：

（一）城乡建设和管理的重大事项；

（二）社会公益事业建设情况；

（三）征收或者征用土地、房屋拆迁及其补偿、补助费用的发放、使用情况；

（四）抢险救灾、优抚、救济、社会捐助等款物的管理、使用和分配情况。

第十二条　乡（镇）人民政府应当依照本条例第九条的规定，在其职责范围内确定主动公开的政府信息的具体内容，并重点公开下列政府信息：

（一）贯彻落实国家关于农村工作政策的情况；

（二）财政收支、各类专项资金的管理和使用情况；

（三）乡（镇）土地利用总体规划、宅基地使用的审核情况；

（四）征收或者征用土地、房屋拆迁及其补偿、补助费用的发放、使用情况；

（五）乡（镇）的债权债务、筹资筹劳情况；

（六）抢险救灾、优抚、救济、社会捐助等款物的发放情况；

（七）乡镇集体企业及其他乡镇经济实体承包、租赁、拍卖等情况；

（八）执行计划生育政策的情况。

第十三条　除本条例第九条、第十条、第十一条、第十二条规定的行政机关主动公开的政府信息外，公民、法人或者其他组织还可以根据自身生产、生活、科研等特殊需要，向国务院部门、地方各级人民政府及县级以上地方人民政府部门申请获取相关政府信息。

第十四条　行政机关应当建立健全政府信息发布保密审查机制，明确审查的程序和责任。

行政机关在公开政府信息前，应当依照《中华人民共和国保守国家秘密法》以及其他法律、法规和国家有关规定对拟公开的政府信息进行审查。

行政机关对政府信息不能确定是否可以公开时，应当依照法律、法规和国家有关规定报有关主管部门或者同级保密工作部门确定。

行政机关不得公开涉及国家秘密、商业秘密、个人隐私的政府信息。但是，经权利人同意公开或者行政机关认为不公开可能对公共利益造成重大影响的涉及商业秘密、个人隐私的政府信息，可以予以公开。

第三章　公开的方式和程序

第十五条　行政机关应当将主动公开的政府信息，通过政府公报、政府网站、新闻发布会以及报刊、广播、电视等便于公众知晓的方式公开。

第十六条　各级人民政府应当在国家档案馆、公共图书馆设置政府信息查阅场所，并配备相应的设施、设备，为公民、法人或者其他组织获取政府信息提供便利。

行政机关可以根据需要设立公共查阅室、资料索取点、信息公告栏、电子信息屏等场所、设施，公开政府信息。

行政机关应当及时向国家档案馆、公共图书馆提供主动公开的政府信息。

第十七条　行政机关制作的政府信息，由制作该政府信息的行政机关负责公开；行政机关从公民、法人或者其他组织获取的政府信息，由保存该政府信息的行政机关负责公开。法律、法规对政府信息公开的权限另有规定的，从其规定。

第十八条　属于主动公开范围的政府信息，应当自该政府信息形成或者变更之日起20个工作日内予以公开。法律、法规对政府信息公开的期限另有规定的，从其规定。

第十九条　行政机关应当编制、公布政府信息公开指南和政府信息公开目录，并及时更新。

政府信息公开指南，应当包括政府信息的分类、编排体系、获取方式，政府信息公开工作机构的名称、办公地址、办公时间、联系电话、传真号码、电子邮箱等内容。

政府信息公开目录，应当包括政府信息的索引、名称、内容概述、生成日期等内容。

第二十条　公民、法人或者其他组织依照本条例第十三条规定向行政机关申请获取政府信息的，应当采用书面形式（包括数据电文形式）；采用书面形式确有困难的，申请人可以口头提出，由受理该申请的行政机关代为填写政府信息公开申请。

政府信息公开申请应当包括下列内容：

（一）申请人的姓名或者名称、联系方式；

（二）申请公开的政府信息的内容描述；

（三）申请公开的政府信息的形式要求。

第二十一条　对申请公开的政府信息，行政机关根据下列情况分别作出答复：

（一）属于公开范围的，应当告知申请人获取该政府信息的方式和途径；

（二）属于不予公开范围的，应当告知申请人并说明理由；

（三）依法不属于本行政机关公开或者该政府信息不存在的，应当告知申请人，对能够确定该政府信息的公开机关的，应当告知申请人该行政机关的名称、联系方式；

（四）申请内容不明确的，应当告知申请人作出更改、补充。

第二十二条　申请公开的政府信息中含有不应当公开的内容，但是能够作区分处理的，行政机关应当向申请人提供可以公开的信息内容。

第二十三条　行政机关认为申请公开的政府信息涉及商业秘密、个人隐私，公开后可能损害第三方合法权益的，应当书面征求第三方的意见；第三方不同意公开的，不得公开。但是，行政机关认为不公开可能对公共利益造成重大影响的，应当予以公开，并将决定公开的政府信息内容和理由书面通知第三方。

第二十四条　行政机关收到政府信息公开申请，能够当场答复的，应当当场予以答复。

行政机关不能当场答复的，应当自收到申请之日起15个工作日内予以答复；如需延长答复期限的，应当经政府信息公开工作机构负责人同意，并告知申请人，延长答复的期限最长不得超过15个工作日。

申请公开的政府信息涉及第三方权益的，行政机关征求第三方意见所需时间不计算在本条第二款规定的期限内。

第二十五条　公民、法人或者其他组织向行政机关申请提供与其自身相关的税费缴纳、社会保障、医疗卫生等政府信息的，应当出示有效身份证件或者证明文件。

公民、法人或者其他组织有证据证明行政机关提供的与其自身相关的政府信息记录不准确的，有权要求该行政机关予以更正。该行政机关无权更正的，应当转送有权更正的行政机关处理，并告知申请人。

第二十六条　行政机关依申请公开政府信息，应当按照申请人要求的形式予以提供；无法按照申请人要求的形式提供的，可以通过安排申请人查阅相关资料、提供复制件或者其他适当形式提供。

第二十七条　行政机关依申请提供政府信息，除可以收取检索、复制、邮寄等成本费用外，不得收取其他费用。行政机关不得通过其他组织、个人以有偿服务方式提供政

府信息。

行政机关收取检索、复制、邮寄等成本费用的标准由国务院价格主管部门会同国务院财政部门制定。

第二十八条　申请公开政府信息的公民确有经济困难的，经本人申请、政府信息公开工作机构负责人审核同意，可以减免相关费用。

申请公开政府信息的公民存在阅读困难或者视听障碍的，行政机关应当为其提供必要的帮助。

第四章　监督和保障

第二十九条　各级人民政府应当建立健全政府信息公开工作考核制度、社会评议制度和责任追究制度，定期对政府信息公开工作进行考核、评议。

第三十条　政府信息公开工作主管部门和监察机关负责对行政机关政府信息公开的实施情况进行监督检查。

第三十一条　各级行政机关应当在每年3月31日前公布本行政机关的政府信息公开工作年度报告。

第三十二条　政府信息公开工作年度报告应当包括下列内容：

（一）行政机关主动公开政府信息的情况；

（二）行政机关依申请公开政府信息和不予公开政府信息的情况；

（三）政府信息公开的收费及减免情况；

（四）因政府信息公开申请行政复议、提起行政诉讼的情况；

（五）政府信息公开工作存在的主要问题及改进情况；

（六）其他需要报告的事项。

第三十三条　公民、法人或者其他组织认为行政机关不依法履行政府信息公开义务的，可以向上级行政机关、监察机关或者政府信息公开工作主管部门举报。收到举报的机关应当予以调查处理。

公民、法人或者其他组织认为行政机关在政府信息公开工作中的具体行政行为侵犯其合法权益的，可以依法申请行政复议或者提起行政诉讼。

第三十四条　行政机关违反本条例的规定，未建立健全政府信息发布保密审查机制的，由监察机关、上一级行政机关责令改正；情节严重的，对行政机关主要负责人依法给予处分。

第三十五条　行政机关违反本条例的规定，有下列情形之一的，由监察机关、上一级行政机关责令改正；情节严重的，对行政机关直接负责的主管人员和其他直接责任人员依法给予处分；构成犯罪的，依法追究刑事责任：

（一）不依法履行政府信息公开义务的；

（二）不及时更新公开的政府信息内容、政府信息公开指南和政府信息公开目录的；

（三）违反规定收取费用的；

（四）通过其他组织、个人以有偿服务方式提供政府信息的；

（五）公开不应当公开的政府信息的；

（六）违反本条例规定的其他行为。

第五章　附　　则

第三十六条　法律、法规授权的具有管理公共事务职能的组织公开政府信息的活动，适用本条例。

第三十七条　教育、医疗卫生、计划生育、供水、供电、供气、供热、环保、公共交通等与人民群众利益密切相关的公共企事业单位在提供社会公共服务过程中制作、获取的信息的公开，参照本条例执行，具体办法由国务院有关主管部门或者机构制定。

第三十八条　本条例自2008年5月1日起施行。

【E-mail推荐 发送 】【纠错】 打印本页 关闭窗口

Copyright©2013 www.gov.cn
All Rights Reserved
版权所有：中国政府网

Order of the People's Republic of China State Council (No. 492)

The Provisions of the People’s Republic of China on the Disclosure of Government Information shall come into force as of May 1st, 2008.

Provisions of the People’s Republic of China

on the Disclosure of Government Information

Article 1 These Provisions are formulated for the purpose of safeguarding legal access to government information by citizens, legal persons and other organizations, improving the transparency of government work, promoting administration according to law and giving full play to the role of government information in serving the people in their production, living, social and economic activities.

Article 2 Government Information herein refers to information produced or acquired and recorded or archived in a certain form by administrative organs in the course of duty.

Article 9 Administrative organs shall disclose on their own initiative government information that satisfies any of the following basic requirements:

(1) Information concerning immediate interests of citizens, legal persons or other organizations;
(2) Information that should be widely known or requires participation by the general public;
(3) Information reflecting the structural establishment, duties, administrative procedures and other facts of the administrative organ;
(4) Other information that should be voluntarily disclosed by the administrative organ as prescribed by laws, regulations and relevant state provisions.

Article 15 An administrative organ shall disclose, through government bulletins, government websites, news releases, newspapers and periodicals, radio, television or other means that facilitate public knowledge government, information to be voluntarily disclosed.

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

Article 18 Government Information falling within the ambit of voluntary disclosure shall be disclosed within twenty (20) working days from the day of creation or change save where the time limit for disclosure is stipulated otherwise by any law or regulation.

Article 35 Where an administrative organ violates these Provisions under any of the following circumstances, the supervisory organ or the administrative organ at the next higher level shall order rectification; and in severe cases, punish, in accordance with the law, personnel directly in charge of said administrative organ and other personnel directly responsible; and where a crime is constituted, criminal liabilities shall be investigated in accordance with the law:

(1) Failing to fulfil government information disclosure obligations according to law;
(2) Failing to update, in a timely manner, the content of disclosed government information, directory for government information disclosure and catalogue of government information disclosure;
(3) Charging fees in violation of regulations;
(4) Providing government information in the form of paid services through any other organization or individual;
(5) Disclosing government information that should not be disclosed;
(6) Other behaviour in violation of these Provisions.

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

ANNEX 9

第六十七条 全国人民代表大会常务委员会行使下列职权：

（一）解释宪法，监督宪法的实施；

（二）制定和修改除应当由全国人民代表大会制定的法律以外的其他法律；

（三）在全国人民代表大会闭会期间，对全国人民代表大会制定的法律进行部分补充和修改，但是不得同该法律的基本原则相抵触；

（四）解释法律；

（五）在全国人民代表大会闭会期间，审查和批准国民经济和社会发展计划、国家预算在执行过程中所必须作的部分调整方案；

（六）监督国务院、中央军事委员会、最高人民法院和最高人民检察院的工作；

（七）撤销国务院制定的同宪法、法律相抵触的行政法规、决定和命令；

（八）撤销省、自治区、直辖市国家权力机关制定的同宪法、法律和行政法规相抵触的地方性法规和决议；

（九）在全国人民代表大会闭会期间，根据国务院总理的提名，决定部长、委员会主任、审计长、秘书长的人选；

（十）在全国人民代表大会闭会期间，根据中央军事委员会主席的提名，

决定中央军事委员会其他组成人员的人选；

（十一）根据最高人民法院院长的提请，任免最高人民法院副院长、审判员、审判委员会委员和军事法院院长；

（十二）根据最高人民检察院检察长的提请，任免最高人民检察院副检察长、检察员、检察委员会委员和军事检察院检察长，并且批准省、自治区、直辖市的人民检察院检察长的任免；

（十三）决定驻外全权代表的任免；

（十四）决定同外国缔结的条约和重要协定的批准和废除；

（十五）规定军人和外交人员的衔级制度和其他专门衔级制度；

（十六）规定和决定授予国家的勋章和荣誉称号；

（十七）决定特赦；

（十八）在全国人民代表大会闭会期间，如果遇到国家遭受武装侵犯或者必须履行国际间共同防止侵略的条约的情况，决定战争状态的宣布；

（十九）决定全国总动员或者局部动员；

（二十）决定全国或者个别省、自治区、直辖市进入紧急状态；

（二十一）全国人民代表大会授予的其他职权。

PRC Constitution

Article 67 The Standing Committee of the National People's Congress exercises the following functions and powers:

(1) to interpret the Constitution and supervise its enforcement;
(2) to enact and amend laws, with the exception of those which should be enacted by the National People's Congress;
(3) to partially supplement and amend, when the National People's Congress is not in session, laws enacted by the National People's Congress provided that the basic principles of those laws are not contravened;
(4) to interpret laws;
(5) to review and approve, when the National People's Congress is not in session, partial adjustments to the plan for national economic and social development or to the state budget that prove necessary in the course of their implementation;
(6) to supervise the work of the State Council, the Central Military Commission, the Supreme People's Court and the Supreme People's Procuratorate;
(7) to annul those administrative rules and regulations, decisions or orders of the State Council that contravene the Constitution or the law;
(8) to annual those local regulations or decisions of the organs of state power of provinces, autonomous regions, and municipalities directly under the Central Government that contravene the Constitution, the law or the administrative rules and regulations;
(9) to decide, when the National People's Congress is not in session, on the choice of Ministers in charge of ministries or commissions, the Auditor General or the Secretary General of the State Council based on nomination by the Premier of the State Council;
(10) to decide, based on nomination by the Chairman of the Central Military Commission, on the choice of other members of the Central Military Commission, when the National People's Congress is not in session;
(11) to appoint or remove, at the recommendation of the President of the Supreme People's Court, the Vice Presidents and Judges of the Supreme People's Court, members of its Judicial Committee and the President of the Military Court;
(12) to appoint or remove, at the recommendation of the Procurator General of the Supreme People's Procuratorate, the Deputy Procurators-General and procurators of the Supreme People's Procuratorate, members of its Procuratorial Committee and the Chief Procurator of the Military Procuratorate, as well as to approve the appointment or removal of the

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

chief procurators of the people's procuratorates of provinces, autonomous regions, and municipalities directly under the Central Government;

(13) to decide on the appointment or recall of plenipotentiary representatives abroad;

(14) to decide on the ratification or abrogation of treaties and important agreements concluded with foreign states;

(15) to institute systems of titles and ranks for military and diplomatic personnel and of other specific titles and ranks;

(16) to institute state medals and titles of honor and decide on their conferment;

(17) to decide on the granting of special pardons;

(18) to decide, when the National People's Congress is not in session, on the proclamation of the state of war in the event or an armed attack on the country or in fulfillment of international treaty obligations concerning common defense against aggression;

(19) to decide on general mobilization or partial mobilization;

(20) to decide on the imposition of martial law throughout the country or in particular provinces, autonomous regions, or municipalities directly under the Central Government; and

(21) to exercise such other functions and powers assigned by the National People's Congress.

This is to certify that this Chinese to English translation is done by AsiaRain Automated Translations Pte Ltd, Singapore (Tel: 63339820), based on a copy of the document provided, and is true and accurate to the best of our knowledge.

ANNEX 10

Instrument:	A106	**THE INTERPRETATION BY THE STANDING COMMITTEE OF THE NATIONAL PEOPLE'S CONGRESS OF ARTICLES 22(4) AND 24(2)(3) OF THE BASIC LAW OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA**	Gazette Number	Version Date
			L.N. 167 of 1999	26/06/1999

Remarks:
This instrument was not given a chapter number in the Loose-leaf edition of the Laws of Hong Kong. An unofficial reference number, however, is assigned to this instrument in BLIS for identification purposes. This also enables users to carry out a search in relation to this instrument by reference to the unofficial reference number.

This is an English translation of the original instrument in Chinese, and is published for information-

THE INTERPRETATION BY THE STANDING COMMITTEE OF THE NATIONAL PEOPLE'S CONGRESS OF ARTICLES 22(4) AND 24(2)(3) OF THE BASIC LAW OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA

(Adopted by the Standing Committee of the Ninth National People's Congress at its Tenth Session on 26 June 1999)

The Standing Committee of the Ninth National People's Congress examined at its Tenth session the "Motion Regarding the Request for an Interpretation of Articles 22(4) and 24(2)(3) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China" submitted by the State Council. The motion of the State Council was submitted upon the report furnished by the Chief Executive of the Hong Kong Special Administrative Region under the relevant provisions of Articles 43 and 48(2) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China. The issue raised in the Motion concerns the interpretation of the relevant provisions of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China by the Court of Final Appeal of the Hong Kong Special Administrative Region in its judgment dated 29 January 1999. Those relevant provisions concern affairs which are the responsibility of the Central People's Government and concern the relationship between the Central Authorities and the Hong Kong Special Administrative Region. Before making its judgment, the Court of Final Appeal had not sought an interpretation of the Standing Committee of the National People's Congress in compliance with the requirement of Article 158(3) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China. Moreover, the interpretation of the Court of Final Appeal is not consistent with the legislative intent. Therefore, having consulted the Committee for the Basic Law of the Hong Kong Special Administrative Region under the Standing Committee of the National People's Congress, the Standing Committee of the National People's Congress has decided to make, under the provisions of Article 67(4) of the Constitution of the People's Republic of China and Article 158(1) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, an interpretation of the provisions of Articles 22(4) and 24(2)(3) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China as follows:

1. The provisions of Article 22(4) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China regarding "For entry into the Hong Kong Special Administrative Region, people from other parts of China must apply for approval" mean as follows: People from all provinces, autonomous regions, or municipalities directly under the Central Government, including those persons of Chinese nationality born outside Hong Kong of Hong Kong permanent residents, who wish to enter the Hong Kong Special Administrative Region for whatever reason, must apply to the relevant authorities of their residential districts for approval in accordance with the relevant national laws and administrative regulations, and must hold valid documents issued by the relevant authorities before they can enter the Hong Kong Special Administrative Region. It is unlawful for people from all provinces,

autonomous regions, or municipalities directly under the Central Government, including persons of Chinese nationality born outside Hong Kong of Hong Kong permanent residents, to enter the Hong Kong Special Administrative Region without complying with the appropriate approval procedure prescribed by the relevant national laws and administrative regulations.

2. It is stipulated in the first three categories of Article 24(2) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China that the "permanent residents of the Hong Kong Special Administrative Region shall be:

(1) Chinese citizens born in Hong Kong before or after the establishment of the Hong Kong Special Administrative Region;
(2) Chinese citizens who have ordinarily resided in Hong Kong for a continuous period of not less than seven years before or after the establishment of the Hong Kong Special Administrative Region;
(3) Persons of Chinese nationality born outside Hong Kong of those residents listed in categories (1) and (2);".

The provisions of category (3) regarding the "persons of Chinese nationality born outside Hong Kong of those residents listed in categories (1) and (2)" mean both parents of such persons, whether born before or after the establishment of the Hong Kong Special Administrative Region, or either of such parents must have fulfilled the condition prescribed by category (1) or (2) of Article 24(2) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China at the time of their birth. The legislative intent as stated by this Interpretation, together with the legislative intent of all other categories of Article 24(2) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, have been reflected in the "Opinions on the Implementation of Article 24(2) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China" adopted at the Fourth Plenary Meeting of the Preparatory Committee for the Hong Kong Special Administrative Region of the National People's Congress on 10 August 1996.

As from the promulgation of this Interpretation, the courts of the Hong Kong Special Administrative Region, when referring to the relevant provisions of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, shall adhere to this Interpretation. This Interpretation does not affect the right of abode in the Hong Kong Special Administrative Region which has been acquired under the judgment of the Court of Final Appeal on the relevant cases dated 29 January 1999 by the parties concerned in the relevant legal proceedings. Other than that, the question whether any other person fulfils the conditions prescribed by Article 24(2)(3) of the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China shall be determined by reference to this Interpretation.

ANNEX 11

中国日报网 Tue, Mar 18, 2014 中文 US CHINA AFRICA ASIA PACIFIC Go Adv Search

CHINADAILY Europe

Subscribe to CHINADAILY European Weekly

Home China Europe World Business Sports Travel Life Culture Entertainment Photo Opinion Video Forum
Mobile

China / Politics

Interpretation on Macao Basic Law adopted

Updated: 2011-12-31 21:26

(Xinhua)

Print Mail Large Medium Small 0

BEIJING - The Standing Committee of the National People's Congress (NPC), China's top legislature, on Saturday adopted an interpretation on two articles of the Basic Law of Macao concerning election issues.

The Basic Law of the Macao Special Administrative Region (Macao SAR) was adopted in 1993 and went into effect on Dec 20, 1999.

The interpretation covers Annex I to the Basic Law, which provides a method for selecting the Macao SAR's chief executives, and Annex II, which sets the method for the formation of its legislative assembly.

Clause 7 of Annex I to the Basic Law says that if there is a need to amend the method for selecting the chief executives for 2009, and the terms subsequent to the year 2009, such amendments must be made with the endorsement of a two-thirds majority of all the members of the Legislative Assembly and the consent of the chief executive, and they shall be reported to the Standing Committee of the NPC for approval.

Clause 3 of Annex II says that if there is a need to amend the method of forming the Legislative Assembly of the Macao SAR in and after 2009, such amendments must be made with the endorsement of a two-thirds majority of all the members of the assembly and the consent of the chief executive, and they shall be reported to the Standing Committee of the NPC for the record.

The phrase "if there is a need to amend ..." in the two clauses should be construed to mean that they may be amended or remain unchanged, said the interpretation published by the NPC Standing Committee on Saturday.

Moreover, the procedures stipulated in the clauses should be regarded as prerequisites to validate such amendments. That is to say, relevant amendments could only go into effect after completing these procedures, including due reporting to the NPC Standing Committee for approval or record, the interpretation said.

Furthermore, the interpretation stated that the necessity of such amendments should be decided by the NPC Standing Committee upon proposal from the Macao SAR's chief executive.

If no amendment is made to the methods, the provisions in the two annexes will continue to hold true, the document said.

The development of Macao's political system should be made within the framework of the Macao SAR's Basic Law and in a manner that helps to maintain the SAR's long-term stability, Li Fei, deputy director of the Commission for Legislative Affairs of the NPC Standing Committee, said at a press conference.

Since Macao returned to China, remarkable progresses have been made in the SAR. Facts show that the political system in Macao suits the SAR's situation well and that efforts to maintain and improve the system will ensure the long-term prosperity and stability of Macao SAR, Li said.

Macao SAR expects the formation of its new Legislative Assembly in 2013, and the selection for the next term of its chief executive in 2014.

Today's Top News

China, US agree to enhance dialogue
Online shops sell year-end reports
Initial probe supports villagers' requests
School buses to meet national conditions
Glitches hamper Web sales of train tickets
Prosecution of ex-fugitive Lai to begin
Appliance retailers face 2012 downturn
US, ROK defense chiefs talk over phone

Video Slide Photos

Digest China: Year 2011 In Quotes

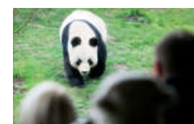
THE WEEK Dec 31: We Messed Up

Hot Topics

Lunar probe , China growth forecasts, Emission rules get tougher, China seen through 'colored lens', International board,

Editor's Picks

Rolling into new terrain


Scotland's 5-year China plan

A captain fully in charge

Madame makeover

No pause at menopause

Snow plow

China
Politics
Society
Sci-Tech
People
China Scene

Business
Policies
Economy
Companies
Markets
Industries
Opinion
Green China

World
Asia & Pacific
Americas
Europe
Africa
Middle East
Kaleidoscope
Newsmaker

Life
People
X-Ray
Hot Pot Column
Food

Entertainment
Celebrities
Movies
Music
Television
Style

Sport
China
Stars
Golf
Tennis
Other Sports

Opinion
Editorals
Op-Ed Contributors
Columnists
Thought Leaders

Forum
News Talk
Leisure Time
English Study
Overseas Students' Family
Europe Discussion

Photo
China
World
Sports
Slides
Odd
Photographers

Video
News
Big Talk
China Lite
Tradition Mission
Focus

Language Tips
Bilingual News
Hot Words
Buzzwords
Translation
Audio
Movie English
Survival English
Study Abroad

Mobile
iPad
iPhone
Kindle
Android
Blackberry

Copyright 1995 - 2013 . All rights reserved. The content (including but not limited to text, photo, multimedia information, etc) published in this site belongs to China Daily Information Co (CDIC). Without written authorization from CDIC, such content shall not be republished or used in any form. Note: Browsers with 1024*768 or higher resolution are suggested for this site.

License for publishing multimedia online 0108263 Registration Number: 20100000002731

abc 1 Jan – 30 Jun 2013
Average per issue: 87,464

ANNEX 12

Vienna Convention on Succession of States in respect of Treaties

1978

Done at Vienna on 23 August 1978. Entered into force on 6 November 1996.
United Nations, *Treaty Series*, vol. 1946, p. 3

Copyright © United Nations
2005

Vienna Convention on Succession of States in respect of Treaties
Done at Vienna on 23 August 1978

The States Parties to the present Convention,

Considering the profound transformation of the international community brought about by the decolonization process,

Considering also that other factors may lead to cases of succession of States in the future,

Convinced, in these circumstances, of the need for the codification and progressive development of the rules relating to succession of States in respect of treaties as a means for ensuring greater juridical security in international relations,

Noting that the principles of free consent, good faith and *pacta sunt servanda* are universally recognized,

Emphasizing that the consistent observance of general multilateral treaties which deal with the codification and progressive development of international law and those the object and purpose of which are of interest to the international community as a whole is of special importance for the strengthening of peace and international cooperation,

Having in mind the principles of international law embodied in the Charter of the United Nations, such as the principles of the equal rights and self-determination of peoples, of the sovereign equality and independence of all States, of non-interference in the domestic affairs of States, of the prohibition of the threat or use of force, and of universal respect for, and observance of, human rights and fundamental freedoms for all,

Recalling that respect for the territorial integrity and political independence of any State is required by the Charter of the United Nations,

Bearing in mind the provisions of the Vienna Convention on the Law of Treaties of 1969,

Bearing also in mind article 73 of that Convention,

Affirming that questions of the law of treaties other than those that may arise from a succession of States are governed by the relevant rules of international law, including those rules of customary international law which are embodied in the Vienna Convention on the Law of Treaties of 1969,

Affirming that the rules of customary international law will continue to govern questions not regulated by the provisions of the present Convention,

Have agreed as follows:

PART I.
GENERAL PROVISIONS

Article 1
Scope of the present Convention

The present Convention applies to the effects of a succession of States in respect of treaties between States.

Article 2
Use of terms

1. For the purposes of the present Convention:

(*a*) "treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments, and whatever its particular designation;

(*b*) "succession of States" means the replacement of one State by another in the responsibility for the international relations of territory;

(*c*) "predecessor State" means the State which has been replaced by another State on the occurrence of a succession of States;

(*d*) "successor State" means the State which has replaced another State on the occurrence of a succession of States;

(*e*) "date of the succession of States" means the date upon which the successor State replaced the predecessor State in the responsibility for the international relations of the territory to which the succession of States relates;

(*f*) "newly independent State" means a successor State the territory of which immediately before the date of the succession of States was a dependent territory for the international relations of which the predecessor State was responsible;

(*g*) "notification of succession" means in relation to a multilateral treaty any notification, however phrased or named, made by a successor State expressing its consent to be considered as bound by the treaty;

(*h*) "full powers" means in relation to a notification of succession or any other notification under the present Convention a document emanating from the competent authority of a State designating a person or persons to represent the State for communicating the notification of succession or, as the case may be, the notification;

(*i*) "ratification", "acceptance" and "approval" mean in each case the international act so named whereby a State establishes on the international plane its consent to be bound by a treaty;

(*j*) "reservation" means a unilateral statement, however phrased or named, made by a State when signing, ratifying, accepting, approving or acceding to a treaty or when making a notification of succession to a treaty, whereby it purports to exclude or to modify the legal effect of certain provisions of the treaty in their application to that State;

(*k*) "contracting State" means a State which has consented to be bound by the treaty, whether or not the treaty has entered into force;

(*l*) "party" means a State which has consented to be bound by the treaty and for which the treaty is in force;

(*m*) "other State party" means in relation to a successor State any party, other than the predecessor State, to a treaty in force at the date of a succession of States in respect of the territory to which that succession of States relates;

(*n*) "international organization" means an intergovernmental organization.

2. The provisions of paragraph 1 regarding the use of terms in the present Convention are without prejudice to the use of those terms or to the meanings which may be given to them in the internal law of any State.

Article 3
Cases not within the scope of the present Convention

The fact that the present Convention does not apply to the effects of a succession of States in respect of international agreements concluded between States and other subjects of international law or in respect of international agreements not in written form shall not affect:

(*a*) the application to such cases of any of the rules set forth in the present Convention to which they are subject under international law independently of the Convention;

(*b*) the application as between States of the present Convention to the effects of a succession of States in respect of international agreements to which other subjects of international law are also parties.

Article 4
Treaties constituting international organizations and treaties adopted within an international organization

The present Convention applies to the effects of a succession of States in respect of:

(*a*) any treaty which is the constituent instrument of an international organization without prejudice to the rules concerning acquisition of membership and without prejudice to any other relevant rules of the organization;

(*b*) any treaty adopted within an international organization without prejudice to any relevant rules of the organization.

Article 5
Obligations imposed by international law independently of a treaty

The fact that a treaty is not considered to be in force in respect of a State by virtue of the application of the present Convention shall not in any way impair the duty of that State to fulfil any obligation embodied in the treaty to which it is subject under international law independently of the treaty.

Article 6
Cases of succession of States covered by the present Convention

The present Convention applies only to the effects of a succession of States occurring in conformity with international law and, in particular, the principles of international law embodied in the Charter of the United Nations.

Article 7
Temporal application of the present Convention

1. Without prejudice to the application of any of the rules set forth in the present Convention to which the effects of a succession of States would be subject under international law independently of the Convention, the Convention applies only in respect of a succession of States which has occurred after the entry into force of the Convention except as may be otherwise agreed.

2. A successor State may, at the time of expressing its consent to be bound by the present Convention or at any time thereafter, make a declaration that it will apply the provisions of the Convention in respect of its own succession of States which has occurred before the entry into force of the Convention in relation to any other contracting State or State Party to the Convention which makes a declaration accepting the declaration, of the successor State. Upon the entry into force of the Convention as between the States making the declarations or upon the making of the declaration of acceptance, whichever occurs later, the provisions of the Convention shall apply to the effects of the succession of States as from the date of that succession of States.

3. A successor State may at the time of signing or of expressing its consent to be bound by the present Convention make a declaration that it will apply the provisions of the Convention provisionally in respect of its own succession of States which has occurred before the entry into force of the Convention in relation to any other signatory or contracting State which makes a declaration accepting the declaration of the successor State; upon the making of the declaration of acceptance, those provisions shall apply provisionally to the effects of the succession of States as between those two States as from the date of that succession of States.

4. Any declaration made in accordance with paragraph 2 or 3 shall be contained in a written notification communicated to the depositary, who shall inform the Parties and the States entitled to

become Parties to the present Convention of the communication to him of that notification and of its terms.

Article 8
Agreements for the devolution of treaty obligations or rights from a predecessor State to a successor State

1. The obligations or rights of a predecessor State under treaties in force in respect of a territory at the date of a succession of States do not become the obligations or rights of the successor State towards other States Parties to those treaties by reason only of the fact that the predecessor State and the successor State have concluded an agreement providing that such obligations or rights shall devolve upon the successor State.

2. Notwithstanding the conclusion of such an agreement, the effects of a succession of States on treaties which, at the date of that succession of States, were in force in respect of the territory in question are governed by the present Convention.

Article 9
Unilateral declaration by a successor State regarding treaties of the predecessor State

1. Obligations or rights under treaties in force in respect of a territory at the date of a succession of States do not become the obligations or rights of the successor State or of other States Parties to those treaties by reason only of the fact that the successor State has made a unilateral declaration providing for the continuance in force of the treaties in respect of its territory.

2. In such a case, the effects of the succession of States on treaties which, at the date of that succession of States, were in force in respect of the territory in question are governed by the present Convention.

Article 10
Treaties providing for the participation of a successor State

1. When a treaty provides that, on the occurrence of a succession of States, a successor State shall have the option to consider itself a party to the treaty, it may notify its succession in respect of the treaty in conformity with the provisions of the treaty or, failing any such provisions, in conformity with the provisions of the present Convention.

2. If a treaty provides that, on the occurrence of a succession of States, a successor State shall be considered as a party to the treaty, that provision takes effect as such only if the successor State expressly accepts in writing to be so considered.

3. In cases falling under paragraph 1 or 2, a successor State which establishes its consent to be a party to the treaty is considered as a party from the date of the succession of States unless the treaty otherwise provides or it is otherwise agreed.

Article 11
Boundary regimes

A succession of States does not as such affect:

(*a*) a boundary established by a treaty; or

(*b*) obligations and rights established by a treaty and relating to the regime of a boundary.

Article 12
Other territorial regimes

1. A succession of States does not as such affect:

(*a*) obligations relating to the use of any territory, or to restrictions upon its use, established by a treaty for the benefit of any territory of a foreign State and considered as attaching to the territories in question;

(*b*) rights established by a treaty for the benefit of any territory and relating to the use, or to restrictions upon the use, of any territory of a foreign State and considered as attaching to the territories in question.

2. A succession of States does not as such affect:

(*a*) obligations relating to the use of any territory, or to restrictions upon its use, established by a treaty for the benefit of a group of States or of all States and considered as attaching to that territory;

(*b*) rights established by a treaty for the benefit of a group of States or of all States and relating to the use of any territory, or to restrictions upon its use, and considered as attaching to that territory.

3. The provisions of the present article do not apply to treaty obligations of the predecessor State providing for the establishment of foreign military bases on the territory to which the succession of States relates.

Article 13
The present Convention and permanent sovereignty
over natural wealth and resources

Nothing in the present Convention shall affect the principles of international law affirming the permanent sovereignty of every people and every State over its natural wealth and resources.

Article 14
Questions relating to the validity of a treaty

Nothing in the present Convention shall be considered as prejudging in any respect any question relating to the validity of a treaty.

Part II.
Succession in Respect of Part of Territory

Article 15
Succession in respect of part of territory

When part of the territory of a State, or when any territory for the international relations of which a State is responsible, not being part of the territory of that State, becomes part of the territory of another State:

(*a*) treaties of the predecessor State cease to be in force in respect of the territory to which the succession of States relates from the date of the succession of States; and

(*b*) treaties of the successor State are in force in respect of the territory to which the succession of States relates from the date of the succession of States, unless it appears from the treaty or is otherwise established that the application of the treaty to that territory would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Part III.
Newly Independent States

Section 1. General rule

Article 16
Position in respect of the treaties of the predecessor State

A newly independent State is not bound to maintain in force, or to become a party to, any treaty by reason only of the fact that at the date of the succession of States the treaty was in force in respect of the territory to which the succession of States relates.

Section 2. Multilateral treaties

Article 17
Participation in treaties in force at the date of the succession of States

1. Subject to paragraphs 2 and 3, a newly independent State may, by a notification of succession, establish its status as a party to any multilateral treaty which at the date of the succession of States was in force in respect of the territory to which the succession of States relates.

2. Paragraph 1 does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the newly independent State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

3. When, under the terms of the treaty or by reason of the limited number of the negotiating States and the object and purpose of the treaty, the participation of any other State in the treaty must be considered as requiring the consent of all the parties, the newly independent State may establish its status as a party to the treaty only with such consent.

Article 18
Participation in treaties not in force at the date of the succession of States

1. Subject to paragraphs 3 and 4, a newly independent State may, by a notification of succession, establish its status as a contracting State to a multilateral treaty which is not in force if at the date of the succession of States the predecessor State was a contracting State in respect of the territory to which that succession of States relates.

2. Subject to paragraphs 3 and 4, a newly independent State may, by a notification of succession, establish its status as a party to a multilateral treaty which enters into force after the date of the succession of States if at the date of the succession of States the predecessor State was a contracting State in respect of the territory to which that succession of States relates.

3. Paragraphs 1 and 2 do not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the newly independent State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

4. When, under the terms of the treaty or by reason of the limited number of the negotiating States and the object and purpose of the treaty, the participation of any other State in the treaty must be considered as requiring the consent of all the parties or of all the contracting States, the newly independent State may establish its status as a party or as a contracting State to the treaty only with such consent.

5. When a treaty provides that a specified number of contracting States shall be necessary for its entry into force, a newly independent State which establishes its status as a contracting State to the treaty under paragraph 1 shall be counted as a contracting State for the purpose of that provision unless a different intention appears from the treaty, or is otherwise established.

Article 19
Participation in treaties signed by the predecessor State subject to ratification, acceptance or approval

1. Subject to paragraphs 3 and 4, if before the date of the succession of States the predecessor State signed a multilateral treaty subject to ratification, acceptance or approval and by the signature intended that the treaty should extend to the territory to which the succession of States relates, the newly independent State may ratify, accept or approve the treaty as if it had signed that treaty and may thereby become a party or a contracting State to it.

2. For the purpose of paragraph 1, unless a different intention appears from the treaty or is otherwise established, the signature by the predecessor State of a treaty is considered to express the

intention that the treaty should extend to the entire territory for the international relations of which the predecessor State was responsible.

3. Paragraph 1 does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the newly independent State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

4. When, under the terms of the treaty or by reason of the limited number of the negotiating States and the object and purpose of the treaty, the participation of any other State in the treaty must be considered as requiring the consent of all the parties or of all the contracting States, the newly independent State may become a party or a contracting State to the treaty only with such consent.

Article 20
Reservations

1. When a newly independent State establishes its status as a party or as a contracting State to a multilateral treaty by a notification of succession under article 17 or 18, it shall be considered as maintaining any reservation to that treaty which was applicable at the date of the succession of States in respect of the territory to which the succession of States relates unless, when making the notification of succession, it expresses a contrary intention or formulates a reservation which relates to the same subject matter as that reservation.

2. When making a notification of succession establishing its status as a party or as a contracting State to a multilateral treaty under article 17 or 18, a newly independent State may formulate a reservation unless the reservation is one the formulation of which would be excluded by the provisions of subparagraph (*a*), (*b*) or (*c*) of article 19 of the Vienna Convention on the Law of Treaties.

3. When a newly independent State formulates a reservation in conformity with paragraph 2, the rules set out in articles 20 to 23 of the Vienna Convention on the Law of Treaties apply in respect of that reservation.

Article 21
Consent to be bound by part of a treaty and choice between differing provisions

1. When making a notification of succession under article 17 or 18 establishing its status as a party or contracting State to a multilateral treaty, a newly independent State may, if the treaty so permits, express its consent to be bound by part of the treaty or make a choice between differing provisions under the conditions laid down in the treaty for expressing such consent or making such choice.

2. A newly independent State may also exercise, under the same conditions as the other parties or contracting States, any right provided for in the treaty to withdraw or modify any consent expressed or choice made by itself or by the predecessor State in respect of the territory to which the succession of States relates.

3. If the newly independent State does not in conformity with paragraph 1 express its consent or make a choice, or in conformity with paragraph 2 withdraw or modify the consent or choice of the predecessor State, it shall be considered as maintaining:

(*a*) the consent of the predecessor State, in conformity with the treaty, to be bound, in respect of the territory to which the succession of States relates, by part of that treaty; or

(*b*) the choice of the predecessor State, in conformity with the treaty, between differing provisions in the application of the treaty in respect of the territory to which the succession of States relates.

Article 22
Notification of succession

1. A notification of succession in respect of a multilateral treaty under article 17 or 18 shall be made in writing.

2. If the notification of succession is not signed by the Head of State, Head of Government or Minister for Foreign Affairs, the representative of the State communicating it may be called upon to produce full powers.

3. Unless the treaty otherwise provides, the notification of succession shall:

(*a*) be transmitted by the newly independent State to the depositary, or, if there is no depositary, to the parties or the contracting States;

(*b*) be considered to be made by the newly independent State on the date on which it is received by the depositary or, if there is no depositary, on the date on which it is received by all the parties or, as the case may be, by all the contracting States.

4. Paragraph 3 does not affect any duty that the depositary may have, in accordance with the treaty or otherwise, to inform the parties or the contracting States of the notification of succession or any communication made in connection therewith by the newly independent State.

5. Subject to the provisions of the treaty, the notification of succession or the communication made in connection therewith shall be considered as received by the State for which it is intended only when the latter State has been informed by the depositary.

Article 23
Effects of a notification of succession

1. Unless the treaty otherwise provides or it is otherwise agreed, a newly independent State which makes a notification of succession under article 17 or article 18, paragraph 2, shall be considered a party to the treaty from the date of the succession of States or from the date of entry into force of the treaty, whichever is the later date.

2. Nevertheless, the operation of the treaty shall be considered as suspended as between the newly independent State and the other parties to the treaty until the date of making of the notification of succession except insofar as that treaty may be applied provisionally in accordance with article 27 or as may be otherwise agreed.

3. Unless the treaty otherwise provides or it is otherwise agreed, a newly independent State which makes a notification of succession under article 18, paragraph 1, shall be considered a contracting State to the treaty from the date on which the notification of succession is made.

SECTION 3. BILATERAL TREATIES

Article 24
Conditions under which a treaty is considered as being in force in the case of a succession of States

1. A bilateral treaty which at the date of a succession of States was in force in respect of the territory to which the succession of States relates is considered as being in force between a newly independent State and the other State party when:

(*a*) they expressly so agree; or

(*b*) by reason of their conduct they are to be considered as having so agreed.

2. A treaty considered as being in force under paragraph 1 applies in the relations between the newly independent State and the other State party from the date of the succession of States, unless a different intention appears from their agreement or is otherwise established.

Article 25
The position as between the predecessor State and the newly independent State

A treaty which under article 24 is considered as being in force between a newly independent State and the other State party is not by reason only of that fact to be considered as being in force also in the relations between the predecessor State and the newly independent State.

Article 26
Termination, suspension of operation or amendment of the treaty as between the predecessor State and the other State party

1. When under article 24 a treaty is considered as being in force between a newly independent State and the other State party, the treaty:

(*a*) does not cease to be in force between them by reason only of the fact that it has subsequently been terminated as between the predecessor State and the other State party;

(*b*) is not suspended in operation as between them by reason only of the fact that it has subsequently been suspended in operation as between the predecessor State and the other State party;

(*c*) is not amended as between them by reason only of the fact that it has subsequently been amended as between the predecessor State and the other State party.

2. The fact that a treaty has been terminated or, as the case may be, suspended in operation as between the predecessor State and the other State party after the date of the succession of States does not prevent the treaty from being considered to be in force or, as the case may be, in operation as between the newly independent State and the other State party if it is established in accordance with article 24 that they so agreed.

3. The fact that a treaty has been amended as between the predecessor State and the other State party after the date of the succession of States does not prevent the unamended treaty from being considered to be in force under article 24 as between the newly independent State and the other State party, unless it is established that they intended the treaty as amended to apply between them.

SECTION 4. PROVISIONAL APPLICATION

Article 27
Multilateral treaties

1. If, at the date of the succession of States, a multilateral treaty was in force in respect of the territory to which the succession of States relates and the newly independent State gives notice of its intention that the treaty should be applied provisionally in respect of its territory, that treaty shall apply provisionally between the newly independent State and any party which expressly so agrees or by reason of its conduct is to be considered as having so agreed.

2. Nevertheless, in the case of a treaty which falls within the category mentioned in article 17, paragraph 3, the consent of all the parties to such provisional application is required.

3. If, at the date of the succession of States, a multilateral treaty not yet in force was being applied provisionally in respect of the territory to which the succession of States relates and the newly independent State gives notice of its intention that the treaty should continue to be applied provisionally in respect of its territory, that treaty shall apply provisionally between the newly independent State and any contracting State which expressly so agrees or by reason of its conduct is to be considered as having so agreed.

4. Nevertheless, in the case of a treaty which falls within the category mentioned in article 17, paragraph 3, the consent of all the contracting States to such continued provisional application is required.

5. Paragraphs 1 to 4 do not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the newly independent State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Article 28
Bilateral treaties

A bilateral treaty which at the date of a succession of States was in force or was being provisionally applied in respect of the territory to which the succession of States relates is considered as applying provisionally between the newly independent State and the other State concerned when:

(*a*) they expressly so agree; or

(*b*) by reason of their conduct they are to be considered as having so agreed.

Article 29
Termination of provisional application

1. Unless the treaty otherwise provides or it is otherwise agreed, the provisional application of a multilateral treaty under article 27 may be terminated:

(*a*) by reasonable notice of termination given by the newly independent State or the party or contracting State provisionally applying the treaty and the expiration of the notice; or

(*b*) in the case of a treaty which falls within the category mentioned in article 17, paragraph 3, by reasonable notice of termination given by the newly independent State or all of the parties or, as the case may be, all of the contracting States and the expiration of the notice.

2. Unless the treaty otherwise provides or it is otherwise agreed, the provisional application of a bilateral treaty under article 28 may be terminated by reasonable notice of termination given by the newly independent State or the other State concerned and the expiration of the notice.

3. Unless the treaty provides for a shorter period for its termination or it is otherwise agreed, reasonable notice of termination shall be twelve months' notice from the date on which it is received by the other State or States provisionally applying the treaty.

4. Unless the treaty otherwise provides or it is otherwise agreed, the provisional application of a multilateral treaty under article 27 shall be terminated if the newly independent State gives notice of its intention not to become a party to the treaty.

SECTION 5. NEWLY INDEPENDENT STATES FORMED
FROM TWO OR MORE TERRITORIES

Article 30
Newly independent States formed from two
or more territories

1. Articles 16 to 29 apply in the case of a newly independent State formed from two or more territories.

2. When a newly independent State formed from two or more territories is considered as or becomes a party to a treaty by virtue of article 17, 18 or 24 and at the date of the succession of States the treaty was in force, or consent to be bound had been given, in respect of one or more, but not all, of those territories, the treaty shall apply in respect of the entire territory of that State unless:

(*a*) it appears from the treaty or is otherwise established that the application of the treaty in respect of the entire territory would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation;

(*b*) in the case of a multilateral treaty not falling under article 17, paragraph 3, or under article 18, paragraph 4, the notification of succession is restricted to the territory in respect of which the treaty was in force at the date of the succession of States, or in respect of which consent to be bound by the treaty had been given prior to that date;

(*c*) in the case of a multilateral treaty falling under article 17, paragraph 3, or under article 18, paragraph 4, the newly independent State and the other States Parties or, as the case may be, the other contracting States otherwise agree; or

(*d*) in the case of a bilateral treaty, the newly independent State and the other State concerned otherwise agree.

3. When a newly independent State formed from two or more territories becomes a party to a multilateral treaty under article 19 and by the signature or signatures of the predecessor State or States it had been intended that the treaty should extend to one or more, but not all, of those territories, the treaty shall apply in respect of the entire territory of the newly independent State unless:

(*a*) it appears from the treaty or is otherwise established that the application of the treaty in respect of the entire territory would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation;

(*b*) in the case of a multilateral treaty not falling under article 19, paragraph 4, the ratification, acceptance or approval of the treaty is restricted to the territory or territories to which it was intended that the treaty should extend; or

(*c*) in the case of a multilateral treaty falling under article 19, paragraph 4, the newly independent State and the other States Parties or, as the case may be, the other contracting States otherwise agree.

PART IV.
UNITING AND SEPARATION OF STATES

Article 31
Effects of a uniting of States in respect of treaties in force at the date of the succession of States

1. When two or more States unite and so form one successor State, any treaty in force at the date of the succession of States in respect of any of them continues in force in respect of the successor State unless:

(*a*) the successor State and the other State party or States Parties otherwise agree; or

(*b*) it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

2. Any treaty continuing in force in conformity with paragraph 1 shall apply only in respect of the part of the territory of the successor State in respect of which the treaty was in force at the date of the succession of States unless:

(*a*) in the case of a multilateral treaty not falling within the category mentioned in article 17, paragraph 3, the successor State makes a notification that the treaty shall apply in respect of its entire territory;

(b) in the case of a multilateral treaty falling within the category mentioned in article 17, paragraph 3, the successor State and the other States Parties otherwise agree; or

(*c*) in the case of a bilateral treaty, the successor State and the other State party otherwise agree.

3. Paragraph 2 (*a*) does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the entire territory of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Article 32
Effects of a uniting of States in respect of treaties not in force at the date of the succession of States

1. Subject to paragraphs 3 and 4, a successor State falling under article 31 may, by making a notification, establish its status as a contracting State to a multilateral treaty which is not in force if, at the date of the succession of States, any of the predecessor States was a contracting State to the treaty.

2. Subject to paragraphs 3 and 4, a successor State falling under article 31 may, by making a notification, establish its status as a party to a multilateral treaty which enters into force after the date of the succession of States if, at that date, any of the predecessor States was a contracting State to the treaty.

3. Paragraphs 1 and 2 do not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

4. If the treaty is one falling within the category mentioned in article 17, paragraph 3, the successor State may establish its status as a party or as a contracting State to the treaty only with the consent of all the parties or of all the contracting States.

5. Any treaty to which the successor State becomes a contracting State or a party in conformity with paragraph 1 or 2 shall apply only in respect of the part of the territory of the successor State in respect of which consent to be bound by the treaty had been given prior to the date of the succession of States unless:

(*a*) in the case of a multilateral treaty not falling within the category mentioned in article 17, paragraph 3, the successor State indicates in its notification made under paragraph 1 or 2 that the treaty shall apply in respect of its entire territory; or

(*b*) in the case of a multilateral treaty falling within the category mentioned in article 17, paragraph 3, the successor State and all the parties or, as the case may be, all the contracting States otherwise agree.

6. Paragraph 5 (*a*) does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the entire territory of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Article 33
Effects of a uniting of States in respect of treaties signed by a predecessor State subject to ratification, acceptance or approval

1. Subject to paragraphs 2 and 3, if before the date of the succession of States one of the predecessor States had signed a multilateral treaty subject to ratification, acceptance or approval, a successor State falling under article 31 may ratify, accept or approve the treaty as if it had signed that treaty and may thereby become a party or a contracting State to it.

2. Paragraph 1 does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

3. If the treaty is one falling within the category mentioned in article 17, paragraph 3, the successor State may become a party or a contracting State to the treaty only with the consent of all the parties or of all the contracting States.

4. Any treaty to which the successor State becomes a party or a contracting State in conformity with paragraph 1 shall apply only in respect of the part of the territory of the successor State in respect of which the treaty was signed by one of the predecessor States unless:

(*a*) in the case of a multilateral treaty not falling within the category mentioned in article 17, paragraph 3, the successor State when ratifying, accepting or approving the treaty gives notice that the treaty shall apply in respect of its entire territory; or

(*b*) in the case of a multilateral treaty falling within the category mentioned in article 17, paragraph 3, the successor State and all the parties or, as the case may be, all the contracting States otherwise agree.

5. Paragraph 4 (*a*) does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the entire territory of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Article 34
Succession of States in cases of separation of parts of a State

1. When a part or parts of the territory of a State separate to form one or more States, whether or not the predecessor State continues to exist:

(*a*) any treaty in force at the date of the succession of States in respect of the entire territory of the predecessor State continues in force in respect of each successor State so formed;

(*b*) any treaty in force at the date of the succession of States in respect only of that part of the territory of the predecessor State which has become a successor State continues in force in respect of that successor State alone.

2. Paragraph 1 does not apply if:

(*a*) the States concerned otherwise agree; or

(*b*) it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Article 35
Position if a State continues after separation of part of its territory

When, after separation of any part of the territory of a State, the predecessor State continues to exist, any treaty which at the date of the succession of States was in force in respect of the predecessor State continues in force in respect of its remaining territory unless:

(*a*) the States concerned otherwise agree;

(*b*) it is established that the treaty related only to the territory which has separated from the predecessor State; or

(*c*) it appears from the treaty or is otherwise established that the application of the treaty in respect of the predecessor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

Article 36
Participation in treaties not in force at the date of the succession of States in cases of separation of parts of a State

1. Subject to paragraphs 3 and 4, a successor State falling under article 34, paragraph 1, may, by making a notification, establish its status as a contracting State to a multilateral treaty which is not in force if, at the date of the succession of States, the predecessor State was a contracting State to the treaty in respect of the territory to which the succession of States relates.

2. Subject to paragraphs 3 and 4, a successor State falling under article 34, paragraph 1, may, by making a notification, establish its status as a party to a multilateral treaty which enters into force after the date of the succession of States if at that date the predecessor State was a contracting State to the treaty in respect of the territory to which the succession of States relates.

3. Paragraphs 1 and 2 do not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

4. If the treaty is one falling within the category mentioned in article 17, paragraph 3, the successor State may establish its status as a party or as a contracting State to the treaty only with the consent of all the parties or of all the contracting States.

Article 37
Participation in cases of separation of parts of a State in treaties signed by the predecessor State subject to ratification, acceptance or approval

1. Subject to paragraphs 2 and 3, if before the date of the succession of States the predecessor State had signed a multilateral treaty subject to ratification, acceptance or approval and the treaty, if it had been in force at that date, would have applied in respect of the territory to which the succession of States relates, a successor State falling under article 34, paragraph 1, may ratify, accept or approve the treaty as if it had signed that treaty and may thereby become a party or a contracting State to it.

2. Paragraph 1 does not apply if it appears from the treaty or is otherwise established that the application of the treaty in respect of the successor State would be incompatible with the object and purpose of the treaty or would radically change the conditions for its operation.

3. If the treaty is one falling within the category mentioned in article 17, paragraph 3, the successor State may become a party or a contracting State to the treaty only with the consent of all the parties or of all the contracting States.

Article 38
Notifications

1. Any notification under articles 31, 32 or 36 shall be made in writing.

2. If the notification is not signed by the Head of State, Head of Government or Minister for Foreign Affairs, the representative of the State communicating it may be called upon to produce full powers.

3. Unless the treaty otherwise provides, the notification shall:

(*a*) be transmitted by the successor State to the depositary, or, if there is no depositary, to the parties or the contracting States;

(*b*) be considered to be made by the successor State on the date on which it is received by the depositary or, if there is no depositary, on the date on which it is received by all the parties or, as the case may be, by all the contracting States.

4. Paragraph 3 does not affect any duty that the depositary may have, in accordance with the treaty or otherwise, to inform the parties or the contracting States of the notification or any communication made in connection therewith by the successor State.

5. Subject to the provisions of the treaty, such notification or communication shall be considered as received by the State for which it is intended only when the latter State has been informed by the depositary.

PART V.
MISCELLANEOUS PROVISIONS

Article 39
Cases of State responsibility and outbreak of hostilities

The provisions of the present Convention shall not prejudge any question that may arise in regard to the effects of a succession of States in respect of a treaty from the international responsibility of a State or from the outbreak of hostilities between States.

Article 40
Cases of military occupation

The provisions of the present Convention shall not prejudge any question that may arise in regard to a treaty from the military occupation of a territory.

Part VI.
Settlement of Disputes

Article 41
Consultation and negotiation

If a dispute regarding the interpretation or application of the present Convention arises between two or more Parties to the Convention, they shall, upon the request of any of them, seek to resolve it by a process of consultation and negotiation.

Article 42
Conciliation

If the dispute is not resolved within six months of the date on which the request referred to in article 41 has been made, any party to the dispute may submit it to the conciliation procedure specified in the Annex to the present Convention by submitting a request to that effect to the Secretary-General of the United Nations and informing the other party or parties to the dispute of the request.

Article 43
Judicial settlement and arbitration

Any State at the time of signature or ratification of the present Convention or accession thereto or at any time thereafter, may, by notification to the depositary, declare that, where a dispute has not been resolved by the application of the procedures referred to in articles 41 and 42, that dispute may be submitted for a decision to the International Court of Justice by a written application of any party to the dispute, or in the alternative to arbitration, provided that the other party to the dispute has made a like declaration.

Article 44
Settlement by common consent

Notwithstanding articles 41, 42 and 43, if a dispute regarding the interpretation or application of the present Convention arises between two or more Parties to the Convention, they may by common consent agree to submit it to the International Court of Justice, or to arbitration, or to any other appropriate procedure for the settlement of disputes.

Article 45
Other provisions in force for the settlement of disputes

Nothing in articles 41 to 44 shall affect the rights or obligations of the Parties to the present Convention under any provisions in force binding them with regard to the settlement of disputes.

PART VII.
FINAL PROVISIONS

Article 46
Signature

The present Convention shall be open for signature by all States until 28 February 1979 at the Federal Ministry for Foreign Affairs of the Republic of Austria, and subsequently, until 31 August 1979, at United Nations Headquarters in New York.

Article 47
Ratification

The present Convention is subject to ratification. The instruments of ratification shall be deposited with the Secretary-General of the United Nations.

Article 48
Accession

The present Convention shall remain open for accession by any State. The instruments of accession shall be deposited with the Secretary-General of the United Nations.

Article 49
Entry into force

1. The present Convention shall enter into force on the thirtieth day following the date of deposit of the fifteenth instrument of ratification or accession.

2. For each State ratifying or acceding to the Convention after the deposit of the fifteenth instrument of ratification or accession, the Convention shall enter into force on the thirtieth day after deposit by such State of its instrument of ratification or accession.

Article 50
Authentic texts

The original of the present Convention, of which the Arabic, Chinese, English, French, Russian and Spanish texts are equally authentic, shall be deposited with the Secretary-General of the United Nations.

IN WITNESS WHEREOF the undersigned Plenipotentiaries, being duly authorized thereto by their respective Governments, have signed the present Convention.

DONE at Vienna this twenty-third day of August, one thousand nine hundred and seventy-eight.

ANNEX

1. A list of conciliators consisting of qualified jurists shall be drawn up and maintained by the Secretary-General of the United Nations. To this end, every State which is a Member of the United Nations or a Party to the present Convention shall be invited to nominate two conciliators, and the names of the persons so nominated shall constitute the list. The term of a conciliator, including that of any conciliator nominated to fill a casual vacancy, shall be five years and may be renewed. A conciliator whose term expires shall continue to fulfil any function for which he shall have been chosen under the following paragraph.

2. When a request has been made to the Secretary-General under article 42, the Secretary-General shall bring the dispute before a conciliation commission constituted as follows:

The State or States constituting one of the parties to the dispute shall appoint:

(*a*) one conciliator of the nationality of that State or of one of those States, who may or may not be chosen from the list referred to in paragraph 1; and

(*b*) one conciliator not of the nationality of that State or of any of those States, who shall be chosen from the list.

The State or States constituting the other party to the dispute shall appoint two conciliators in the same way. The four conciliators chosen by the parties shall be appointed within sixty days following the date on which the Secretary-General receives the request.

The four conciliators shall, within sixty days following the date of the appointment of the last of them, appoint a fifth conciliator chosen from the list, who shall be chairman.

If the appointment of the chairman or of any of the other conciliators has not been made within the period prescribed above for such appointment, it shall be made by the Secretary-General within sixty days following the expiry of that period. The appointment of the chairman may be made by the Secretary-General either from the list or from the membership of the International Law Commission. Any of the periods within which appointments must be made may be extended by agreement between the parties to the dispute.

Any vacancy shall be filled in the manner prescribed for the initial appointment.

3. The Conciliation Commission shall decide its own procedure. The Commission, with the consent of the parties to the dispute, may invite any Party to the present Convention to submit to it its views orally or in writing. Decisions and recommendations of the Commission shall be made by a majority vote of the five members.

4. The Commission may draw the attention of the parties to the dispute to any measures which might facilitate an amicable settlement.

5. The Commission shall hear the parties, examine the claims and objections, and make proposals to the parties with a view to reaching an amicable settlement of the dispute.

6. The Commission shall report within twelve months of its constitution. Its report shall be deposited with the Secretary-General and transmitted to the parties to the dispute. The report of the Commission, including any conclusions stated therein regarding the facts or questions of law, shall not be binding upon the parties and it shall have no other character than that of recommendations submitted for the consideration of the parties in order to facilitate an amicable settlement of the dispute.

7. The Secretary-General shall provide the Commission with such assistance and facilities as it may require. The expenses of the Commission shall be borne by the United Nations.

____

ANNEX 13

Vienna Convention on the Law of Treaties
1969

Done at Vienna on 23 May 1969. Entered into force on 27 January 1980.
United Nations, *Treaty Series*, vol. 1155, p. 331

Copyright © United Nations
2005

Vienna Convention on the Law of Treaties
Done at Vienna on 23 May 1969

The States Parties to the present Convention,

Considering the fundamental role of treaties in the history of international relations,

Recognizing the ever-increasing importance of treaties as a source of international law and as a means of developing peaceful cooperation among nations, whatever their constitutional and social systems,

Noting that the principles of free consent and of good faith and the *pacta sunt servanda* rule are universally recognized,

Affirming that disputes concerning treaties, like other international disputes, should be settled by peaceful means and in conformity with the principles of justice and international law,

Recalling the determination of the peoples of the United Nations to establish conditions under which justice and respect for the obligations arising from treaties can be maintained,

Having in mind the principles of international law embodied in the Charter of the United Nations, such as the principles of the equal rights and self-determination of peoples, of the sovereign equality and independence of all States, of non-interference in the domestic affairs of States, of the prohibition of the threat or use of force and of universal respect for, and observance of, human rights and fundamental freedoms for all,

Believing that the codification and progressive development of the law of treaties achieved in the present Convention will promote the purposes of the United Nations set forth in the Charter, namely, the maintenance of international peace and security, the development of friendly relations and the achievement of cooperation among nations,

Affirming that the rules of customary international law will continue to govern questions not regulated by the provisions of the present Convention,

Have agreed as follows:

PART I.
INTRODUCTION

Article 1
Scope of the present Convention

The present Convention applies to treaties between States.

Article 2
Use of terms

1. For the purposes of the present Convention:

(*a*) “treaty” means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation;

(*b*) “ratification”, “acceptance”, “approval” and “accession” mean in each case the international act so named whereby a State establishes on the international plane its consent to be bound by a treaty;

(*c*) “full powers” means a document emanating from the competent authority of a State designating a person or persons to represent the State for negotiating, adopting or authenticating the text of a treaty, for expressing the consent of the State to be bound by a treaty, or for accomplishing any other act with respect to a treaty;

(*d*) “reservation” means a unilateral statement, however phrased or named, made by a State, when signing, ratifying, accepting, approving or acceding to a treaty, whereby it purports to exclude or to modify the legal effect of certain provisions of the treaty in their application to that State;

(*e*) “negotiating State” means a State which took part in the drawing up and adoption of the text of the treaty;

(*f*) “contracting State” means a State which has consented to be bound by the treaty, whether or not the treaty has entered into force;

(*g*) “party” means a State which has consented to be bound by the treaty and for which the treaty is in force;

(*h*) “third State” means a State not a party to the treaty;

(*i*) “international organization” means an intergovernmental organization.

2. The provisions of paragraph 1 regarding the use of terms in the present Convention are without prejudice to the use of those terms or to the meanings which may be given to them in the internal law of any State.

Article 3
International agreements not within the scope
of the present Convention

The fact that the present Convention does not apply to international agreements concluded between States and other subjects of international law or between such other subjects of international law, or to international agreements not in written form, shall not affect:

(*a*) the legal force of such agreements;

(*b*) the application to them of any of the rules set forth in the present Convention to which they would be subject under international law independently of the Convention;

(*c*) the application of the Convention to the relations of States as between themselves under international agreements to which other subjects of international law are also parties.

Article 4
Non-retroactivity of the present Convention

Without prejudice to the application of any rules set forth in the present Convention to which treaties would be subject under international law independently of the Convention, the Convention applies only to treaties which are concluded by States after the entry into force of the present Convention with regard to such States.

Article 5
Treaties constituting international organizations and treaties adopted within an international organization

The present Convention applies to any treaty which is the constituent instrument of an international organization and to any treaty adopted within an international organization without prejudice to any relevant rules of the organization.

PART II.
CONCLUSION AND ENTRY INTO FORCE OF TREATIES
SECTION 1. CONCLUSION OF TREATIES

Article 6
Capacity of States to conclude treaties

Every State possesses capacity to conclude treaties.

Article 7
Full powers

1. A person is considered as representing a State for the purpose of adopting or authenticating the text of a treaty or for the purpose of expressing the consent of the State to be bound by a treaty if:

(*a*) he produces appropriate full powers; or

(*b*) it appears from the practice of the States concerned or from other circumstances that their intention was to consider that person as representing the State for such purposes and to dispense with full powers.

2. In virtue of their functions and without having to produce full powers, the following are considered as representing their State:

(*a*) Heads of State, Heads of Government and Ministers for Foreign Affairs, for the purpose of performing all acts relating to the conclusion of a treaty;

(*b*) heads of diplomatic missions, for the purpose of adopting the text of a treaty between the accrediting State and the State to which they are accredited;

(*c*) representatives accredited by States to an international conference or to an international organization or one of its organs, for the purpose of adopting the text of a treaty in that conference, organization or organ.

Article 8
Subsequent confirmation of an act performed without authorization

An act relating to the conclusion of a treaty performed by a person who cannot be considered under article 7 as authorized to represent a State for that purpose is without legal effect unless afterwards confirmed by that State.

Article 9
Adoption of the text

1. The adoption of the text of a treaty takes place by the consent of all the States participating in its drawing up except as provided in paragraph 2.

2. The adoption of the text of a treaty at an international conference takes place by the vote of two thirds of the States present and voting, unless by the same majority they shall decide to apply a different rule.

Article 10
Authentication of the text

The text of a treaty is established as authentic and definitive:

(*a*) by such procedure as may be provided for in the text or agreed upon by the States participating in its drawing up; or

(*b*) failing such procedure, by the signature, signature ad referendum or initialling by the representatives of those States of the text of the treaty or of the Final Act of a conference incorporating the text.

Article 11
Means of expressing consent to be bound by a treaty

The consent of a State to be bound by a treaty may be expressed by signature, exchange of instruments constituting a treaty, ratification, acceptance, approval or accession, or by any other means if so agreed.

Article 12
Consent to be bound by a treaty expressed by signature

1. The consent of a State to be bound by a treaty is expressed by the signature of its representative when:

(*a*) the treaty provides that signature shall have that effect;

(*b*) it is otherwise established that the negotiating States were agreed that signature should have that effect; or

(*c*) the intention of the State to give that effect to the signature appears from the full powers of its representative or was expressed during the negotiation.

2. For the purposes of paragraph 1:

(*a*) the initialling of a text constitutes a signature of the treaty when it is established that the negotiating States so agreed;

(*b*) the signature ad referendum of a treaty by a representative, if confirmed by his State, constitutes a full signature of the treaty.

Article 13
Consent to be bound by a treaty expressed by an exchange of instruments constituting a treaty

The consent of States to be bound by a treaty constituted by instruments exchanged between them is expressed by that exchange when:

(*a*) the instruments provide that their exchange shall have that effect; or

(*b*) it is otherwise established that those States were agreed that the exchange of instruments should have that effect.

Article 14
Consent to be bound by a treaty expressed by ratification, acceptance or approval

1. The consent of a State to be bound by a treaty is expressed by ratification when:

(*a*) the treaty provides for such consent to be expressed by means of ratification;

(*b*) it is otherwise established that the negotiating States were agreed that ratification should be required;

(*c*) the representative of the State has signed the treaty subject to ratification; or

(*d*) the intention of the State to sign the treaty subject to ratification appears from the full powers of its representative or was expressed during the negotiation.

2. The consent of a State to be bound by a treaty is expressed by acceptance or approval under conditions similar to those which apply to ratification.

Article 15
Consent to be bound by a treaty expressed by accession

The consent of a State to be bound by a treaty is expressed by accession when:

(*a*) the treaty provides that such consent may be expressed by that State by means of accession;

(*b*) it is otherwise established that the negotiating States were agreed that such consent may be expressed by that State by means of accession; or

(*c*) all the parties have subsequently agreed that such consent may be expressed by that State by means of accession.

Article 16
Exchange or deposit of instruments of ratification, acceptance, approval or accession

Unless the treaty otherwise provides, instruments of ratification, acceptance, approval or accession establish the consent of a State to be bound by a treaty upon:

(*a*) their exchange between the contracting States;

(*b*) their deposit with the depositary; or

(*c*) their notification to the contracting States or to the depositary, if so agreed.

Article 17
Consent to be bound by part of a treaty and choice of differing provisions

1. Without prejudice to articles 19 to 23, the consent of a State to be bound by part of a treaty is effective only if the treaty so permits or the other contracting States so agree.

2. The consent of a State to be bound by a treaty which permits a choice between differing provisions is effective only if it is made clear to which of the provisions the consent relates.

Article 18
Obligation not to defeat the object and purpose of a treaty prior to its entry into force

A State is obliged to refrain from acts which would defeat the object and purpose of a treaty when:

(*a*) it has signed the treaty or has exchanged instruments constituting the treaty subject to ratification, acceptance or approval, until it shall have made its intention clear not to become a party to the treaty; or

(*b*) it has expressed its consent to be bound by the treaty, pending the entry into force of the treaty and provided that such entry into force is not unduly delayed.

SECTION 2. RESERVATIONS

Article 19
Formulation of reservations

A State may, when signing, ratifying, accepting, approving or acceding to a treaty, formulate a reservation unless:

(*a*) the reservation is prohibited by the treaty;

(*b*) the treaty provides that only specified reservations, which do not include the reservation in question, may be made; or

(*c*) in cases not failing under subparagraphs (*a*) and (*b*), the reservation is incompatible with the object and purpose of the treaty.

Article 20
Acceptance of and objection to reservations

1. A reservation expressly authorized by a treaty does not require any subsequent acceptance by the other contracting States unless the treaty so provides.

2. When it appears from the limited number of the negotiating States and the object and purpose of a treaty that the application of the treaty in its entirety between all the parties is an essential condition of the consent of each one to be bound by the treaty, a reservation requires acceptance by all the parties.

3. When a treaty is a constituent instrument of an international organization and unless it otherwise provides, a reservation requires the acceptance of the competent organ of that organization.

4. In cases not falling under the preceding paragraphs and unless the treaty otherwise provides:

(*a*) acceptance by another contracting State of a reservation constitutes the reserving State a party to the treaty in relation to that other State if or when the treaty is in force for those States;

(*b*) an objection by another contracting State to a reservation does not preclude the entry into force of the treaty as between the objecting and reserving States unless a contrary intention is definitely expressed by the objecting State;

(*c*) an act expressing a State's consent to be bound by the treaty and containing a reservation is effective as soon as at least one other contracting State has accepted the reservation.

5. For the purposes of paragraphs 2 and 4 and unless the treaty otherwise provides, a reservation is considered to have been accepted by a State if it shall have raised no objection to the reservation by the end of a period of twelve months after it was notified of the reservation or by the date on which it expressed its consent to be bound by the treaty, whichever is later.

Article 21
Legal effects of reservations and of objections to reservations

1. A reservation established with regard to another party in accordance with articles 19, 20 and 23:

(*a*) modifies for the reserving State in its relations with that other party the provisions of the treaty to which the reservation relates to the extent of the reservation; and

(*b*) modifies those provisions to the same extent for that other party in its relations with the reserving State.

2. The reservation does not modify the provisions of the treaty for the other parties to the treaty inter se.

3. When a State objecting to a reservation has not opposed the entry into force of the treaty between itself and the reserving State, the provisions to which the reservation relates do not apply as between the two States to the extent of the reservation.

Article 22
Withdrawal of reservations and of objections to reservations

1. Unless the treaty otherwise provides, a reservation may be withdrawn at any time and the consent of a State which has accepted the reservation is not required for its withdrawal.

2. Unless the treaty otherwise provides, an objection to a reservation may be withdrawn at any time.

3. Unless the treaty otherwise provides, or it is otherwise agreed:

(*a*) the withdrawal of a reservation becomes operative in relation to another contracting State only when notice of it has been received by that State;

(*b*) the withdrawal of an objection to a reservation becomes operative only when notice of it has been received by the State which formulated the reservation.

Article 23
Procedure regarding reservations

1. A reservation, an express acceptance of a reservation and an objection to a reservation must be formulated in writing and communicated to the contracting States and other States entitled to become parties to the treaty.

2. If formulated when signing the treaty subject to ratification, acceptance or approval, a reservation must be formally confirmed by the reserving State when expressing its consent to be bound by the treaty. In such a case the reservation shall be considered as having been made on the date of its confirmation.

3. An express acceptance of, or an objection to, a reservation made previously to confirmation of the reservation does not itself require confirmation.

4. The withdrawal of a reservation or of an objection to a reservation must be formulated in writing.

SECTION 3. ENTRY INTO FORCE AND PROVISIONAL, APPLICATION OF TREATIES

Article 24
Entry into force

1. A treaty enters into force in such manner and upon such date as it may provide or as the negotiating States may agree.

2. Failing any such provision or agreement, a treaty enters into force as soon as consent to be bound by the treaty has been established for all the negotiating States.

3. When the consent of a State to be bound by a treaty is established on a date after the treaty has come into force, the treaty enters into force for that State on that date, unless the treaty otherwise provides.

4. The provisions of a treaty regulating the authentication of its text, the establishment of the consent of States to be bound by the treaty, the manner or date of its entry into force, reservations, the functions of the depositary and other matters arising necessarily before the entry into force of the treaty apply from the time of the adoption of its text.

Article 25
Provisional application

1. A treaty or a part of a treaty is applied provisionally pending its entry into force if:

(*a*) the treaty itself so provides; or

(*b*) the negotiating States have in some other manner so agreed.

2. Unless the treaty otherwise provides or the negotiating States have otherwise agreed, the provisional application of a treaty or a part of a treaty with respect to a State shall be terminated if that State notifies the other States between which the treaty is being applied provisionally of its intention not to become a party to the treaty.

PART III.
OBSERVANCE, APPLICATION AND INTERPRETATION OF TREATIES

SECTION 1. OBSERVANCE OF TREATIES

Article 26
"Pacta sunt servanda"

Every treaty in force is binding upon the parties to it and must be performed by them in good faith.

Article 27
Internal law and observance of treaties

A party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. This rule is without prejudice to article 46.

SECTION 2. APPLICATION OF TREATIES

Article 28
Non-retroactivity of treaties

Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party.

Article 29
Territorial scope of treaties

Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.

Article 30
Application of successive treaties relating to the same subject matter

1. Subject to Article 103 of the Charter of the United Nations, the rights and obligations of States Parties to successive treaties relating to the same subject matter shall be determined in accordance with the following paragraphs.

2. When a treaty specifies that it is subject to, or that it is not to be considered as incompatible with, an earlier or later treaty, the provisions of that other treaty prevail.

3. When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.

4. When the parties to the later treaty do not include all the parties to the earlier one:

(*a*) as between States Parties to both treaties the same rule applies as in paragraph 3;

(*b*) as between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations.

5. Paragraph 4 is without prejudice to article 41, or to any question of the termination or suspension of the operation of a treaty under article 60 or to any question of responsibility which may arise for a State from the conclusion or application of a treaty the provisions of which are incompatible with its obligations towards another State under another treaty.

SECTION 3. INTERPRETATION OF TREATIES

Article 31
General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(*a*) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(*b*) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(*a*) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(*b*) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(*c*) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32
Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

(*a*) leaves the meaning ambiguous or obscure; or

(*b*) leads to a result which is manifestly absurd or unreasonable.

Article 33
Interpretation of treaties authenticated in two or more languages

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall prevail.

2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.

3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

SECTION 4. TREATIES AND THIRD STATES

Article 34
General rule regarding third States

A treaty does not create either obligations or rights for a third State without its consent.

Article 35
Treaties providing for obligations for third States

An obligation arises for a third State from a provision of a treaty if the parties to the treaty intend the provision to be the means of establishing the obligation and the third State expressly accepts that obligation in writing.

Article 36
Treaties providing for rights for third States

1. A right arises for a third State from a provision of a treaty if the parties to the treaty intend the provision to accord that right either to the third State, or to a group of States to which it belongs, or to all States, and the third State assents thereto. Its assent shall be presumed so long as the contrary is not indicated, unless the treaty otherwise provides.

2. A State exercising a right in accordance with paragraph 1 shall comply with the conditions for its exercise provided for in the treaty or established in conformity with the treaty.

Article 37
Revocation or modification of obligations or rights of third States

1. When an obligation has arisen for a third State in conformity with article 35, the obligation may be revoked or modified only with the consent of the parties to the treaty and of the third State, unless it is established that they had otherwise agreed.

2. When a right has arisen for a third State in conformity with article 36, the right may not be revoked or modified by the parties if it is established that the right was intended not to be revocable or subject to modification without the consent of the third State.

Article 38
Rules in a treaty becoming binding on third States through international custom

Nothing in articles 34 to 37 precludes a rule set forth in a treaty from becoming binding upon a third State as a customary rule of international law, recognized as such.

PART IV.
AMENDMENT AND MODIFICATION OF TREATIES

Article 39
General rule regarding the amendment of treaties

A treaty may be amended by agreement between the parties. The rules laid down in Part II apply to such an agreement except insofar as the treaty may otherwise provide.

Article 40
Amendment of multilateral treaties

1. Unless the treaty otherwise provides, the amendment of multilateral treaties shall be governed by the following paragraphs.

2. Any proposal to amend a multilateral treaty as between all the parties must be notified to all the contracting States, each one of which shall have the right to take part in:

(*a*) the decision as to the action to be taken in regard to such proposal;

(*b*) the negotiation and conclusion of any agreement for the amendment of the treaty.

3. Every State entitled to become a party to the treaty shall also be entitled to become a party to the treaty as amended.

4. The amending agreement does not bind any State already a party to the treaty which does not become a party to the amending agreement; article 30, paragraph 4 (b), applies in relation to such State.

5. Any State which becomes a party to the treaty after the entry into force of the amending agreement shall, failing an expression of a different intention by that State:

(*a*) be considered as a party to the treaty as amended; and

(*b*) be considered as a party to the unamended treaty in relation to any party to the treaty not bound by the amending agreement.

Article 41
Agreements to modify multilateral treaties between certain of the parties only

1. Two or more of the parties to a multilateral treaty may conclude an agreement to modify the treaty as between themselves alone if:

(*a*) the possibility of such a modification is provided for by the treaty; or

(*b*) the modification in question is not prohibited by the treaty and:

  (i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations;
  (ii) does not relate to a provision, derogation from which is incompatible with the effective execution of the object and purpose of the treaty as a whole.

2. Unless in a case falling under paragraph 1 (*a*) the treaty otherwise provides, the parties in question shall notify the other parties of their intention to conclude the agreement and of the modification to the treaty for which it provides.

Part V.
Invalidity, Termination and Suspension of the Operation of Treaties
Section 1. General provisions

Article 42
Validity and continuance in force of treaties

1. The validity of a treaty or of the consent of a State to be bound by a treaty may be impeached only through the application of the present Convention.

2. The termination of a treaty, its denunciation or the withdrawal of a party, may take place only as a result of the application of the provisions of the treaty or of the present Convention. The same rule applies to suspension of the operation of a treaty.

Article 43
Obligations imposed by international law independently of a treaty

The invalidity, termination or denunciation of a treaty, the withdrawal of a party from it, or the suspension of its operation, as a result of the application of the present Convention or of the provisions of the treaty, shall not in any way impair the duty of any State to fulfil any obligation embodied in the treaty to which it would be subject under international law independently of the treaty.

Article 44
Separability of treaty provisions

1. A right of a party, provided for in a treaty or arising under article 56, to denounce, withdraw from or suspend the operation of the treaty may be exercised only with respect to the whole treaty unless the treaty otherwise provides or the parties otherwise agree.

2. A ground for invalidating, terminating, withdrawing from or suspending the operation of a treaty recognized in the present Convention may be invoked only with respect to the whole treaty except as provided in the following paragraphs or in article 60.

3. If the ground relates solely to particular clauses, it may be invoked only with respect to those clauses where:

(*a*) the said clauses are separable from the remainder of the treaty with regard to their application;

(*b*) it appears from the treaty or is otherwise established that acceptance of those clauses was not an essential basis of the consent of the other party or parties to be bound by the treaty as a whole; and

(*c*) continued performance of the remainder of the treaty would not be unjust.

4. In cases falling under articles 49 and 50, the State entitled to invoke the fraud or corruption may do so with respect either to the whole treaty or, subject to paragraph 3, to the particular clauses alone.

5. In cases falling under articles 51, 52 and 53, no separation of the provisions of the treaty is permitted.

Article 45
Loss of a right to invoke a ground for invalidating, terminating, withdrawing from or suspending the operation of a treaty

A State may no longer invoke a ground for invalidating, terminating, withdrawing from or suspending the operation of a treaty under articles 46 to 50 or articles 60 and 62 if, after becoming aware of the facts:

(*a*) it shall have expressly agreed that the treaty is valid or remains in force or continues in operation, as the case may be; or

(*b*) it must by reason of its conduct be considered as having acquiesced in the validity of the treaty or in its maintenance in force or in operation, as the case may be.

SECTION 2. INVALIDITY OF TREATIES

Article 46
Provisions of internal law regarding competence to conclude treaties

1. A State may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance.

2. A violation is manifest if it would be objectively evident to any State conducting itself in the matter in accordance with normal practice and in good faith.

Article 47
Specific restrictions on authority to express the consent of a State

If the authority of a representative to express the consent of a State to be bound by a particular treaty has been made subject to a specific restriction, his omission to observe that restriction may not be invoked as invalidating the consent expressed by him unless the restriction was notified to the other negotiating States prior to his expressing such consent.

Article 48
Error

1. A State may invoke an error in a treaty as invalidating its consent to be bound by the treaty if the error relates to a fact or situation which was assumed by that State to exist at the time when the treaty was concluded and formed an essential basis of its consent to be bound by the treaty.

2. Paragraph 1 shall not apply if the State in question contributed by its own conduct to the error or if the circumstances were such as to put that State on notice of a possible error.

3. An error relating only to the wording of the text of a treaty does not affect its validity; article 79 then applies.

Article 49
Fraud

If a State has been induced to conclude a treaty by the fraudulent conduct of another negotiating State, the State may invoke the fraud as invalidating its consent to be bound by the treaty.

Article 50
Corruption of a representative of a State

If the expression of a State's consent to be bound by a treaty has been procured through the corruption of its representative directly or indirectly by another negotiating State, the State may invoke such corruption as invalidating its consent to be bound by the treaty.

Article 51
Coercion of a representative of a State

The expression of a State's consent to be bound by a treaty which has been procured by the coercion of its representative through acts or threats directed against him shall be without any legal effect.

Article 52
Coercion of a State by the threat or use of force

A treaty is void if its conclusion has been procured by the threat or use of force in violation of the principles of international law embodied in the Charter of the United Nations.

Article 53
Treaties conflicting with a peremptory norm of general international law ("jus cogens")

A treaty is void if, at the time of its conclusion, it conflicts with a peremptory norm of general international law. For the purposes of the present Convention, a peremptory norm of general international law is a norm accepted and recognized by the international community of States as a whole as a norm from which no derogation is permitted and which can be modified only by a subsequent norm of general international law having the same character.

SECTION 3. TERMINATION AND SUSPENSION OF THE OPERATION OF TREATIES

Article 54
Termination of or withdrawal from a treaty under its provisions or by consent of the parties

The termination of a treaty or the withdrawal of a party may take place:

(*a*) in conformity with the provisions of the treaty; or

(*b*) at any time by consent of all the parties after consultation with the other contracting States.

Article 55
Reduction of the parties to a multilateral treaty below the number necessary for its entry into force

Unless the treaty otherwise provides, a multilateral treaty does not terminate by reason only of the fact that the number of the parties falls below the number necessary for its entry into force.

Article 56
Denunciation of or withdrawal from a treaty containing no provision regarding termination, denunciation or withdrawal

1. A treaty which contains no provision regarding its termination and which does not provide for denunciation or withdrawal is not subject to denunciation or withdrawal unless:

(*a*) it is established that the parties intended to admit the possibility of denunciation or withdrawal; or

(*b*) a right of denunciation or withdrawal may be implied by the nature of the treaty.

2. A party shall give not less than twelve months' notice of its intention to denounce or withdraw from a treaty under paragraph 1.

Article 57
Suspension of the operation of a treaty under its provisions or by consent of the parties

The operation of a treaty in regard to all the parties or to a particular party may be suspended:

(*a*) in conformity with the provisions of the treaty; or

(*b*) at any time by consent of all the parties after consultation with the other contracting States.

Article 58
Suspension of the operation of a multilateral treaty by agreement between certain of the parties only

1. Two or more parties to a multilateral treaty may conclude an agreement to suspend the operation of provisions of the treaty, temporarily and as between themselves alone, if:

(*a*) the possibility of such a suspension is provided for by the treaty; or

(*b*) the suspension in question is not prohibited by the treaty and:

(i) does not affect the enjoyment by the other parties of their rights under the treaty or the performance of their obligations;
(ii) is not incompatible with the object and purpose of the treaty.

2. Unless in a case falling under paragraph 1 (*a*) the treaty otherwise provides, the parties in question shall notify the other parties of their intention to conclude the agreement and of those provisions of the treaty the operation of which they intend to suspend.

Article 59
Termination or suspension of the operation of a treaty implied by conclusion of a later treaty

1. A treaty shall be considered as terminated if all the parties to it conclude a later treaty relating to the same subject matter and:

(*a*) it appears from the later treaty or is otherwise established that the parties intended that the matter should be governed by that treaty; or

(*b*) the provisions of the later treaty are so far incompatible with those of the earlier one that the two treaties are not capable of being applied at the same time.

2. The earlier treaty shall be considered as only suspended in operation if it appears from the later treaty or is otherwise established that such was the intention of the parties.

Article 60
Termination or suspension of the operation of a treaty as a consequence of its breach

1. A material breach of a bilateral treaty by one of the parties entitles the other to invoke the breach as a ground for terminating the treaty or suspending its operation in whole or in part.

2. A material breach of a multilateral treaty by one of the parties entitles:

(*a*) the other parties by unanimous agreement to suspend the operation of the treaty in whole or in part or to terminate it either:

(i) in the relations between themselves and the defaulting State; or

(ii) as between all the parties;

(*b*) a party specially affected by the breach to invoke it as a ground for suspending the operation of the treaty in whole or in part in the relations between itself and the defaulting State;

(*c*) any party other than the defaulting State to invoke the breach as a ground for suspending the operation of the treaty in whole or in part with respect to itself if the treaty is of such a character that a material breach of its provisions by one party radically changes the position of every party with respect to the further performance of its obligations under the treaty.

3. A material breach of a treaty, for the purposes of this article, consists in:

(*a*) a repudiation of the treaty not sanctioned by the present Convention; or

(*b*) the violation of a provision essential to the accomplishment of the object or purpose of the treaty.

4. The foregoing paragraphs are without prejudice to any provision in the treaty applicable in the event of a breach.

5. Paragraphs 1 to 3 do not apply to provisions relating to the protection of the human person contained in treaties of a humanitarian character, in particular to provisions prohibiting any form of reprisals against persons protected by such treaties.

Article 61
Supervening impossibility of performance

1. A party may invoke the impossibility of performing a treaty as a ground for terminating or withdrawing from it if the impossibility results from the permanent disappearance or destruction of an object indispensable for the execution of the treaty. If the impossibility is temporary, it may be invoked only as a ground for suspending the operation of the treaty.

2. Impossibility of performance may not be invoked by a party as a ground for terminating, withdrawing from or suspending the operation of a treaty if the impossibility is the result of a breach by that party either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.

Article 62
Fundamental change of circumstances

1. A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:

(*a*) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and

(*b*) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

2. A fundamental change of circumstances may not be invoked as a ground for terminating or withdrawing from a treaty:

(*a*) if the treaty establishes a boundary; or

(*b*) if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty.

3. If, under the foregoing paragraphs, a party may invoke a fundamental change of circumstances as a ground for terminating or withdrawing from a treaty it may also invoke the change as a ground for suspending the operation of the treaty.

Article 63
Severance of diplomatic or consular relations

The severance of diplomatic or consular relations between parties to a treaty does not affect the legal relations established between them by the treaty except insofar as the existence of diplomatic or consular relations is indispensable for the application of the treaty.

Article 64
Emergence of a new peremptory norm of general international law ("jus cogens")

If a new peremptory norm of general international law emerges, any existing treaty which is in conflict with that norm becomes void and terminates.

SECTION 4. PROCEDURE

Article 65
Procedure to be followed with respect to invalidity, termination, withdrawal from or suspension of the operation of a treaty

1. A party which, under the provisions of the present Convention, invokes either a defect in its consent to be bound by a treaty or a ground for impeaching the validity of a treaty, terminating it, withdrawing from it or suspending its operation, must notify the other parties of its claim. The notification shall indicate the measure proposed to be taken with respect to the treaty and the reasons therefor.

2. If, after the expiry of a period which, except in cases of special urgency, shall not be less than three months after the receipt of the notification, no party has raised any objection, the party making the notification may carry out in the manner provided in article 67 the measure which it has proposed.

3. If, however, objection has been raised by any other party, the parties shall seek a solution through the means indicated in Article 33 of the Charter of the United Nations.

4. Nothing in the foregoing paragraphs shall affect the rights or obligations of the parties under any provisions in force binding the parties with regard to the settlement of disputes.

5. Without prejudice to article 45, the fact that a State has not previously made the notification prescribed in paragraph 1 shall not prevent it from making such notification in answer to another party claiming performance of the treaty or alleging its violation.

Article 66
Procedures for judicial settlement, arbitration and conciliation

If, under paragraph 3 of article 65, no solution has been reached within a period of 12 months following the date on which the objection was raised, the following procedures shall be followed:

(*a*) any one of the parties to a dispute concerning the application or the interpretation of article 53 or 64 may, by a written application, submit it to the International Court of Justice for a decision unless the parties by common consent agree to submit the dispute to arbitration;

(*b*) any one of the parties to a dispute concerning the application or the interpretation of any of the other articles in part V of the present Convention may set in motion the procedure specified in the Annex to the Convention by submitting a request to that effect to the Secretary-General of the United Nations.

Article 67
Instruments for declaring invalid, terminating, withdrawing from or suspending the operation of a treaty

1. The notification provided for under article 65, paragraph 1, must be made in writing.

2. Any act of declaring invalid, terminating, withdrawing from or suspending the operation of a treaty pursuant to the provisions of the treaty or of paragraphs 2 or 3 of article 65 shall be carried out through an instrument communicated to the other parties. If the instrument is not signed by the Head of State, Head of Government or Minister for Foreign Affairs, the representative of the State communicating it may be called upon to produce full powers.

Article 68
Revocation of notifications and instruments provided for in articles 65 and 67

A notification or instrument provided for in article 65 or 67 may be revoked at any time before it takes effect.

SECTION 5. CONSEQUENCES OF THE INVALIDITY, TERMINATION OR SUSPENSION OF THE OPERATION OF A TREATY

Article 69
Consequences of the invalidity of a treaty

1. A treaty the invalidity of which is established under the present Convention is void. The provisions of a void treaty have no legal force.

2. If acts have nevertheless been performed in reliance on such a treaty:

(*a*) each party may require any other party to establish as far as possible in their mutual relations the position that would have existed if the acts had not been performed;

(*b*) acts performed in good faith before the invalidity was invoked are not rendered unlawful by reason only of the invalidity of the treaty.

3. In cases falling under article 49, 50, 51 or 52, paragraph 2 does not apply with respect to the party to which the fraud, the act of corruption or the coercion is imputable.

4. In the case of the invalidity of a particular State's consent to be bound by a multilateral treaty, the foregoing rules apply in the relations between that State and the parties to the treaty.

Article 70
Consequences of the termination of a treaty

1. Unless the treaty otherwise provides or the parties otherwise agree, the termination of a treaty under its provisions or in accordance with the present Convention:

(*a*) releases the parties from any obligation further to perform the treaty;

(*b*) does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination.

2. If a State denounces or withdraws from a multilateral treaty, paragraph 1 applies in the relations between that State and each of the other parties to the treaty from the date when such denunciation or withdrawal takes effect.

Article 71
Consequences of the invalidity of a treaty which conflicts with a peremptory norm of general international law

1. In the case of a treaty which is void under article 53 the parties shall:

(*a*) eliminate as far as possible the consequences of any act performed in reliance on any provision which conflicts with the peremptory norm of general international law; and

(*b*) bring their mutual relations into conformity with the peremptory norm of general international law.

2. In the case of a treaty which becomes void and terminates under article 64, the termination of the treaty:

(*a*) releases the parties from any obligation further to perform the treaty;

(*b*) does not affect any right, obligation or legal situation of the parties created through the execution of the treaty prior to its termination, provided that those rights, obligations or situations may thereafter be maintained only to the extent that their maintenance is not in itself in conflict with the new peremptory norm of general international law.

Article 72
Consequences of the suspension of the operation of a treaty

1. Unless the treaty otherwise provides or the parties otherwise agree, the suspension of the operation of a treaty under its provisions or in accordance with the present Convention:

(*a*) releases the parties between which the operation of the treaty is suspended from the obligation to perform the treaty in their mutual relations during the period of the suspension;

(*b*) does not otherwise affect the legal relations between the parties established by the treaty.

2. During the period of the suspension the parties shall refrain from acts tending to obstruct the resumption of the operation of the treaty.

PART VI.
MISCELLANEOUS PROVISIONS

Article 73
Cases of State succession, State responsibility and outbreak of hostilities

The provisions of the present Convention shall not prejudge any question that may arise in regard to a treaty from a succession of States or from the international responsibility of a State or from the outbreak of hostilities between States.

Article 74
Diplomatic and consular relations and the conclusion of treaties

The severance or absence of diplomatic or consular relations between two or more States does not prevent the conclusion of treaties between those States. The conclusion of a treaty does not in itself affect the situation in regard to diplomatic or consular relations.

Article 75
Case of an aggressor State

The provisions of the present Convention are without prejudice to any obligation in relation to a treaty which may arise for an aggressor State in consequence of measures taken in conformity with the Charter of the United Nations with reference to that State's aggression.

PART VII.
DEPOSITARIES, NOTIFICATIONS, CORRECTIONS AND REGISTRATION

Article 76
Depositaries of treaties

1. The designation of the depositary of a treaty may be made by the negotiating States, either in the treaty itself or in some other manner. The depositary may be one or more States, an international organization or the chief administrative officer of the organization.

2. The functions of the depositary of a treaty are international in character and the depositary is under an obligation to act impartially in their performance. In particular, the fact that a treaty has not entered into force between certain of the parties or that a difference has appeared between a State and a depositary with regard to the performance of the latter's functions shall not affect that obligation.

Article 77
Functions of depositaries

1. The functions of a depositary, unless otherwise provided in the treaty or agreed by the contracting States, comprise in particular:

(*a*) keeping custody of the original text of the treaty and of any full powers delivered to the depositary;

(*b*) preparing certified copies of the original text and preparing any further text of the treaty in such additional languages as may be required by the treaty and transmitting them to the parties and to the States entitled to become parties to the treaty;

(*c*) receiving any signatures to the treaty and receiving and keeping custody of any instruments, notifications and communications relating to it;

(*d*) examining whether the signature or any instrument, notification or communication relating to the treaty is in due and proper form and, if need be, bringing the matter to the attention of the State in question;

(*e*) informing the parties and the States entitled to become parties to the treaty of acts, notifications and communications relating to the treaty;

(*f*) informing the States entitled to become parties to the treaty when the number of signatures or of instruments of ratification, acceptance, approval or accession required for the entry into force of the treaty has been received or deposited;

(*g*) registering the treaty with the Secretariat of the United Nations;

(*h*) performing the functions specified in other provisions of the present Convention.

2. In the event of any difference appearing between a State and the depositary as to the performance of the latter's functions, the depositary shall bring the question to the attention of the signatory States and the contracting States or, where appropriate, of the competent organ of the international organization concerned.

Article 78
Notifications and communications

Except as the treaty or the present Convention otherwise provide, any notification or communication to be made by any State under the present Convention shall:

(*a*) if there is no depositary, be transmitted direct to the States for which it is intended, or if there is a depositary, to the latter;

(*b*) be considered as having been made by the State in question only upon its receipt by the State to which it was transmitted or, as the case may be, upon its receipt by the depositary;

(*c*) if transmitted to a depositary, be considered as received by the State for which it was intended only when the latter State has been informed by the depositary in accordance with article 77, paragraph 1 (*e*).

Article 79
Correction of errors in texts or in certified copies of treaties

1. Where, after the authentication of the text of a treaty, the signatory States and the contracting States are agreed that it contains an error, the error shall, unless they decide upon some other means of correction, be corrected:

(*a*) by having the appropriate correction made in the text and causing the correction to be initialled by duly authorized representatives;

(*b*) by executing or exchanging an instrument or instruments setting out the correction which it has been agreed to make; or

(*c*) by executing a corrected text of the whole treaty by the same procedure as in the case of the original text.

2. Where the treaty is one for which there is a depositary, the latter shall notify the signatory States and the contracting States of the error and of the proposal to correct it and shall specify an appropriate time-limit within which objection to the proposed correction may be raised. If, on the expiry of the time-limit:

(*a*) no objection has been raised, the depositary shall make and initial the correction in the text and shall execute a procès-verbal of the rectification of the text and communicate a copy of it to the parties and to the States entitled to become parties to the treaty;

(*b*) an objection has been raised, the depositary shall communicate the objection to the signatory States and to the contracting States.

3. The rules in paragraphs I and 2 apply also where the text has been authenticated in two or more languages and it appears that there is a lack of concordance which the signatory States and the contracting States agree should be corrected.

4. The corrected text replaces the defective text ab initio, unless the signatory States and the contracting States otherwise decide.

5. The correction of the text of a treaty that has been registered shall be notified to the Secretariat of the United Nations.

6. Where an error is discovered in a certified copy of a treaty, the depositary shall execute a procès-verbal specifying the rectification and communicate a copy of it to the signatory States and to the contracting States.

Article 80
Registration and publication of treaties

1. Treaties shall, after their entry into force, be transmitted to the Secretariat of the United Nations for registration or filing and recording, as the case may be, and for publication.

2. The designation of a depositary shall constitute authorization for it to perform the acts specified in the preceding paragraph.

PART VIII.
FINAL PROVISIONS

Article 81
Signature

The present Convention shall be open for signature by all States Members of the United Nations or of any of the specialized agencies or of the International Atomic Energy Agency or parties to the Statute of the International Court of Justice, and by any other State invited by the General Assembly of the United Nations to become a party to the Convention, as follows: until 30 November 1969, at the

Federal Ministry for Foreign Affairs of the Republic of Austria, and subsequently, until 30 April 1970, at United Nations Headquarters, New York.

Article 82
Ratification

The present Convention is subject to ratification. The instruments of ratification shall be deposited with the Secretary-General of the United Nations.

Article 83
Accession

The present Convention shall remain open for accession by any State belonging to any of the categories mentioned in article 81. The instruments of accession shall be deposited with the Secretary-General of the United Nations.

Article 84
Entry into force

1. The present Convention shall enter into force on the thirtieth day following the date of deposit of the thirty-fifth instrument of ratification or accession.

2. For each State ratifying or acceding to the Convention after the deposit of the thirty-fifth instrument of ratification or accession, the Convention shall enter into force on the thirtieth day after deposit by such State of its instrument of ratification or accession.

Article 85
Authentic texts

The original of the present Convention, of which the Chinese, English, French, Russian and Spanish texts are equally authentic, shall be deposited with the Secretary-General of the United Nations.

IN WITNESS WHEREOF the undersigned Plenipotentiaries, being duly authorized thereto by their respective Governments, have signed the present Convention.

DONE at Vienna this twenty-third day of May, one thousand nine hundred and sixty-nine.

ANNEX

1. A list of conciliators consisting of qualified jurists shall be drawn up and maintained by the Secretary-General of the United Nations. To this end, every State which is a Member of the United Nations or a party to the present Convention shall be invited to nominate two conciliators, and the names of the persons so nominated shall constitute the list. The term of a conciliator, including that of any conciliator nominated to fill a casual vacancy, shall be five years and may be renewed. A conciliator whose term expires shall continue to fulfil any function for which he shall have been chosen under the following paragraph.

2. When a request has been made to the Secretary-General under article 66, the Secretary-General shall bring the dispute before a conciliation commission constituted as follows:

The State or States constituting one of the parties to the dispute shall appoint:

(*a*) one conciliator of the nationality of that State or of one of those States, who may or may not be chosen from the list referred to in paragraph 1; and

(*b*) one conciliator not of the nationality of that State or of any of those States, who shall be chosen from the list.

The State or States constituting the other party to the dispute shall appoint two conciliators in the same way. The four conciliators chosen by the parties shall be appointed within sixty days following the date on which the Secretary-General receives the request.

The four conciliators shall, within sixty days following the date of the last of their own appointments, appoint a fifth conciliator chosen from the list, who shall be chairman.

If the appointment of the chairman or of any of the other conciliators has not been made within the period prescribed above for such appointment, it shall be made by the Secretary-General within sixty days following the expiry of that period. The appointment of the chairman may be made by the Secretary-General either from the list or from the membership of the International Law Commission. Any of the periods within which appointments must be made may be extended by agreement between the parties to the dispute.

Any vacancy shall be filled in the manner prescribed for the initial appointment.

3. The Conciliation Commission shall decide its own procedure. The Commission, with the consent of the parties to the dispute, may invite any party to the treaty to submit to it its views orally or in writing. Decisions and recommendations of the Commission shall be made by a majority vote of the five members.

4. The Commission may draw the attention of the parties to the dispute to any measures which might facilitate an amicable settlement.

5. The Commission shall hear the parties, examine the claims and objections, and make proposals to the parties with a view to reaching an amicable settlement of the dispute.

6. The Commission shall report within twelve months of its constitution. Its report shall be deposited with the Secretary-General and transmitted to the parties to the dispute. The report of the Commission, including any conclusions stated therein regarding the facts or questions of law, shall not be binding upon the parties and it shall have no other character than that of recommendations submitted for the consideration of the parties in order to facilitate an amicable settlement of the dispute.

7. The Secretary-General shall provide the Commission with such assistance and facilities as it may require. The expenses of the Commission shall be borne by the United Nations.

____

ANNEX 14

A/CN.4/SER.A/1974/Add.1 (Part One)

YEARBOOK OF THE INTERNATIONAL LAW COMMISSION 1974

Volume II
Part One

Documents of the twenty-sixth session: Reports of Special Rapporteurs, other documents submitted by members of the Commission and report of the Commission to the General Assembly

UNITED NATIONS

YEARBOOK OF THE INTERNATIONAL LAW COMMISSION

1974

Volume II
Part One

Documents of the twenty-sixth session:
Reports of Special Rapporteurs, other documents submitted by members of the Commission and report of the Commission to the General Assembly

UNITED NATIONS
New York, 1975

NOTE

Symbols of United Nations documents are composed of capital letters combined with figures. Mention of such a symbol indicates a reference to a United Nations document.

The word *Yearbook* followed by suspension points and the year (e.g. *Yearbook . . . 1970*) indicates a reference to the *Yearbook of the International Law Commission.*

A/CN.4/SER.A/1974/Add.1 (Part 1)

UNITED NATIONS PUBLICATION

Sales No. E.75.V.7 (Part I)

Price: $U.S. 14.00
(or equivalent in other currencies)

CONTENTS

Page

Prefatory note iv

Succession of States in respect of treaties (agenda item 4)

Document A/CN.4/278 and Add.1-6: First report on succession of States in respect of treaties, by Sir Francis Vallat, Special Rapporteur 1

Document A/CN.4/L.206: Article for insertion in Part I of the draft articles on succession of States in respect of treaties, proposed by Mr. Ushakov 89

Succession of States in respect of matters other than treaties (agenda item 5)

Document A/CN.4/282: Seventh report on succession of States in respect of matters other than treaties, by Mr. Mohammed Bedjaoui, Special Rapporteur—draft articles on succession to public property, with commentaries 91

Most-favoured-nation clause (agenda item 6)

Document A/CN.4/280: Fifth report on the most-favoured-nation clause, by Mr. Endre Ustor, Special Rapporteur—draft articles with commentaries *(continued)* 117

Question of treaties concluded between States and international organizations or between two or more international organizations (agenda item 7)

Document A/CN.4/279: Third report on the question of treaties concluded between States and international organizations or between two or more international organizations, by Mr. Paul Reuter, Special Rapporteur—draft articles with commentaries 135

Co-operation with other bodies (agenda item 10)

Document A/CN.4/L.214: Report on the twenty-first session of the European Committee on Legal Co-operation, by Mr. A. H. Tabibi, observer for the Commission 153

Report of the Commission to the General Assembly

Document A/9610/Rev.1: Report of the International Law Commission on the work of its twenty-sixth session, 6 May-26 July 1974 157

Check list of documents referred to in this volume 332

Check list of documents of the twenty-sixth session not reproduced in volume II 333

PREFATORY NOTE

Volume II of the 1974 *Yearbook* consists of two separately published parts containing the following documents:

PART ONE *(present volume)*

A/9610/Rev.1	Report of the International Law Commission on the work of its twenty-sixth session (6 May-26 July 1974)
A/CN.4/278 and Add.1-6	First report on succession of States in respect of treaties, by Sir Francis Vallat, Special Rapporteur
A/CN.4/279	Third report on the question of treaties concluded between States and international organizations or between two or more international organizations, by Mr. Paul Reuter, Special Rapporteur—draft articles with commentaries
A/CN.4/280	Fifth report on the most-favoured-nation clause, by Mr. Endre Ustor, Special Rapporteur—draft articles with commentaries *(continued)*
A/CN.4/282	Seventh report on succession of States in respect of matters other than treaties, by Mr. Mohammed Bedjaoui, Special Rapporteur—draft articles on succession to public property, with commentaries
A/CN.4/L.206	Article for insertion in Part I of the draft articles on succession of States in respect of treaties, proposed by Mr. Ushakov
A/CN.4/L.214	Report on the twenty-first session of the European Committee on Legal Co-operation, by Mr. A. H. Tabibi, observer for the Commission

PART TWO (*United Nations publications, Sales No. E.75.V.7 (Part II)*)

A/5409	Legal problems relating to the utilization and use of international rivers: report of the Secretary-General
A/CN.4/274	Legal problems relating to the non-navigational uses of international watercourses: supplementary report submitted by the Secretary-General
A/CN.4/276	Filling of casual vacancies: note by the Secretariat
A/CN.4/277	Selected bibliography on the question of treaties concluded between States and international organizations or between two or more international organizations: document prepared by the Secretariat
A/CN.4/281	Possibilities of participation by the United Nations in international agreements on behalf of a territory: study prepared by the Secretariat

SUCCESSION OF STATES IN RESPECT OF TREATIES

(Agenda item 4)

DOCUMENT A/CN.4/278 AND ADD.1-6*

First report on succession of States in respect of treaties, by Sir Francis Vallat, Special Rapporteur

[Original: English]
[19 and 22 April, 8, 24 and 31 May and 10 and 21 June 1974]

CONTENTS

	Paragraphs	Page
I. INTRODUCTION	1-9	3
A. Basis of the present report	1-7	3
B. Arrangement of the present report	8-9	4
II. OBSERVATIONS ON THE DRAFT ARTICLES AS A WHOLE	10-92	4
A. Importance of and need for the codification of the topic	11-15	4
B. Sources of the draft articles	16-18	6
C. The concept of " succession of States "	19-20	6
D. Relationship between succession in respect of treaties and the general law of treaties	21-23	6
E. The principle of self-determination and the law relating to succession in respect of treaties	24-30	7
F. Form of the draft	31-41	10
G. Scope of the draft	42-48	11
H. Scheme of the draft	49-65	13
1. Categories of succession of States	50-57	14
2. Categories of treaties	58-61	16
3. Arrangement of the draft articles	62-65	17
I. Recognition and succession of States	66-80	17
J. Interrelation between the present draft articles and the draft articles on succession of States in respect of matters other than treaties	81-87	20
K. General approval or disapproval	88-92	22
III. OBSERVATIONS ON THE SPECIFIC PROVISIONS OF THE DRAFT ARTICLES	93-471	23
Preliminary observations of the Special Rapporteur	93-94	23
Part I. General provisions	95-196	23
Article 1. Scope of the present articles	95-98	23
Article 2. Use of terms	99-135	24
Paragraph 1 (*a*)	99-158	24
Paragraph 1 (*b*)	102-119	24
Paragraph 1 (*c*)	120	28
Paragraph 1 (*d*)	121-123	28
Paragraph 1 (*e*)	124-135	28
Paragraph 1 (*f*)	136-143	30
Paragraph 1 (*g*)	144-146	31
Paragraph 1 (*h*)	147	32
Paragraph 1 (*i*)	148-150	32
Paragraph 1 (*j*)	151	32
Paragraph 1 (*k*)	152	32
Paragraph 1 (*l*)	153	32

* Incorporating A/CN.4/278/Add.5/Corr.1.

	Paragraphs	*Page*
Paragraph 1 (*m*)	154	32
Paragraph 1 (*n*)	155-157	32
Paragraph 2	158	32
Article 3. Cases not within the scope of the present articles	159-162	32
Article 4. Treaties constituting international organizations and treaties adopted within an international organization	163-165	33
Article 5. Obligations imposed by international law independently of a treaty	166-169	33
Article 6. Cases of succession of States covered by the present articles	170-179	33
Article 7. Agreements for the devolution of treaty obligations or rights from a predecessor to a successor State	180-186	35
Article 8. Successor State's unilateral declaration regarding its predecessor State's treaties	187-190	36
Article 9. Treaties providing for the participation of a successor State	191-196	36
Part II. Transfer of territory	197-213	37
Article 10. Transfer of territory	197-213	37
Part III. Newly independent States	214-363	39
Section 1. General rule	214-319	39
Article 11. Position in respect of the predecessor State's treaties	214-217	39
Section 2. Multilateral treaties	218-256	40
Article 12. Participation in treaties in force	218-256	40
Article 13. Participation in treaties not yet in force	257-263	48
Article 14. Ratification, acceptance, or approval of a treaty signed by the predecessor State	264-274	49
Article 15. Reservations	275-298	50
Article 16. Consent to be bound by part of a treaty and choice between differing provisions	299-306	55
Article 17. Notification of succession	307-308	56
Article 18. Effects of a notification of succession	309-319	56
Section 3. Bilateral treaties	320-333	58
Article 19. Conditions under which a treaty is considered as being in force	320-326	58
Article 20. The position as between the predecessor and the successor State	327-328	59
Article 21. Termination, suspension of operation or amendment of the treaty as between the predecessor State and the other State party	329-333	59
Section 4. Provisional application	334-352	59
Article 22. Multilateral treaties	334-342	59
Article 23. Bilateral treaties	343-346	61
Article 24. Termination of provisional application	347-352	61
Section 5. States formed from two or more territories	353-363	62
Article 25. Newly independent States formed from two or more territories	353-363	62
Part IV. Uniting, dissolution and separation of States	364-416	64
Article 26. Uniting of States	364-389	64
Article 27. Dissolution of a State	390-405	68
Article 28. Separation of part of a State	406-416	71
Part V. Boundary régimes or other territorial régimes established by a treaty	417-462	73
Article 29. Boundary régimes and Article 30. Other territorial régimes	417-462	73
Part VI. Miscellaneous provisions	463-471	87
Article 31. Cases of military occupation, State responsibility and outbreak of hostilities	463-471	87

Northern Ireland, United States of America.[8] Comments had also been received in a letter dated 30 April 1973 addressed to the Secretary-General of the United Nations by the Prime Minister and Minister of Foreign Affairs of Tonga, at that time a non-member State. At the request of the Chairman of the Commission, the letter was circulated to members of the Commission during its twenty-fifth session.[9]

B. Arrangement of the present report

8. Following the introduction contained in section I, the remainder of the present report consists of:

Section II: Observations on the draft articles as a whole;

Section III: Observations on the specific provisions of the draft articles;

Section IV: The problem of procedures for the settlement of disputes concerning interpretation and application of a convention based on the draft articles.[10]

To ensure continuity and ease of reference, the sub-headings in section II are based on those used for the corresponding passages in the 1972 report of the Sixth Committee.[11]

9. In section II, maximum use is made of the summaries in that report and in the 1973 report of the Sixth Committee [12] of the comments made by delegations at the twenty-seventh and twenty-eighth sessions of the General Assembly. The written comments submitted by each Government will be recorded individually. In section III so far as feasible, comments will be attributed specifically to the States on whose behalf they were made whether orally or in writing. In some instances, however, it may be difficult to reflect accurately the views expressed by delegations because of the natural consequences of oral expression and the condensation of speeches in summary records. The Special Rapporteur has done his best to extract the views of delegations from the summary records of the Sixth Committee, but wishes to apologize in advance for any errors or omissions that he may have made in that regard.

II. Observations on the draft articles as a whole

10. From the statements made at the twenty-seventh and twenty-eighth sessions of the General Assembly, it is plain that the provisional draft articles contained in the report of the International Law Commission on the work of its twenty-fourth session are regarded as a sound basis for the further work of the Commission and the production of a set of draft articles which are likely to prove generally acceptable. There has been much praise for the high quality of the work already done and for the excellence of the commentaries. But, in the opinion of the Special Rapporteur, this does not mean that there is no room for improvement in the light of the comments made by delegations and by Governments. Bearing in mind the general approbation of the provisional draft articles, it is now the function of the Special Rapporteur to set out those comments systematically and to submit his own observations and proposals.

A. Importance of and need for the codification of the topic

Comments of Governments

Oral comments

11. According to the 1972 report of the Sixth Committee,[13] several delegations to the twenty-seventh session of the General Assembly stated that the greatest merit of the provisional draft articles was that they took account of the principles of international law enshrined in the Charter, particularly of the principle of self-determination and the principle of the sovereign equality of States, as well as of the realities of contemporary international life. It was said that the draft was the more remarkable because the task of codification was particularly difficult in the field where there was no general doctrine, and State practice and custom had not yet produced well established and consistent precedents. Gaps and conflicting views had obliged the Commission to make certain innovations and to creative work with a view to finding appropriate and balanced solutions to the problems involved. The draft articles prepared by the Commission, which contained elements of codification as well as of progressive development, were intended "to lay down practicable and detailed provisions which would introduce uniformity and clearness in the sparse present rules, develop them and fill the existing lacunae, taking into consideration the interests of the States as well as those of the international Community".[14] This generally favourable approach did not, however, mean that the draft articles were free from criticism.

Some delegations considered that the codification of the topic of succession in respect of treaties was an urgent task, because certain additions were still needed to the codification of the law of treaties embodied in the 1969 Vienna Convention on the Law of Treaties [15] and mentioned that the draft articles constituted a link between the law of treaties and the law of the succession of States. Several representatives underlined the special

[8] For the text of the written comments received from Governments of Member States, see below, pp. 313-330, document A/9610/Rev.1, annex I.

[9] Document ILC (XXV)/Misc.2.

[10] The Special Rapporteur did not find it feasible or expedient to complete this section of the report, but, if required, will submit a separate report on the settlement of disputes in connexion with the proposed convention.

[11] See *Official Records of the General Assembly, Twenty-seventh Session, Annexes*, agenda item 85, document A/8892, sect. III,B,1.

[12] See foot-note 6 above,

[13] See *Official Records of the General Assembly, Twenty-seventh Session, Annexes*, agenda item 85, document A/8892, paras. 24-33.

[14] *Ibid.*, para. 26.

[15] For all references to the Vienna Convention on the Law of Treaties (referred to hereafter as " the Vienna Convention "), see *Official Records of the United Nations Conference on the Law of Treaties, Documents of the Conference* (United Nations publication, Sales No. E.70.V.5), p. 289.

importance of the draft articles for the newly independent States. They considered that the Commission had rightly concentrated on the newly independent States and proceeded with appropriate reference to the views of States which had achieved independence since the Second World War. They recalled that the process of decolonization was far from complete. But they acknowledged that the draft articles also contained important provisions concerning the uniting, dissolution and separation of States. Other delegations considered that the draft articles paid too much attention to the problem of newly independent States, at a time when the era of decolonization was drawing to a close, at the expense of succession problems of the future. In their view, the provisions of the draft relating to the uniting, dissolution and separation of States should be developed in the light of the practical needs of the future and due consideration given to new forms of association of States such as economic integration units or fiscal unions. Some delegations said that, as only few dependent territories remained, the topic had to a great extent lost its practical importance.

Written comments

12. *Austria.* As divergent views on the present topic have in the past been expounded by eminent scholars of international law, the Government of Austria considers that it is an important task to arrive at a solution of the problems arising in connexion with the succession of States in respect of treaties which will gain as widespread an acceptance as possible by the international community.

German Democratic Republic. The Government of the German Democratic Republic considers with regard to State succession in general that it is a matter important for the development of international relations, both as a result of national liberation and social revolution and of the uniting, separation or dissolution of States. Future rules on succession of States should facilitate the entry into international relations of the successor State and should therefore be such as to enable the latter to enjoy its rights as a sovereign, equal State without hindrance or delay. At the same time it is in the interest of all States that cases of States succession should not disturb international treaty and other relations which were established in accordance with the principles of international law in force and that the previous state of such relations should be maintained.

Sweden. The Swedish Government regarded the draft articles and the commentaries pertaining thereto as a most valuable contribution to the study of a difficult and vital problem in international law and organization. The Swedish Government noted that the Commission had given special attention to the practice of the newly independent States but had observed that, as the era of decolonization was nearing its completion, it was in connexion with other cases that in future problems of succession were likely to arise. In view of that forecast, which was shared by the Swedish Government, it seemed somewhat impractical to let rules related to a temporary and perhaps exceptional situation dominate a draft of articles intended for future application over a long period of time.

The Swedish Government added,

Moreover, the draft articles on newly independent States hardly solve the problem to what extent treaties concluded by predecessor States are still valid for States which have achieved independence since the Second World War. They rather tend to confirm the prevailing uncertainty in that respect. The General Assembly's wishes might better be met by seeking a separate solution to treaty problems related to succession connected with decolonization, *i.e.*, by an *ad hoc* settlement of an *ad hoc* situation.

Observations and proposals of the Special Rapporteur

13. In the opinion of the Special Rapporteur, there is no doubt about the importance of and need for codification (including progressive development) of the topic of succession of States in respect of treaties. This is so both from the juridical and the practical point of view. The topic involves a significant aspect of the law of treaties whose codification is needed as an important step towards completion of the codification in the Vienna Convention. From the practical point of view, the facts that there are comparatively few dependent territories remaining and that the period of decolonization is drawing to a close in no way diminishes the importance of clarifying the legal position, at least for those territories which have not yet attained independence. For so many States that have acquired independence since the Second World War the whole question of succession in respect of treaties has been beset by doubt and complexity. The fact that comparatively few territories have not yet attained independence does not diminish the importance of making the way as clear and simple as possible for them. The fact that the era of decolonization is drawing to a close only underlines the urgency of the task of codification so far as dependent territories are concerned.

14. On the other hand, many of the comments have brought out the point that in a codification, which must look to the future, all aspects of the topic should be considered with equal care and thoroughness. Every effort should be made to ensure that the articles concerning cases other than that of newly independent States are as satisfactory in substance and as well drafted as the articles concerning those States. It is also necessary, in the opinion of the Special Rapporteur, to ensure that all relevant cases are covered without, however, including cases that do not properly fall within the concept of "succession of States". In this connexion, certain comments have mentioned cases of social revolution and new forms of association of States such as economic integration units or fiscal units. While such cases will, of course, have to be considered seriously, it will be more convenient to examine them subsequently in the present report, particularly in connexion with the scheme of the draft.[16]

15. The Swedish Government, in its written comments, has suggested that the General Assembly might seek a separate solution to treaty problems related to succession connected with decolonization "by an *ad hoc* settlement of an *ad hoc* situation". The Special Rapporteur believes that such an approach would have to face great political obstacles and would run counter to the wishes of the large majority of Member States. The Special Rapporteur

[16] See below paras. 42-48 and 50-57.

does not advise the adoption of any such approach. On the contrary, he proposes that the articles on newly independent States should remain as part of the draft and that, in accordance with the wish of the General Assembly expressed in resolution 3071 (XXVIII), the International Law Commission should complete at its twenty-sixth session the second reading of "the draft articles on succession of States in respect of treaties adopted at its twenty-fourth session".

B. Sources of the draft articles

Comments of Governments

Oral comments

16. Little need be said under this heading. There was a large measure of approval among delegations at the twenty-seventh session of the General Assembly for the sources on which the Commission had drawn. However, a few of the comments made at that session are worth mentioning. Certain representatives stressed that a sharp distinction between the value of the earlier and later precedents should be avoided. The view was also expressed that the practice of depositaries was purely administrative in character and could not be regarded as being binding on States parties or giving rise to a customary rule. Finally, some doubts were expressed whether full justice was done to the many occasions when, without controversy, the States concerned had continued to apply treaties, particularly in the bilateral field.[17]

Written comments

17. Remarks about sources were made in some of the written comments of Governments, such as those of the German Democratic Republic, Sweden and the United Kingdom, but it is more convenient to record them in relation to the context in which they were made. This will be done.

Observations and proposals of the Special Rapporteur

18. While the comments made on sources should and will be borne in mind, it is not considered that they require any observations or proposals by the Special Rapporteur.

C. The concept of "succession of States"

Comments of Governments

19. According to the 1972 report of the Sixth Committee

> All representatives who referred to the matter, shared the Commission's view that analogies drawn from municipal law concepts of succession should be avoided. They agreed with the use, for the purpose of the draft articles, of the expression "succession of States" to denote simply the fact of the replacement of one State by another, thus excluding all questions of rights and obligations as a legal incident of that change.[18]

[17] *Official Records of the General Assembly, Twenty-seventh Session, Annexes*, agenda item 85, document A/8892, para. 34.

[18] *Ibid.*, para. 35.

Observations and proposals of the Special Rapporteur

20. Apart from stressing the importance of these comments as confirming the approach adopted by the Commission, the Special Rapporteur has no observations or proposals to make in this connexion.

D. Relationship between succession in respect of treaties and the general law of treaties

Comments of Governments

Oral comments

21. A number of delegations agreed that State practice afforded no convincing evidence of any general doctrine by reference to which the various problems of succession in respect of treaties would find their appropriate solution and that the task of codification appeared to be rather one of determining within the law of treaties the impact of the occurrence of a "succession of States" than *vice versa*. They endorsed the Commission's approach that the provisions of the Vienna Convention should be taken as an essential framework of the law relating to succession of States in respect of treaties. However, one delegation expressed the view that the analogy with the Vienna Convention was carried too far and that the statement (which is reflected in the two preceding sentences) contained in paragraph 32 of the Commission's report was not acceptable.[19]

Written comments

22. *Denmark.* In the context of general approval of the draft articles, the Danish Government mentioned that they underscored the relationship with the Vienna Convention.

Poland. The Government of the Polish People's Republic deemed that the question of succession of States in respect of treaties should be considered with due regard to the provisions of the Vienna Convention.

United Kingdom. The United Kingdom Government supported the decision of the Commission to take the provisions of the Vienna Convention as an essential framework of the law relating to succession of States in respect of treaties.

United States of America. The Government of the United States stated that the decision of the Commission to maintain, particularly in part I (General Provisions) a substantial parallelism with the Vienna Convention was a sensible one. The United States Government also stated that "the unification of international law is promoted by the adoption of substantially identical texts to the greatest extent that varying subject-matters permit".

Observations and proposals of the Special Rapporteur

23. Although the proposition has been stated in different ways, there has been general approval for the approach of the Commission in taking the Vienna Convention as an essential framework of the law relating to succession

[19] *Ibid.*, para. 36.

include a definition of the term "territory" for the purposes of article 12, but it confirmed the decision made in 1972 mentioned above.[221]

Article 13. [222] *Questions relating to the validity of a treaty*

Nothing in the present articles shall be considered as prejudicing in any respect any question relating to the validity of a treaty.

Commentary

(1) The Commission decided to include article 13 in the draft for the reasons mentioned above.[223] It is intended to avoid any implication that the effects of a succession of States, for which the present articles provide, could in any way prejudice any question relating to the validity of a treaty. Although the article was introduced with specific reference to articles 11 and 12, it was cast in general form, as explained in the commentary to those articles. Accordingly, it has been included in Part I, "General Provisions", together with articles 11 and 12.

(2) Article 13 provides that *nothing* in the present articles shall be considered *as prejudicing* in any respect *any question* relating to the *validity* of a treaty.

PART II

SUCCESSION IN RESPECT OF PART OF TERRITORY

Article 14. [224] *Succession in respect of part of territory*

When part of the territory of a State, or when any territory, not being part of the territory of a State, for the international relations of which that State is responsible, becomes part of the territory of another State;

(*a*) treaties of the predecessor State cease to be in force in respect of the territory to which the succession of States relates from the date of the succession of States; and

(*b*) treaties of the successor State are in force in respect of the territory to which the succession of States relates from the date of the succession of States, unless it appears from the treaty or is otherwise established that the application of the treaty to that territory would be incompatible with its object and purpose or would radically change the conditions for the operation of the treaty.

Commentary

(1) This article concerns the application of a rule, which is often referred to by writers at the "moving treaty-frontiers" rule, in cases where territory not itself a State undergoes a change of sovereignty and the successor State is an already existing State. The article thus concerns cases which do not involve a union of States or merger of one State with another, and equally do not involve the emergence of a newly independent State. The moving treaty-frontiers principle also operates in varying degrees in certain other contexts. But in these other contexts it functions in conjunction with other rules, while in the cases covered by the present article—the mere addition of a piece of territory to an existing State—the moving treaty-frontiers rule appears in pure form. Although in a sense the rule underlies much of the law regarding succession of States in respect of treaties, the present case constitutes a particular category of succession of States, which the Commission considered should be in a separate part. Having regard to its relevance in other contexts, the Commission decided to place it in part II of the draft, immediately after the general provisions in part I.

(2) Shortly stated, the moving treaty-frontiers rule means that, on a territory's undergoing a change of sovereignty, it passes automatically out of the treaty régime of the predecessor sovereign into the treaty régime of the successor sovereign. It thus has two aspects, one positive and the other negative. The positive aspect is that the treaties of the successor State begin automatically to apply in respect of the territory in question as from the date of the succession. The negative aspect is that the treaties of the predecessor State, in turn, cease automatically to apply in respect of such territory as from that date.

(3) The rule, since it envisages a simple substitution of one treaty régime for another, may appear *prima facie* not to involve any succession of States in respect of treaties. Nevertheless the cases covered by the rule do involve a "succession of States" in the sense that this concept is used in the present draft articles, namely a replacement of one State by another in the responsibility for the international relations of territory. Moreover, the rule is well established in State practice and is commonly included by writers among the cases of succession of States. As to the rationale of the rule, it is sufficient to refer to the principle embodied in article 29 of the Vienna Convention under which, unless a different intention is established, a treaty is binding upon each party in respect of its entire territory. This means generally that at any given time a State is bound by a treaty in respect of any territory of which it is sovereign, but is equally not bound in respect of territory which it no longer holds.

(4) On the formation of Yugoslavia after the First World War, the former treaties of Serbia were regarded as having become applicable to the whole territory of Yugoslavia. If some have questioned whether it was correct to treat Yugoslavia as an enlarged Serbia rather than as a new State, in State practice the situation was treated as one where the treaties of Serbia should be regarded as applicable *ipso facto* in respect of the whole of Yugoslavia. This seems to have been the implication of article 12 of the Treaty of Saint-Germain-en-Laye so far as concerns all treaties concluded between Serbia and

[221] See para. 40 above.

[222] New article.

[223] See paras. 43-45 of the commentary to articles 11 and 12.

[224] 1972 draft, article 10.

the several Principal Allied and Associated Powers.[225] The United States of America afterwards took the position that Serbian treaties with the United States both continued to be applicable and extended to the whole of Yugoslavia,[226] while a number of neutral Powers, including Denmark, the Netherlands, Spain, Sweden and Switzerland, also appear to have recognized the continued application of Serbian treaties and their extension to Yugoslavia. The United States position was made particularly clear in a memorandum filed by the State Department as *amicus curiae* in the case of *Ivancevic* v. *Artukovic*.[227]

(5) Among more recent examples of the application of this rule may be mentioned the extension of Canadian treaties to Newfoundland upon the latter's becoming part of Canada,[228] the extension of Ethiopian treaties to Eritrea in 1952, when Eritrea became an autonomous unit federated with Ethiopia,[229] the extension of Indian treaties to the former French[230] and Portuguese possessions on their absorption into India, and the extension of Indonesian treaties to West Iran after the transfer of that territory from the Netherlands to Indonesia.[231]

(6) Article 14 sets out the two aspects of the moving treaty-frontiers rule mentioned above. This article, like the draft articles as a whole, has to be read in conjunction with article 6 which limits the present articles to lawful situations and with the saving clause of articles 38 and 39 concerning cases of military occupation, etc. Article 14 is limited to normal changes in the sovereignty or in the responsibility for the international relations of a territory. Article 39 makes it plain that the present article does not cover the case of a military occupant. As to article 6, although the limitation to lawful situations applies throughout the draft articles, some members of the Commission considered it to be of particular importance in the present connexion.

(7) The scope of the article is defined in its *opening phrase* which in the 1972 text read as follows: "When territory under the sovereignty or administration of a State becomes part of another State:". It was however observed by Governments and members of the Commission that, in the first place, such a wording did not make it sufficiently clear that the article did not apply to the case of the incorporation of the entire territory of a State into the territory of an existing State and, in the second place, that the words "territory... under the administration of a State" should be replaced by an expression based on the definition of "succession of States" given in article 2, paragraph 1 (*b*), for the purposes both of clarity and consistency. The Commission, at its present session, found that there was substance in those observations and decided to reword the opening phrase of the article to read: "When part of the territory of a State, or when any territory, not being part of the territory of a State, for the international relations of which that State is responsible, becomes part of the territory of another State:". The article would thus not include cases of total incorporation, which would be covered as instances of the "uniting of States". The words "or when any territory, not being part of the territory of a State, for the international relations of which that State is responsible" have been used in order to cover cases in which the territory in question was not under the sovereignty of the predecessor State, but only under an administering Power responsible for its international relations.[232] Having reached these conclusions, the Commission decided likewise to modify the *title* of Part II and of the article by replacing the heading "Transfer of territory" by the heading "Succession in respect of part of territory."

(8) The Commission was aware that the words "becomes part of the territory of another State" might exclude the application of the article as such to a case in which a dependent territory was transferred from one administering Power to another. It recognized that such cases might occur, but observed that they were likely to be very rare. During the course of the second reading, other instances of unusual cases were mentioned which might require the application of special rules. In general, the Commission considered that it would be wiser not to complicate the present draft articles by adding detailed provisions to cover such cases. In the instance of a change in the responsibility for the international relations of a territory from one administering Power to another, the Commission considered that the moving treaty-frontiers rule would not necessarily apply. In such a case, regard should be had to the circumstances in which the change occurred and so far as necessary the rules set out in the present articles should be applied by analogy.

(9) Sub-paragraph (*a*) of article 14 states the negative aspect, namely that the treaties of the predecessor State cease to be in force from the date of the succession of States in respect of territory which has become part of

---

[225] United Kingdom, *Treaty Series* (1919), No. 17 [Cmd. 461] (London, H.M. Stationery Office, 1919), p. 94.

[226] See G. H. Hackworth, *Digest of International Law* (Washington, D.C., U.S. Government Printing Office, 1940-1944), vol. V, pp. 374-375; *Foreign Relations of the United States (1927)* (Washington, D.C., U.S. Government Printing Office, 1942), vol. III, pp. 842-843.

[227] See M. M. Whiteman, *Digest of International Law* (Washington, D.C., U.S. Government Printing Office, 1963), vol. 2, pp. 940-945, and especially at pp. 944-945.

[228] See, for example, *Yearbook ... 1971*, vol. II (Part Two), pp. 132-135, document A/CN.4/243, paras. 85-101, and *ibid.*, p. 176, document A/CN.4/243/Add.1, para. 137.

[229] See "Summary of the practice of the Secretary-General as depositary of multilateral agreements" (ST/LEG/7), p. 63; and *Yearbook ... 1970*, vol. II, p. 87, document A/CN.4/225, paras. 102-103. See also *Yearbook ... 1971*, vol. II (Part Two), p. 175, document A/CN.4/243/Add.1, para. 128.

[230] See, for example, *Yearbook ... 1970*, vol. II, p. 93, document A/CN.4/225, paras. 127-128.

[231] *Ibid.*, p. 94, paras. 132-133.

[232] In this connexion it may be recalled that the principle of equal rights and self-determination of peoples embodied in the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations, approved by resolution 2625 (XXV) of the General Assembly, states:

"The establishment of a sovereign and independent State, *the free association or integration with an independent State* * or the emergence into any other political status freely determined by a people constitute modes of implementing the right of self-determination by that people."

another State. From the standpoint of the law of treaties, this aspect of the rule can be explained be reference to certain principles, such as those governing the territorial scope of treaties, supervening impossibility of performance or fundamental change of circumstances (articles 29, 61 and 62 of the Vienna Convention). Accordingly, the rights and obligations under a treaty cease in respect of territory which is no longer within the sovereignty or under the responsibility, for its international relations, of the State party concerned. The only drafting changes made by the Commission in sub-paragraph (*a*) at the second reading were the substitution of the words "the territory to which the succession of States relates" for the words "that territory", a consequential change also made in sub-paragraph (*b*), and the replacement of the words "the succession" by the expression "the succession of States" since it is the latter expression—and not the term "succession"—which is defined in article 2.

(10) Sub-paragraph (*a*) does not, of course, touch the treaties of the predecessor State otherwise than in respect of their application to the territory which passes out of its sovereignty or responsibility for international relations. Apart from the contraction in their territorial scope, its treaties are not normally affected by the loss of the territory. Only if the piece of territory concerned had been the object, or very largely the object, of a particular treaty might the continuance of the treaty in respect of the predecessor's own remaining territory be brought into question on the ground of impossibility of performance or fundamental change of circumstances. In such cases, the question should be settled in accordance with the general rules of treaty law codified by the Vienna Convention and did not seem to require any specific rule in the context of the present draft articles. In this connexion, however, certain members recalled that under sub-paragraph (*b*) of paragraph 2 of article 62 (fundamental change of circumstances) of the Vienna Convention, a fundamental change of circumstances might not be invoked as a ground for terminating or withdrawing from a treaty "if the fundamental change is the result of a breach by the party invoking it either of an obligation under the treaty or of any other international obligation owed to any other party to the treaty".

(11) In the case of some treaties, more especially general multilateral treaties, the treaty itself may still be applicable to the territory after the succession, for the simple reason that the successor State also is a party to the treaty. In such a case there is not, of course, any succession to or continuance of the treaty rights or obligations of the predecessor State. On the contrary, even in these cases the treaty régime of the territory is changed and the territory becomes subject to the treaty exclusively in virtue of the successor State's independent participation in the treaty. For example, any reservation made to the treaty by the predecessor State would cease to be relevant while any reservation made by the successor State would become relevant in regard to the territory.

(12) Sub-paragraph (*b*) of article 14 provides for the positive aspect of the moving treaty-frontiers rule in its application to cases where territory is added to an already existing State, by stating that treaties of the successor State *are in force in respect of* that territory from the date of the succession of States. Under this sub-paragraph the treaties of the successor State are considered as applicable of their own force in respect of the newly acquired territory. Even if in some cases the application of the treaty régime of the successor State to the newly acquired territory may be said to result from an agreement, tacit or otherwise, between it and the other States parties to the treaties concerned, in most cases the moving of the treaty frontier is an automatic process. The change in the treaty régime applied to the territory is rather the natural consequence of its having become part of the territory of the State now responsible for its international relations.

(13) Exception should be made, however, of certain treaties, for example those having a restricted territorial scope which does not embrace the territory newly acquired by the successor State. Moreover, the Commission considered, at its present session, that the exception should also cover cases in which the application of a treaty of the successor State to the newly acquired territory is radically to change the conditions for the operation of the treaty, as was provided for in other articles of the 1972 draft such as, for instance, in articles 25, 26, 27 and 28. This explains the addition to sub-paragraph (*b*) of the proviso "unless it appears from the treaty or is otherwise established that the application of the treaty to that territory would be incompatible with its object and purpose or would radically change the conditions for the operation of the treaty". The word "particular" which in the 1972 treaty appeared before the word "treaty" was considered unnecessary and therefore deleted at the second reading.

(14) As stated in the 1972 draft, by such a formula

the Commission intends to lay down an *international objective legal test of compatibility* which, if applied in good faith, should provide a reasonable, flexible and practical rule. The "incompatibility with the object and purpose of the treaty" and the "radical change in the conditions for the operation of the treaty," used in other contexts by the Vienna Convention on the Law of Treaties, in the Commission's view, are the appropriate criteria in the present case to take account of the interests of all the States concerned and to cover all possible situations and all kinds of treaties.[233]

Although the words "or would radically change the conditions for the operation of the treaty" are an adaptation of the words in paragraph 1 (*b*) of article 62 (Fundamental change of circumstances) of the Vienna Convention, the Commission did not consider that in cases of the succession of States it would be appropriate to incorporate all the conditions for which that article provides. On the other hand, it thought that in most, if not all, cases of succession of States the territorial changes might result in "incompatibility with the object and purpose of the treaty" or "radical change in the conditions for the operation of the treaty". Accordingly, the formula used in article 14 as now drafted has been repeated in a number of other articles where it seemed to be appropriate. The commentaries on those articles do not, however, repeat the explanation of the formula given here.

[233] *Yearbook . . . 1972*, vol. II, p. 292, document A/8710/Rev.1, chap. II, C, para. 29 of the commentary to article 26.

(15) Lastly, article 14 should be read in conjunction with the specific rules relating to boundary régimes or other territorial régimes established by a treaty set forth in articles 11 and 12.

PART III

NEWLY INDEPENDENT STATES

SECTION 1. GENERAL RULE

Article 15. [234] *Position in respect of the Treaties of the predecessor State*

A newly independent State is not bound to maintain in force, or to become a party to, any treaty by reason only of the fact that at the date of the succession of States the treaty was in force in respect of the territory to which the succession of States relates.

Commentary

(1) This article formulates the general rule concerning the position of a newly independent State in respect of treaties previously applied to its territory by the predecessor State.

(2) The question of a newly independent State's inheritance of the treaties of its predecessor has two aspects: (*a*) whether that State is under an *obligation* to continue to apply those treaties to its territory after the succession of States, and (*b*) whether it is *entitled* to consider itself as a party to the treaties in its own name after the succession of States. These two aspects of succession in the matter of treaties cannot in the view of the Commission be treated as if they were the same problem. If a newly independent State were to be considered as automatically bound by the treaty obligations of its predecessor, reciprocity would, it is true, require that it should also be entitled to invoke the rights contained in the treaties. And, similarly, if a newly independent State were to possess and to assert a right to be considered as a party to its predecessor's treaties, reciprocity would require that it should at the same time be subject to the obligations contained in them. But reciprocity does not demand that, if a State should be *entitled* to consider itself a party to a treaty it must equally be *bound* to do so. Thus, a State which signs a treaty subject to ratification has a right to become a party but is under no obligation to do so. In short, the question whether a newly independent State is under an *obligation* to consider itself a party to its predecessor's treaties is legally quite distinct from the question whether it may have a *right* to consider or to make itself a party to those treaties.

Clearly, if a newly independent State is under a legal *obligation* to assume its predecessor's treaties, the question whether it has a right to claim the status of a party to them becomes irrelevant. The first point, therefore, is to determine whether such a legal obligation does exist in general international law, and it is this point to which the present article is directed.

[234] 1972 draft, article 11.

(3) The majority of writers take the view, supported by State practice, that a newly independent State begins its life with a clean slate, except in regard to "local" or "real" obligations. The clean slate is generally recognized to be the "traditional" view on the matter. It has been applied to earlier cases of newly independent States emerging either from former colonies (i.e. the United States of America; the Spanish American Republics) or from a process of secession or dismenberment (i.e. Belgium, Panama, Ireland, Poland, Czechoslovakia, Finland). Particularly clear on the point is a statement made by the United Kingdom defining its attitude towards Finland's position in regard to Russian treaties applicable with respect to Finland prior to its independence:

> ... I am advised that in the case of a new State being formed out of part of an old State there is no succession by the new State to the treaties of the old one, though the obligations of the old State in relation to such matters as the navigation of rivers, which are in the nature of servitudes, would normally pass to the new State. Consequently there are no treaties in existence between Finland and this country.[235]

(4) It is also this view of the law which is expressed in the legal opinion given by the United Nations Secretariat in 1947 concerning Pakistan's position in relation to the Charter of the United Nations. Assuming that the situation was one in which part of an existing State had broken off and become a new State,[236] the Secretariat advised:

> The territory which breaks off, Pakistan, will be a new State; it will not have the treaty rights and obligations of the old State, and will not, of course, have membership in the United Nations.
>
> In international law, the situation is analogous to the separation of the Irish Free State from Great Britain, and of Belgium from the Netherlands. In these cases, the portion which separated was considered a new State; the remaining portion continued as an existing State with all the rights and duties which it had before.[237]

Today the practice of States and organizations concerning the participation of newly independent States in multilateral treaties, as it has developed, may call for some qualification of that statement and for a sharper distinction to be drawn between participation in multilateral treaties in general and participation in constituent instruments of international organizations. Even so, the Secretariat's opinion, given in 1947, that Pakistan, as a new State, would not have *any* of the treaty rights of its predecessor was certainly inspired by the clean slate doctrine and confirms that this was the "traditional" and generally accepted view at that date.

(5) Examples of the clean slate doctrine in connexion with bilateral treaties are to be found in the Secretariat studies on "succession of States in respect of bilateral treaties" [238] and in the publication *Materials on Succession of States.*[239] For instance, Afghanistan invoked

[235] See A. D. McNair, *The Law of Treaties* (Oxford, Clarendon Press, 1961), p. 605. See also *Yearbook ... 1970*, vol. II, p. 122, document A/CN.4/229, para. 109.

[236] This assumption was disputed by Pakistan.

[237] See *Yearbook ... 1962*, vol. II, p, 101, document A/CN.4/149 and Add.1, para. 3.

[238] See above. sect. A, para. 44.

[239] United Nations, *Materials on Succession of States (op. cit.).*

ANNEX 15

Principles of International Investment Law

RUDOLF DOLZER AND CHRISTOPH SCHREUER

OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS

Great Clarendon Street, Oxford OX2 6DP

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide in

Oxford New York

Auckland Cape Town Dar es Salaam Hong Kong Karachi
Kuala Lumpur Madrid Melbourne Mexico City Nairobi
New Delhi Shanghai Taipei Toronto

With offices in

Argentina Austria Brazil Chile Czech Republic France Greece
Guatemala Hungary Italy Japan Poland Portugal Singapore
South Korea Switzerland Thailand Turkey Ukraine Vietnam

Oxford is a registered trade mark of Oxford University Press
in the UK and in certain other countries

Published in the United States
by Oxford University Press Inc., New York

© Rudolf Dolzer, Christoph Schreuer 2008

The moral rights of the authors have been asserted

Crown copyright material is reproduced under Class Licence
Number C01P0000148 with the permission of OPSI
and the Queen's Printer for Scotland

Database right Oxford University Press (maker)

First published 2008

All rights reserved. No part of this publication may be reproduced,
stored in a retrieval system, or transmitted, in any form or by any means,
without the prior permission in writing of Oxford University Press,
or as expressly permitted by law, or under terms agreed with the appropriate
reprographics rights organization. Enquiries concerning reproduction
outside the scope of the above should be sent to the Rights Department,
Oxford University Press, at the address above

You must not circulate this book in any other binding or cover
and you must impose the same condition on any acquirer

British Library Cataloguing in Publication Data
Data available

Library of Congress Cataloging in Publication Data
Data available

Typeset by Newgen Imaging Systems (P) Ltd., Chennai, India
Printed in Great Britain
on acid-free paper by
Biddles Ltd., King's Lynn, Norfolk

ISBN 978-0-19-921175-3 978-0-19-921176-0 (pbk.)

1 3 5 7 9 10 8 6 4 2

state, which had access to these materials, and a claimant investor, who did not. In July 2004 the NAFTA Free Trade Commission announced the release of the negotiating history of Chapter 11 of NAFTA dealing with investment.[19]

The tribunal in *Methanex v United States*[20] stressed the limited relevance of the negotiating history of the NAFTA in the light of Article 32 of the VCLT:

> ... pursuant to Article 32, recourse may be had to supplementary means of interpretation only in the limited circumstances there specified. Other than that, the approach of the Vienna Convention is that the text of the treaty is deemed to be the authentic expression of the intentions of the parties; and its elucidation, rather than wide-ranging searches for the supposed intentions of the parties, is the proper object of interpretation.[21]

(c) Interpretative Statements

Unilateral assertions of the disputing state party on the meaning of a treaty provision, made in the process of ongoing proceedings, are of limited value. Such statements are likely to be perceived as self-serving and as determined by the desire to influence the tribunal's decision in favour of the state offering the interpretation.

In one case,[22] the tribunal sought information from the investor's home state on certain aspects of the BIT's interpretation. But it did not find the information thus obtained helpful.[23]

In another case,[24] the government of the claimant's nationality (Switzerland) took the unusual step of writing to ICSID to complain about an interpretation given by an ICSID tribunal. The Swiss Government in a letter to ICSID's Deputy Secretary-General also stated that the Swiss authorities were wondering why the tribunal had not found it necessary to enquire about their view of the meaning of the provision in the Pakistan–Switzerland BIT.[25]

Occasionally the states parties to a treaty may express an opinion on its proper interpretation in the course of arbitration proceedings. The two states, parties to a BIT, may issue a joint, non-binding statement on a question of interpretation pending before a tribunal.[26]

[19] The documents are published at <http://www.naftaclaims.com/commission.htm>. It is unclear whether the available documentation covers all existing documents.

[20] *Methanex Corp. v United States*, Award, 3 August 2005.

[21] At Part II, Chapter B, para 22. Footnote omitted.

[22] *Aguas del Tunari v Bolivia*, Decision on Jurisdiction, 21 October 2005.

[23] At paras 47, 249–263.

[24] *SGS v Pakistan*, Decision on Jurisdiction, 6 August 2003, 8 ICSID Reports 406.

[25] See S A Alexandrov, 'Breaches of Contract and Breaches of Treaty' (2004) 5 *Journal of World Investment & Trade* 555, 570–571; E Gaillard, 'Investment Treaty Arbitration and Jurisdiction over Contract Claims—The SGS Cases Considered', in T Weiler (ed) *International Investment Law and Arbitration* (2005) 325, 341–342.

[26] In *CME v The Czech Republic*, the BIT between the Czech Republic and the Netherlands provided for 'consultations' with a view to resolving any issue of interpretation and application of the Treaty. Pursuant to this procedure, the Netherlands and the Czech Republic issued 'Agreed Minutes' containing a 'common position' on the BIT's interpretation, after the tribunal had issued

The NAFTA has a mechanism whereby the Free Trade Commission (FTC), a body composed of representatives of the three states parties, can adopt binding interpretations of the treaty.[27] The FTC has made use of this method in July 2001 in interpreting the concepts of 'fair and equitable treatment' and 'full protection and security' under Article 1105 of the NAFTA.[28] NAFTA tribunals have accepted this interpretation as binding.[29]

BITs do not normally have institutional mechanisms to obtain authentic interpretations of their meaning. But the United States Model BIT of 2004 provides for a mechanism that is similar to the one in the NAFTA:

ARTICLE 30(3)

A joint decision of the Parties, each acting through its representative designated for purposes of this Article, declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision.

This method may be efficient, but has a serious drawback. States may strive to issue official interpretations to influence proceedings to which they are parties. However, a mechanism whereby a party to a dispute is able to influence the outcome of judicial proceedings, by issuing an official interpretation to the detriment of the other party, is incompatible with principles of a fair procedure and is hence undesirable.

(d) The Authority of 'Precedents'

Reliance on past decisions is a typical feature of any orderly decision process. Drawing on the experience of past decision makers plays an important role in securing the necessary uniformity and stability of the law. A coherent case law strengthens the predictability of decisions and enhances their authority.

a Partial Award. In its Final Award, 14 March 2003, 9 ICSID Reports 264, the tribunal took this joint statement into account as supporting its view (at paras 87–93, 437, 504).

[27] NAFTA Article 2001(1): 'The Parties hereby establish the Free Trade Commission, comprising cabinet-level representatives of the Parties or their designees.'

NAFTA Article 1131(2): 'An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.'

[28] FTC Note of Interpretation of 31 July 2001, 6 ICSID Reports 567.

[29] See *Mondev International Ltd. v United States of America*, Award, 11 October 2002, 6 ICSID Reports 192, paras 100 *et seq.*; *United Parcel Service of America, Inc. v Canada*, Award, 22 November 2002, 7 ICSID Reports 288, para 97; *ADF Group, Inc. v United States of America*, Award, 9 January 2003, 6 ICSID Reports 470, paras 175–178; *Loewen Group, Inc. and Raymond L. Loewen v United States of America*, Award, 26 June 2003, 7 ICSID Reports 442, paras 124–128; *Waste Management, Inc. v United Mexican States*, Award, 30 April 2004, 43 ILM 957 (2004), paras 90–91; *Methanex v United States*, Award, 3 August 2005, Part II, Chapter H, at para 23. See also *United Mexican States v Metalclad Corp.*, Judgment, Supreme Court of British Columbia, 2 May 2001, 5 ICSID Reports 236, paras 61–65.

ANNEX 16

Commentary on the 1969 Vienna Convention on the Law of Treaties

By

Mark E. Villiger

MARTINUS
NIJHOFF
PUBLISHERS

LEIDEN • BOSTON
2009

Contents

Preface xix
Acknowledgments xxi
Foreword xxiii
Abbreviations xxvii
How to employ this commentary xxxiii

* * *

Issues of customary international law 1
History of the Convention 28
Preamble 39

* * *

PART I

INTRODUCTION

ARTICLE 1
Scope of the present Convention 55

Resolution relating to Article 1 62

ARTICLE 2
Use of terms 65

ARTICLE 3
International agreements not within the scope of the present Convention 98

ARTICLE 4
Non-retroactivity of the Convention 107

ARTICLE 5
Treaties constituting international organisations and treaties adopted within international organisations 115

PART II

CONCLUSION AND ENTRY INTO FORCE OF TREATIES

Section 1. Conclusion of Treaties

Article 6
Capacity of States to conclude treaties 125

Article 7
Full Powers 132

Article 8
Subsequent confirmation of an act performed without authorisation 147

Article 9
Adoption of the text 154

Article 10
Authentication of the text 165

Article 11
Means of expressing consent to be bound by a treaty 172

Article 12
Consent to be bound by a treaty expressed by signature 181

Article 13
Consent to be bound by a treaty expressed by an exchange of instruments constituting a treaty 195

Article 14
Consent to be bound by a treaty expressed by ratification, acceptance or approval 203

Article 15
Consent to be bound by a treaty expressed by accession 214

Declaration on universal participation in the Vienna Convention on the Law of Treaties 224

ARTICLE 16
Exchange or deposit of instruments of ratification, acceptance, approval or acceptance 229

ARTICLE 17
Consent to be bound by part of a treaty and choice of differing provisions 235

ARTICLE 18
Obligation not to defeat the object and purpose of a treaty prior to its entry into force 242

SECTION 2. RESERVATIONS

ARTICLE 19
Formulation of reservations 257

ARTICLE 20
Acceptance of and objections to reservations 276

ARTICLE 21
Legal effects of reservations and of objections to reservations 295

ARTICLE 22
Withdrawal of reservations and of objections to reservations 304

ARTICLE 23
Procedure regarding reservations 313

Articles 19–23—Subsequent developments 320

SECTION 3. ENTRY INTO FORCE AND PROVISIONAL APPLICATION OF TREATIES

ARTICLE 24
Entry into force 339

ARTICLE 25
Provisional application 349

PART III

OBSERVANCE, APPLICATION AND INTERPRETATION OF TREATIES

SECTION 1. OBSERVANCE OF TREATIES

ARTICLE 26
Pacta sunt servanda 361

ARTICLE 27
Internal law and observance of treaties 369

SECTION 2. APPLICATION OF TREATIES

ARTICLE 28
Non-retroactivity of treaties 379

ARTICLE 29
Territorial scope of treaties 387

ARTICLE 30
Application of successive treaties relating to the same subject-matter 395

SECTION 3. INTERPRETATION OF TREATIES

ARTICLE 31
General rule of interpretation 415

ARTICLE 32
Supplementary means of interpretation 442

ARTICLE 33
Interpretation of treaties authenticated in two or more languages 450

SECTION 4. TREATIES AND THIRD STATES

ARTICLE 34
General rule regarding third States 465

ARTICLE 35
Treaties providing for obligations for third States 474

Article 36
Treaties providing for rights for third States 481

Article 37
Revocation or modification of obligations or rights of third States 489

Article 38
Rules in a treaty becoming binding on third States
through international custom 497

PART IV

AMENDMENT AND MODIFICATION OF TREATIES

Article 39
General rule regarding the amendment of treaties 507

Article 40
Amendment of multilateral treaties 517

Article 41
Agreements to modify multilateral treaties between
certain of the parties only 528

PART V

INVALIDITY, TERMINATION AND SUSPENSION OF THE OPERATION OF TREATIES

Section 1. General Provisions

Article 42
Validity and continuance in force of treaties 541

Article 43
Obligations imposed by international law independently of a treaty 550

Article 44
Separability of treaty provisions 556

Article 45
Loss of a right to invoke a ground for invalidating, terminating,
withdrawing from or suspending the operation of a treaty 572

SECTION 2. INVALIDITY OF TREATIES

ARTICLE 46
Provisions of internal law regarding competence to conclude treaties 583

ARTICLE 47
Specific restrictions on authority to express the consent of a State 595

ARTICLE 48
Error 603

ARTICLE 49
Fraud 613

ARTICLE 50
Corruption of a representative of a State 621

ARTICLE 51
Coercion of a representative of a State 629

ARTICLE 52
Coercion of a State by the threat or use of force 638

Declaration on the prohibition of military, political or economic coercion in the conclusion of treaties 651

Resolution relating to the Declaration on the prohibition of military, political or economic coercion in the conclusion of treaties 658

ARTICLE 53
Treaties conflicting with a peremptory norm of general international law (*jus cogens*) 661

SECTION 3. TERMINATION AND SUSPENSION OF THE OPERATION OF TREATIES

ARTICLE 54
Termination of or withdrawal from a treaty under its provisions or by consent of the parties 681

ARTICLE 55
Reduction of the parties to a multilateral treaty below the number necessary for its entry into force 690

ARTICLE 56
Denunciation of or withdrawal from a treaty containing no provision regarding termination, denunciation or withdrawal 695

ARTICLE 57
Suspension of the operation of a treaty under its provisions or by consent of the parties 707

ARTICLE 58
Suspension of the operation of a multilateral treaty by agreement between certain of the parties only 712

ARTICLE 59
Termination or suspension of the operation of a treaty implied by conclusion of a later treaty 720

ARTICLE 60
Termination or suspension of the operation of a treaty as a consequence of its breach 730

ARTICLE 61
Supervening impossibility of performance 752

ARTICLE 62
Fundamental change of circumstances 762

ARTICLE 63
Severance of diplomatic or consular relations 782

ARTICLE 64
Emergence of a new peremptory norm of general international law (*jus cogens*) 790

SECTION 4. PROCEDURE

ARTICLE 65
Procedure to be followed with respect to invalidity, termination, withdrawal from or suspension of the operation of a treaty 799

ARTICLE 66
Procedures for judicial settlement, arbitration and conciliation 816

Annex to Article 66 824

Resolution relating to Article 66 and the Annex 835

ARTICLE 67
Instruments for declaring invalid, terminating, withdrawing from or suspending the operation of a treaty 837

ARTICLE 68
Revocation of notifications and instruments provided for in Articles 65 and 67 845

SECTION 5. CONSEQUENCES OF THE INVALIDITY, TERMINATION OR SUSPENSION OF THE OPERATION OF A TREATY

ARTICLE 69
Consequences of the invalidity of a treaty 853

ARTICLE 70
Consequences of the termination of a treaty 865

ARTICLE 71
Consequences of the invalidity of a treaty which conflicts with a peremptory norm of general international law 876

ARTICLE 72
Consequences of the suspension of the operation of a treaty 883

PART VI

MISCELLANEOUS PROVISIONS

ARTICLE 73
Cases of State succession, State responsibility and outbreak of hostilities 895

ARTICLE 74
Diplomatic and consular relations and the conclusion of treaties 905

ARTICLE 75
Case of an aggressor State 911

PART VII

DEPOSITARIES, NOTIFICATIONS, CORRECTIONS AND REGISTRATION

ARTICLE 76
Depositaries of treaties 921

ARTICLE 77
Functions of depositaries 934

ARTICLE 78
Notifications and communications 947

ARTICLE 79
Correction of errors in texts or in certified copies of treaties 955

ARTICLE 80
Registration and publication of treaties 970

PART VIII

FINAL PROVISIONS

ARTICLE 81
Signature 979

ARTICLE 82
Ratification 985

ARTICLE 83
Accession 987

ARTICLE 84
Entry into force 990

ARTICLE 85
Authentic texts 994

Final Act of the United Nations Conference on the Law of Treaties 999

Annex
(see *Article 66*)

* * *

Status of the Convention 1003

Reservations and declarations to the Convention and objections thereto 1007

Bibliography 1027

Table of cases 1035

Submissions by States 1039

Index 1043

4 Article 39 contains the **general rule regarding the amendment of treaties** and must be read together with *Articles 40* and *41* (*q.v.*). No specification as to the type of treaties is made in Article 39. Thus, Articles 39–41 all relate to multilateral treaties, whereas Article 39, in addition, concerns bilateral treaties.[21]

5 The first sentence of Article 39 provides that **a treaty may be amended.** There are no unchangeable treaties.[22] Where a treaty makes no provision for the duration of its existence (*e.g.*, in terms of time, or depending on particular conditions),[23] it can be amended at any time. Even where the treaty states conditions, *e.g.*, a time-limit as to its amendment, the subsequent unanimous agreement of the parties can override this condition (*Article 30, para. 3*, N. 13).[24]

2. Agreement

6 The amendment occurs by means of an **agreement between the parties** (occasionally called a Protocol). Strictly speaking, it is not the former treaty which is altered, rather a new treaty is concluded which supersedes (but does not substitute itself for) the previous one.[25] The conception that a treaty may only be amended by a new and separate agreement derives from the notion of *pacta sunt servanda* according to which treaties remain in force during their existence (*Article 26*, N. 3).[26] The agreement is between **the** parties, but not *a priori*—as for instance in *Article 54, para. (b)* (*q.v.*, N. 7)—between all parties. (Only in the case of the amendment of bilateral treaties does Article 39 necessarily require the agreement of both—all—parties.)

This agreement between **the parties** has a threefold implication: (*i*) the original treaty may stipulate a qualified majority of treaty parties for its amendment; only where no such provision has been made, will the agreement of all parties be required; (*ii*) Article

---

[21] Statements by Waldock and Rosenne in the ILC, YBILC 1964 I 189, para. 58, and 195, para. 60, respectively; and by Briggs, YBILC 1966 I/2 114, para. 29.

[22] But see *Issues of Customary International Law*, N. 30–34.

[23] Examples in Blix/Emerson 223 ff; *e.g.*, Article 7 of the 1951 ANZUS Pact ("this treaty shall remain in force indefinitely"), in Grewe, EPIL 4 (2000) 982.

[24] Statements in the ILC in 1964 by Tunkin and de Luna, YBILC 1964 I 137, para. 55, and 146, paras. 71 f., respectively; see also I. Seidl-Hohenveldern, Hierarchy of Treaties, in: J. Klabbers/R. Lefeber (eds.), Essays on the Law of Treaties. A Collection of Essays in Honour of B. Vierdag (1998), 7 ff, 11 f.

[25] Statements in the ILC in 1964 by Tunkin, Rosenne and Waldock, YBILC 1964 I 145, para. 61; 148, para. 14; and 154, para. 23, respectively. But see Reuter, Introduction N. 204. For Grewe, EPIL 4 (2000) 982, the treaty's amendment entails "for a logical second" the termination of the original treaty. But see Sinclair, Vienna Convention 108, for whom "the conclusion of a new treaty [is] opposed to the revision of an existing treaty".

[26] Statement by Yasseen in the ILC, YBILC 1964 I 143, para. 40.

39 envisages the tacit acceptance of the amendment (N. 7); and (*iii*) Article 39 leaves room for *inter se*-agreements as in *Article 41 (q.v.)*.[27]

7 Article 39 does not require an equal act, an *acte contraire*, for the amendment of the former treaty. It also does not stipulate that the treaty be amended by the same authority. The term **agreement** serves as a common denominator of all forms of amending a treaty.[28] It transpires in particular from the materials of the Vienna Conference that the agreement need not be in writing;[29] it may—notwithstanding any constitutional difficulties[30]—be oral or even tacit (*Article 3, para. (b)*, N. 6)[31] and can occur, for instance, by means of subsequent practice (N. 14).[32] As with any agreement, the amendment agreement has no retroactive effect (*Article 28*, q.v.). Treaty amendments take effect *ex nunc*.

In view of the two separate instruments, it may at times be difficult to establish whether the subsequent agreement is at all modifying the original treaty (and, hence, requiring compliance with the conditions in Articles 39–41), particularly if the later agreement makes no reference to the treaty. In such a case, the substance of the two instruments will have to be examined and compared in order to establish any difference (N. 3).

8 The requirement of an agreement corresponds with the notion that a State party not willing to amend the treaty will not be affected by an amending instrument[33] which remains *res inter alios acta* (*Articles 34, q.v.*). Unilateral action of a treaty party is irrelevant, though it may qualify as a breach of treaty (*Article 60, q.v.*).[34] As *Articles 40* and *41* readily confirm (and not unlike reservations, *Article 19*, N. 7), the amendment or modification of treaties may lead to a fragmentation of treaty relations.[35] The relations between the parties to the various treaties are governed by *Article 30 (q.v.)*.[36]

---

[27] ILC Report 1966, YBILC 1966 II 232, para. 4.

[28] Statements in the ILC by its Chairman, AGO, YBILC 1964 I 190, para. 69; and by YASSEEN, *ibid.* 193, para. 23.

[29] *E.g.*, the statements by the delegation of *Australia*, OR 1968 CoW 202, para. 65; and the *US* (KEARNEY), *ibid.* 203, para. 77; also by the Expert Consultant, Sir HUMPHREY WALDOCK, *ibid.* 204, para. 15.

[30] ADEDE, Virginia JIL 17 (1977) 201 ff.

[31] ILC Report 1966, YBILC 1966 II 233, para. 4; SINCLAIR, Vienna Convention 107; VERDROSS/SIMMA N. 792; AUST, Modern Treaty Law 263. *Contra* KARL, Vertrag 341, 355.

[32] Amendment may also occur by means of customary law (*Issues of Customary International Law*, N. 30); differently DELBRÜCK/WOLFRUM III 664.

[33] WALDOCK in the ILC, YBILC 1964 I 142, para. 30; 155 f, para. 32; and 194, para. 41. Exceptions are, *e.g.*, constituent instruments of international organisations requiring a qualified majority for their amendment.

[34] DIXIT, IJIL 10 (1970) 37 ff.

[35] SINCLAIR, Vienna Convention 106. The result is not unlike the situation resulting from reservations to a treaty, REUTER, Introduction N. 205.

[36] But see the particular relationship between *Articles 41* and *30, para. 5* (*Article 41*, N. 14).

ANNEX 17

Date of dispatch to the parties: May 22, 2007

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

WASHINGTON, D.C.

IN THE PROCEEDINGS BETWEEN

ENRON CORPORATION

PONDEROSA ASSETS, L.P

(CLAIMANTS)

AND

ARGENTINE REPUBLIC

(RESPONDENT)

ICSID Case No. ARB/01/3

AWARD

Members of the Tribunal:

Professor Francisco Orrego-Vicuña, President

Professor Albert Jan van den Berg, Arbitrator

Mr. Pierre-Yves Tschanz, Arbitrator

Secretary of the Tribunal:

Ms. Claudia Frutos-Peterson

Representing the Claimants

Mr. R. Doak Bishop
King & Spalding
Washington, D.C.
United States of America

and

Mr. Guido Santiago Tawil
M&M Bomchil
Buenos Aires
Argentina

Representing the Respondent

H.E. Osvaldo César Guglielmino
Procurador del Tesoro de la Nación
Procuración del Tesoro de la Nación
Buenos Aires
Argentina

A. Introduction

1. The Claimants, Enron Corporation and Ponderosa Assets, L.P., are companies respectively established under the laws of the State of Oregon and the State of Delaware, United States of America. Enron's principal place of business is located in Houston, Texas. Enron owns and controls Ponderosa Assets, L.P., with its principal place of business in Houston, Texas. The Claimants are represented in this proceeding by:

Mr. R. Doak Bishop
King & Spalding
1100 Louisiana, Suite 3300
Houston, Texas 77002

Mr. Guido Santiago Tawil
M&M Bomchil
Suipacha 268, Piso 12
C1008AAF
Buenos Aires, Argentina

2. The Respondent is the Argentine Republic, represented in this proceeding by:

H.E. Osvaldo César Guglielmino
Procurador del Tesoro de la Nación
Procuración del Tesoro de la Nación
Posadas 1641
CP 1112 Buenos Aires, Argentina

3. By letter of March 22, 2007 the Secretary of the Tribunal informed the parties that the Tribunal had declared the proceedings closed in accordance with ICSID Arbitration Rule 38 (1). This Award contains the Tribunal's Decision on the Merits rendered in accordance with ICSID Arbitration Rule 47, as well as the Tribunal's Decisions on Objections to Jurisdiction, which are part of this Award. The Award also contains a Procedural Order issued by the Tribunal on the discontinuance of certain tax claims. In rendering its Award, the Tribunal has taken into account all pleadings, documents and testimony produced in this case insofar as it considered them relevant.

B. Summary of the Proceedings

1. Procedure leading to the Decisions on Jurisdiction

4. On February 26, 2001, the International Centre for Settlement of Investment Disputes ("ICSID" or the "Centre") received from Enron Corporation and Ponderosa Assets L.P., (the "Claimants") a Request for Arbitration against the Argentine Republic (the "Argentine Republic" or the "Respondent"). On February 27, 2001, the Centre acknowledged receipt and transmitted a copy of the Request to the Argentine Republic and to the Argentine Embassy in Washington, D.C., in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings ("Institution Rules"). The Request concerned certain tax assessments allegedly imposed by some Argentinean provinces in respect to a gas transportation company in which the Claimants participated through investments in various corporate arrangements (the "original" or "stamp tax claim"). In the Request, the Claimants invoke the provisions of the 1991 Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments ("the Bilateral Investment Treaty", "Bilateral Treaty" or "Argentina-US BIT")[1].

5. On March 25, 2003, the Claimants filed before the Centre a new Request for Arbitration against the Argentine Republic, invoking the protections of the Bilateral Investment Treaty. The Request concerns the refusal of the Argentine Government to allow tariff adjustments in accordance with the United States Producer Price Index ("PPI") and the

[1] Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments, signed on November 14, 1991, which entered into force on October 20, 1994.

enactment of Law No. 25.561 which nullified PPI adjustments and the calculation of tariffs in dollars of the United States of America (the "ancillary claim").

6. On March 28, 2003, pursuant to Article 46 of the ICSID Convention, the Centre forwarded the new Request to the Arbitral Tribunal to determine whether to receive it as an ancillary claim to the stamp tax claim. On the same date, the Tribunal requested the Argentine Republic to submit any observations that it may have in this respect. On April 15, 2003, the Argentine Republic presented its observations concerning the Claimants' new Request for Arbitration. On April 25, 2003, after having examined the observations submitted by both parties in this respect, the Tribunal decided to accept the new Request for Arbitration as a claim ancillary to the stamp tax claim in accordance with Article 46 of the ICSID Convention, and to have both cases proceed on separate tracks until the Tribunal has decided on jurisdiction with respect to both claims. In its communication, the Tribunal also proposed an expedited procedure to the parties for filing their submissions on jurisdiction in connection with the ancillary claim.

(i) The Stamp Tax Claim

7. With respect to the "stamp tax claim", after receiving the Claimants' Request for Arbitration, on April 5, 2001, the Centre requested the Claimants to explain how each of the two Claimants in the present case would meet the conditions for registration of the Request. On April 6, 2001, the Claimants satisfied this request from the Centre.

8. Pursuant to Article 36(3) of the ICSID Convention, on April 11, 2001, the Secretary-General of the Centre registered the Request. On the same date, in accordance with Institution Rule 7, the Secretary-General notified the parties of the registration of the Request and invited them to proceed to constitute an arbitral tribunal as soon as possible.

9. On April 12, 2001, the Claimants submitted a proposal for the number of arbitrators and the method of their appointment. Under the Claimants' proposal, the Tribunal would consist of three arbitrators, one arbitrator to be appointed by each party and the third, who would be the President of the Tribunal, to be appointed by agreement of the parties.

10. On April 25, 2001, the Argentine Republic notified the Centre of its agreement to the Claimants' proposal concerning the number of arbitrators and the method of their appointment. In those circumstances, on April 27, 2001, the Centre confirmed that the Arbitral Tribunal in the present case would consist of three arbitrators, one arbitrator appointed by each party and the third, who would serve as the President of the Tribunal, to be appointed by agreement of the parties.

11. On May 11, 2001, the Claimants appointed Mr. Pierre-Yves Tschanz, a Swiss national. On July 10, 2001, the Argentine Republic appointed Dr. Héctor Gros Espiell, a national of Uruguay. The parties, however, failed to agree on the appointment of the third, presiding, arbitrator. By letter dated August 30, 2001, the Claimants requested that the third, presiding, arbitrator be appointed pursuant to Article 38 of the ICSID Convention and Rule 4 of the ICSID Rules of Procedure for Arbitration Proceedings ("Arbitration Rules").

12. In those circumstances, and after consulting the parties, Professor Francisco Orrego Vicuña, a Chilean national, was appointed by the Centre as the third presiding arbitrator. Pursuant to Rule 6(1) of the Arbitration Rules, on November 1, 2001, the Secretary-General notified the parties that all three arbitrators had accepted their appointment and the Arbitral Tribunal was therefore deemed to have been constituted on that date. On the same date, in accordance with ICSID Administrative and Financial Regulation 25, the parties were informed that Ms. Claudia Frutos-Peterson, ICSID Counsel, would serve as Secretary of the Arbitral Tribunal.

13. The first session of the Tribunal with the parties was held on December 5, 2001, in Washington, D.C. During the first session, the parties agreed that the Tribunal was

properly constituted in accordance with the ICSID Convention and the Arbitration Rules and that they did not have any objections to any members of the Tribunal.

14. During the first session, the parties also agreed on several procedural issues, which were later reproduced in the written minutes signed by the President and the Secretary of the Tribunal. Regarding the written phase of the proceedings, the Tribunal, after consulting with the parties in this respect, fixed the following time limits for the presentation of the parties' pleadings: The Claimants would file a memorial within 90 days from the date of the first session; the Respondent would file a counter-memorial within 90 days from its receipt of the Claimants' memorial; the Claimants would file a reply within 60 days from their receipt of the Respondent's counter-memorial and the Respondent would file a rejoinder within 60 days from its receipt of the Claimants' reply. It was further agreed that if the Respondent raised any objections to jurisdiction the following alternative tentative schedule would apply: The Respondent would file a memorial on jurisdiction within 45 days from the receipt of the Claimants' memorial on the merits; the Claimants would file a counter-memorial on jurisdiction within 45 days from their receipt of the Respondent's memorial on jurisdiction; the Respondent would file a reply on jurisdiction within 30 days from its receipt of the Claimants' counter-memorial on jurisdiction, and the Claimants would file a rejoinder within 30 days from their receipt of the Respondent's reply on jurisdiction.

15. On January 14, 2002, the Claimants requested a suspension of the proceedings for six months in order to explore the possibility of settling the dispute through direct consultations with the authorities appointed by a new government of the Argentine Republic. By a letter dated January 30, 2002, the Argentine Republic informed the Centre that it did not consider necessary that the proceedings be suspended at this stage.

16. On January 31, 2002, the Claimants requested the suspension of the proceedings for a period of six months in order to obtain certain internal authorizations to continue with the

arbitration. On February 5, 2002, the Tribunal requested the Argentine Republic to present any observations in this respect. The Argentine Republic presented its observations on February 18, 2002, agreeing to an extension of only three months. On February 25, 2002, the Tribunal issued Procedural Order No. 1, granting an extension of 90 days, from the date of the Procedural Order, for the Claimants to obtain the relevant authorization to continue with the proceeding.

17. On May 22, 2002, the Claimants informed the Tribunal that they had been authorized to proceed with the arbitration and requested an extension until August 1, 2002 to file their memorial on the merits. On May 29, 2002, the Tribunal granted the extension sought by the Claimants. In its communication, the Tribunal noted that the Argentine Republic would, if it requested, be entitled to the same time extension granted to the Claimants to file its counter-memorial on the merits.

18. On August 1, 2002, the Claimants filed their memorial on the merits and accompanying documentation. On December 13, 2002, the Argentine Republic notified the Tribunal that it would be using part of the extension granted by the Tribunal in its letter of May 29, 2002 to file its memorial on January 15, 2003. Pursuant to ICSID Arbitration Rule 41(1), on January 15, 2003, the Argentine Republic filed a memorial raising objections to the jurisdiction of the Centre and the competence of the Tribunal.

19. On January 21, 2003, in accordance with ICSID Arbitration Rule 41(3), the proceedings on the merits were suspended by the Tribunal.

20. On March 5, 2003, the Claimants requested an extension of time to file their counter-memorial on jurisdiction. On the same date, the Tribunal invited the Argentine Republic to provide its observations to the Claimants' request. The Argentine Republic presented its observations on March 7, 2003. On March 11, 2003, the Tribunal granted the extension sought by the Claimants and informed the parties that the Argentine Republic

would be granted an extension on the same terms to file its reply on jurisdiction if it so requested.

21. On March 31, 2003, the Claimants filed their counter-memorial on jurisdiction. Thereafter, on May 20, 2003, the Argentine Republic filed its reply on jurisdiction and on June 26, 2003 the Claimants filed their rejoinder on jurisdiction.

22. The hearing on jurisdiction took place in Paris on September 3-4, 2003. At the hearing the Claimants were represented by Messrs. R. Doak Bishop (King & Spalding, Houston), Guido Santiago Tawil (M. & M. Bomchil, Buenos Aires), Craig S. Miles (King & Spalding, Houston) and Ignacio Minorini Lima (M. & M. Bomchil, Buenos Aires); all of whom addressed the Tribunal on behalf of the Claimants. The Respondent was represented by Messrs. Carlos Ignacio Suárez Anzorena, Jorge Barraguirre and Ms. Beatriz Pallarés, all from the office of the Procuración del Tesoro de la Nación Argentina. Mr. Suárez addressed the Tribunal on behalf of the Argentine Republic. During the hearing, the Tribunal also put questions to the parties in accordance with ICSID Arbitration Rule 32(3).

23. On January 14, 2004, the Tribunal issued its unanimous Decision on Jurisdiction concerning the Claimants' original claim. In its Decision, the Tribunal rejected the Respondent's objections to jurisdiction. On this basis, the Tribunal concluded that the Centre had jurisdiction and that the Tribunal was competent to consider the dispute between the parties concerning the original claim in accordance with the provisions of the Argentina-U.S. BIT. On the same day, the Tribunal issued its Procedural Order No. 2 declaring the continuation of the proceeding on the merits, regarding the original claim.

24. Certified copies of the Tribunal's Decision on Jurisdiction were distributed to the parties by the Secretary of the Tribunal.

25. In accordance with Procedural Order No. 2, on May 17, 2004, the Respondent filed its counter-memorial on the merits.

(ii) The Discontinuance of the Stamp Tax Claim

26. On May 28, 2004, the Claimants requested the suspension of the proceeding concerning the Claimants' original claim for a period of six months in order to verify if certain decisions currently before the courts in Argentina could have an effect in the Claimants' original claim. On June 1, 2004, the Tribunal requested the Argentine Republic to present its observations to Claimants' request. On June 8, 2004, the Argentine Republic presented its observations accepting to suspend the proceedings, but requested the suspension to be for a period of eighteen months. On June 10, 2004, having examined the positions of both parties, the Tribunal issued its Procedural Order No. 3, declaring the suspension of the stamp tax claim for a period of eight months. Thereafter the parties successively agreed and the Tribunal granted, by letters of February 25 and September 8, 2005, further suspensions of the stamp tax claim for a period of six and four months respectively.

27. On December 8, 2005, at the end of the hearing on the merits for the ancillary claim, after having heard the position of the parties, the Tribunal issued a Procedural Order on Discontinuance of the Stamp Tax Claim embodying the parties' agreement on the discontinuance, without prejudice to the merits of the proceeding of the stamp tax claim.

28. In its Procedural Order on Discontinuance the Tribunal declared, among other things, that the discontinuance of the stamp tax claim shall in no way affect the disposition of the ancillary claim. The Procedural Order decides as follows:

> 1. The proceeding of the Stamp Tax Claim is hereby discontinued without prejudice to the Parties' claims on the merits;
>
> 2. Either Party shall be entitled to file the Stamp Tax Claim as a new proceeding with ICSID;
>
> 3. In such new proceeding,

- the Parties shall remain bound by the decision on jurisdiction rendered by the Arbitral Tribunal in the Stamp Tax Claim of January 14, 2004,

- the arbitral tribunal to be appointed shall have the same members as currently the Arbitral Tribunal -- or if one or more arbitrators become unavailable for any reason he shall be replaced by using the method in which he was appointed,

- the memorials, evidence and other submissions already submitted in the Stamp Tax Claim shall become part of the record;

4. The discontinuance of the Stamp Tax Claim shall in no way affect the disposition of the Ancillary Claim;

5. The costs incurred in the Stamp Tax Claim until its discontinuance shall be borne in equal shares by the Parties.

(iii) The Ancillary Claim

29. As noted above, the Tribunal proposed an expedited schedule to the parties for filing their submissions on jurisdiction in connection with the ancillary claim. Based on this schedule, Argentina filed its memorial on jurisdiction on August 20, 2003, while the Claimants filed their counter-memorial on jurisdiction on October 17, 2003. On November 19, 2003, Argentina filed its reply and on December 22, 2003, the Claimants filed their rejoinder.

30. Subsequently, a hearing on jurisdiction regarding the ancillary claim was held in Paris, on April 1 and 2, 2004. At the hearing the Claimants were represented by Messrs. R. Doak Bishop and Craig S. Miles from the law firm of King & Spalding, Houston, United States, as well as by Messrs. Guido Santiago Tawil, Alix M. Martínez and Ms. Silvia M. Marchili from the law firm of M. & M. Bomchil, Buenos Aires, Argentina. Messrs. Bishop and Tawil addressed the Tribunal on behalf of the Claimants. The Argentine Republic was represented by Ms. Cintia Yaryura, Ms. Ana Badillos, and Mr. Ignacio Pérez Cortés from the office of the Procuración del Tesoro de la Nación Argentina. All of them addressed the Tribunal on behalf of the Argentine Republic.

31. During the hearing, the Tribunal also put questions to the parties in accordance with ICSID Arbitration Rule 32(3).

32. On August 2, 2004, the Tribunal issued its unanimous Decision on Jurisdiction concerning the ancillary claim rejecting the Respondent's objections to jurisdiction. In its Decision the Tribunal concluded that the Centre had jurisdiction and that the Tribunal was competent to consider the dispute between the parties regarding the ancillary claim in accordance with the provisions of the Argentina-U.S. BIT. Certified copies of the Tribunal's Decision on Jurisdiction were distributed to the parties by the Secretary of the Tribunal.

33. On August 18, 2005, after an exchange between the parties, the Tribunal issued Procedural Order No. 4, ordering the continuation of the proceeding concerning the ancillary claim. The ancillary claim constitutes the object of the present Award on the merits.

2. Procedure Leading to the Award on the Merits

34. Pursuant to the Tribunal's Procedural Order No. 4, on November 17, 2004 the Claimants submitted their memorial on the merits while the Respondent submitted its Counter-memorial on March 7, 2005. On May 6, 2005, the Claimants submitted their Reply on the merits and on July 7, 2005, the Respondent submitted its Rejoinder.

35. After consulting with both sides, the Tribunal by letter dated June 15, 2005 informed the parties that the hearing on the merits would be held at the seat of the Centre in Washington D.C. from November 28, 2005 to December 8, 2005.

36. The hearing was held as scheduled. At the hearing the Claimants were represented by Messrs. Doak Bishop, Craig S. Miles, Martin Gusy and Ms. Zhennia Silverman of the law firm of King & Spalding LLP Houston, United States; Messrs. Guido Santiago Tawil,

Hector M. Huici and Ms. Silvia M. Marchili of the law firm of M & M Bomchil, Buenos Aires, Argentina. The Respondent was represented by Messrs. Osvaldo César Guglielmino, Gustavo Scrinzi, Jorge Barraguirre, Félix Helou, Ignacio Pérez Cortéz, Tomás Braceras, Rodolfo Alberto García Bollini, Rodrigo Ruíz Ezquide, Fabián Markaida, Carlos Winograb and Mesdames María Luz Moglia, Leticia Sierra Lobos and Alicia Federico, all from the Procuración del Tesoro de la Nación Argentina, Buenos Aires, Argentina.

37. As indicated by the Tribunal, on February 28, 2006 the parties filed their post-hearing briefs.

38. In the course of the hearing, the Tribunal and the parties discussed the possibility of retaining independent expert advice to better understand the underlying assumptions and methodology relied upon in the valuation reports offered by the parties' experts. After a brief exchange between the parties and the Tribunal as to the appointment of the independent expert, the Tribunal by letter dated March 16, 2006, appointed Mr. Luis Hernán Paul, a Chilean engineer, finance consultant and professor of economics, as its expert.

39. On May 26, 2006, Mr. Héctor Gros Espiell submitted his resignation as an arbitrator. On the same date, a vacancy on the Tribunal was announced by the Centre, and pursuant to ICSID Arbitration Rule 10(2), the proceeding was suspended. On July 10, 2006, after consulting the parties, the Chairman of the Administrative Council appointed Professor Albert Jan van den Berg, a Dutch national, as arbitrator in accordance with ICSID Arbitration Rule 11(2)(a). On July 11, 2006, the Tribunal was reconstituted and the proceedings were resumed.

40. On October 30, 2006, the Claimants submitted to the Tribunal an Application for Provisional Measures requesting the Tribunal to order the office of the Procurador del Tesoro de la Nación Argentina "to cease its actions (or inactions) with respect to the

ENARGAS file and exercise all deliberate dispatch to ensure the resumption of Claimants' right to consummate the CIESA swap and their right to manage, control and dispose of their CIESA/TGS shares". Subsequently, the Claimants' request for provisional measures was slightly modified requesting the Tribunal to order "Argentina to exercise all deliberate dispatch to ensure approval of the second stage of the CIESA swap and to refrain from taking any further act itself or through any of its agencies that aggravates the present dispute." After hearing the Respondent's observations in this respect, the Tribunal dismissed on December 13, 2006 the Claimants' request for lack of jurisdiction over the subject matter of the requests made, either in its original or in its modified versions.

C. Considerations

Argentina's Privatization Program

41. Beginning in 1989, the Government of Argentina undertook a vast program of privatization of State-owned companies, including, among other key sectors of the economy, gas transportation and distribution. With a view to restructure the Argentine economy, the Currency Convertibility was introduced in 1991 (Law 23.928) and the Argentine peso was fixed at par with the United States dollar (Decree 2128/91). Various other measures were directed at opening the economy to foreign trade and investments, including most significantly among them the policy of negotiating bilateral investment treaties with many countries.

42. New rules governing gas transportation and distribution were introduced in 1992 by the Gas Law (Law 24.076) and the implementing regulations embodied in de Gas Decree (Decree 1738/92). Under this regulatory framework, gas transportation was separated

from distribution. Two major transportation companies were created to this effect, resulting in Transportadora de Gas del Sur ("TGS") and Transportadora de Gas del Norte ("TGN"), while eight other companies were established for gas distribution. This award concerns the dispute arising from the Claimants' investment in TGS.

43. In order to facilitate the process of privatization, a Standard Gas Transportation License or "Model Licence" was approved by Decree 2255/92 including the applicable Basic Rules; all such rules were embodied in the License actually signed by TGS and the Government of Argentina and approved by Decree 2458/92. The duration of the License is of 35 years, leading up to 2027. An "Information Memorandum" concerning the privatization of Gas del Estado, the former State-owned transportation and distribution company, together with a "Pliego" explaining the bidding rules and the legal and contractual arrangements, were provided to prospective investors so as to organize the bidding process. The parties dispute the legal significance of these information materials. Discussions to attract investors were held with prospective foreign investors in Argentina and abroad, while the broad program of bilateral investment treaties noted was simultaneously undertaken with a view to provide guarantees to such investments.

44. The Claimants explain that in making the decision to invest in TGS, they relied specifically on the conditions offered by these various legislative and regulatory enactments. These conditions, the Claimants assert, included the calculation of tariffs in US dollars; their semiannual adjustment according to changes in the US Producer Price Index ("PPI"); the commitment that there would be no price freeze applicable to the tariff system and, if one was imposed, the licensee had a right to compensation; the commitment that the license would not be amended by the Government, in full or in part, except with the prior consent of the licensee; a 35-year license, with the possibility of a 10-year extension; and the commitment not to withdraw the license except in case of specific breaches listed.

45. All of the above, the Claimants maintain, was in turn related to the setting of gas tariffs at a level that would ensure operators with sufficient revenues to cover all reasonable costs, taxes, depreciation and a reasonable profit. In this context, the Claimants assert, the Government of Argentina made additional representations concerning the immediate and automatic adjustment of tariffs in case the parity between the dollar and the peso would experience a variation, the use of the New York exchange rate for adjustments, and the passing through to consumers of all cost variations resulting from changes in tax provisions.

46. The Government of Argentina, as will be discussed further below, has a different understanding about the meaning and extent of these various elements of the legal and regulatory framework.

Claimants' investment in TGS

47. The Claimants' investment in TGS has evolved over time by means of a number of complex transactions. It began in 1992 when Enron Pipeline Company Argentina S. A. ("EPCA"), an indirectly wholly-owned subsidiary of Enron, formed with three other companies a bidding consortium to submit a bid for TGS. The Consortium was awarded 70% of the shares of TGS. Ultimately, in order to comply with the requirement that an Argentine company should hold the shares in TGS, the Consortium incorporated Compañía de Inversiones de Energía S. A. ("CIESA"), which became the holder of the 70% of the shares awarded. Each of the four members of the Consortium acquired a 25% interest in CIESA, and consequently, through CIESA, an indirect 17.5% interest in TGS.

48. The purchase price for the 70% of the shares of TGS is put by the Claimants at US$561,189,000. The Consortium contributed to CIESA first US$305,000,000 (or US$76,250,000 for each member) and later the balance of US$256,189,000 (or

US$64,047,250 for each member). In respect of the first contribution, the Claimants explain that Enron made a direct cash contribution of US$7,625,000 to CIESA, while the balance of US$68,625,000 was satisfied through a loan to CIESA by Chase Manhattan Bank, which Enron guaranteed. The Tribunal must note at this point that this loan became a crucial issue in the discussions on valuation that will be addressed further below. It is further explained that in respect of the second contribution, Enron contributed its total share by means of Argentine foreign and domestic debt securities[2].

49. EPCA in turn qualified as a member having the technical operation expertise required by the regulations. In this capacity it entered into a Technical Assistance Agreement with TGS. EPCA also contributed, it is explained by the Claimants, US$21,900,000 to CIESA in the form of a direct payment to the Chase Manhattan Bank in partial satisfaction of the loan referred to above.

50. In 1996, both Enron and one other member of the Consortium purchased an additional 25% interest in CIESA from another member, each paying US$117,500,000. Enron thus became the indirect owner of a 37.5% interest in CIESA and, through it, of a 26.25% interest in TGS.

51. Also in 1996 Enron and one other member purchased the remaining 25% of the shares of CIESA from another shareholder, for a total price of US$ 249,150,000, of which Enron paid its share by two transfers of funds. Enron thus became the indirect owner of 50% interest in CIESA and, through it, of 35% interest in TGS.

52. Other transactions made in 1999 between CIESA's shareholders and their subsidiaries, and the purchase of publicly traded shares of TGS by EPCA in the amount of US$ 7,000,170, according to the Claimants, resulted in Enron becoming the indirect holder of a 27.65% interest in TGS through its 50% participation in CIESA, the indirect holder of

[2] Witness Statement of K. George Wasaff of November 12, 2004, paras. 22-31.

an additional 7.593% interest in TGS through its participation in the subsidiary company EDIDESCA and the indirect holder of 0.02% in TGS through its participation in EPCA. The aggregate of Enron's interest in TGS at this stage is thus claimed to be 35.263%.

53. The evolving structure of ownership, however, does not end there. Enron's participation in TGS, while remaining the same in respect of CIESA, changed again in respect of both the subsidiaries EDIDESCA (7.62%) and EPCA (.23%), thus totaling (through Ponderosa) an indirect ownership of 35.5% interest in TGS, as explained by the Claimants.

54. Additional transactions took place in 2005 and 2006. The first of these transactions, the *Rawhide* or *Ponderosa Settlement* and the parallel *CIESA Settlement*, was executed in part on August 29, 2005 and resulted in reducing Ponderosa's interest in TGS from 35.5% to 20.7% in the Claimants' estimate, a figure which the Respondent puts at 19.5%. In view of the fact that the parties have constantly referred to a 19.5% in this proceeding, the Tribunal will use this last figure for ease of reference. This reduction involved complex arrangements under which the Claimants and related subsidiaries, by means of an exchange of shares through a trusteeship agreement, transferred their participation in CIESA to Petrobras and others of its various subsidiaries, acquiring from them a direct participation in TGS of 11.65% that together with Enron's participation of 7.85% through its subsidiaries totaled 19.5%. On January 27, 2006, the Claimants sold shares representing 15.2% of TGS to D. E. Shaw Laminar Emerging Markets LL. C. for US$114.6 million, with an option to buy the remainder of the Claimants' shares in TGS (*i.e.,* 4.3%) for US$33.9 million.

55. The Government of Argentina, while not disputing that the transactions described in the preceding paragraphs took place, considers that their true meaning is different from that explained by the Claimants. The Respondent asserts that Enron could only claim for a 19.5% indirect interest in TGS, not for 35.5%, because its investment was financed in part by the loan taken by CIESA. The fact that Enron guaranteed this loan, the Respondent

maintains, does not mean that the cash flow received by CIESA from TGS would benefit Enron as it would have to be applied first to CIESA's creditors. The Respondent also argues in this respect that the 2005 transaction noted above confirms this view in so far the Claimants exchanged their nominal 35.5% indirect interest in TGS for a real 19.5% direct interest.

56. The Respondent also objects to other aspects of the Claimants' description of their investment, in particular the distinction between a regulated and a non-regulated sector of the business and the true value of the debt securities with which the purchase of the shares in TGS was paid in part. The Respondent also explains that the technical assistance agreement between TGS and EPCA was transferred to Petrobras in 2004, for an undisclosed amount, thus not allowing for any claims in this respect after the transfer date.

57. As a result of these various differences about the meaning of the investment, the Parties have also different views about the amounts that were actually involved, the returns obtained on the investment and the true measure of damages.

58. The Claimants estimate their total investment in TGS to be in the amount of US$343,954,134 and that TGS invested in Argentina's gas transportation system US$925.5 million. This, in the Claimants' view, resulted in significant improvements in the performance of the gas sector; financial gains for the Government of Argentina in terms of cash revenue from the sale of *Gas del Estado*; transfer of indebtedness; tax revenues; and low gas prices ranking among the lowest in the world.

59. The Government of Argentina has a very different view about the amounts actually invested by Enron in the indirect purchase of TGS. In the Respondent's estimate, Enron would have paid US$84.8 million for the purchase of the original 17.5% interest in TGS and an alleged US$250.4 million for the additional 18% purchased later, resulting in a total investment of US$335.1 million for the claimed 35.5% interest.

60. This, the Respondent asserts, would have resulted in benefits to the investor of US$487 million through 2004 in dividends and fees, a residual value of US$349.1 million and a rate of return on the investment of 39.4%, all of it totaling a net result of US$500 million in favor of Enron. In other estimates the rate of return on the investment for the period 1992-2004 is put at 64.1%, and at 35.9% for Enron's total participation, with net gains of US$527 million. The Claimants dispute these estimates because in their view, if a 64% return were true, it would have resulted in a cumulative staggering figure of US$7355.10 million through 2004; it is argued that the true rate of return was not more than 8.4% with a total income received by Enron of US$390.5 million, while the real damage suffered amounts to US$278.7 million to August 2000 or US$323.4 million to December 2001. The precise figures which the Claimants have requested as damages will be discussed in the context of valuation.

61. As many of these views are inextricably related to valuation issues and the conclusions of expert reports, they will be considered further below in this other context.

The measures complained of

1. No adjustment for PPI since 1999

62. Throughout the 1990s the regulatory system devised for the gas transportation sector operated without difficulties, including most significantly the periodic modification of tariffs to reflect changes in the cost of natural gas and the adjustment of tariffs, both up and down, following the variations in the US PPI. A quinquiennial tariff revision was also approved by ENARGAS, the government regulatory agency for the gas sector, for the period 1997-2002.

63. In late 1999, however, the situation began to change as the impending economic, social and political crisis evidenced its early symptoms. The political and public opinion environment was not sympathetic towards utility companies and the foreign investors therein as a consequence of tariff increases resulting from the operation of the regulatory framework, including the influence of higher natural gas prices and taxes.

64. Government officials met with industry representatives in late 1999 and early 2000 to discuss the suspension of tariff increases. As a result, an agreement was signed on January 6, 2000, postponing for six months the PPI adjustment due on January 1, 2000 and providing that the deferred increase would be recovered with interest in the period July 1, 2000-April 30, 2001 (ENARGAS Resolution 1470/00).

65. This agreement, however, proved to be short-lived. The Government insisted a few months later that tariffs should be frozen altogether for a two-year period. As a result, a second suspension agreement intervened on July 17, 2000, suspending through June 30, 2002 PPI adjustments as from July 1, 2000 and providing that the differences would be placed in an interesting-bearing stabilization fund and tariff increases would resume at the end of the suspension period, including the recovering of the deficits originating in these arrangements (Decree 669/00).

66. The Government of Argentina expressly stated in this last decree that investments connected to the privatization process were protected by the legislation in force and, in particular, by the bilateral investment treaties signed by the Government. It should be noted that while the Government of Argentina considers the above-mentioned agreements as the outcome of genuine consent by the parties, the Claimants assert that Licensees were pressured by the Government into giving their consent.

67. Not long after the second agreement, a judicial injunction was requested by the Argentine Ombudsman ("*Defensor del Pueblo de la Nación*") against Decree 669/00 on the argument that it was both unconstitutional and contrary to the law. The injunction was

granted on August 18, 2000, suspending this decree pending a ruling on the legality of the PPI adjustment mechanism, a ruling that has not been issued thus far; the Respondent has explained, however, that the injunction would have been confirmed indirectly by the Argentine Supreme Court in 2005. The injunction was appealed by both the ENARGAS and the Ministry of Economy on the argument that it would upset the economic balance of the license and alter the system of tariffs established in US dollars and their PPI adjustment, which were the instruments chosen with "the aim of luring investors" in the privatization process. The appeal was rejected on October 5, 2001.

68. On the basis of this injunction, ENARGAS directed the licensees to suspend all PPI adjustments and has rejected all requests for adjustment made since. This includes the PPI adjustment under the first agreement noted. As a result, no such adjustments have been made since 1999. This is the situation that gives rise to the first claim before this Tribunal.

69. The Government of Argentina has a different view of the ultimate meaning of this process. The Respondent explains that the PPI adjustment made sense at a time when adjustments in pesos were prohibited under the Convertibility law, because of the adverse effect that indexation had on inflation, and the US price indexes were considerably lower than those of Argentina. This, however, it is further explained, changed dramatically in 1998-1999 when the Argentine economy entered into recession and deflation, with lower costs and prices, and the US inflation became considerably higher than that of Argentina, thus making the PPI an unreasonable mechanism that would only lead to tariff increases.

70. The Respondent also explains that a PPI adjustment of tariffs on January 1, 2000 would have meant a 3.78% increase, while that due on July 1, 2000 would have meant a 6.18% increase, including the increase postponed under the first agreement noted above. This is what, in Respondent's view, justifies the need for the agreements made with the licensees and was also the issue considered by the judge granting the injunction, together with the interests of consumers. In any event, it is asserted, the Government is only complying

with a binding judicial decision even if not agreeing with its terms. The non-adjustment of tariffs for PPI increases would thus be the result of, first, the consent of the parties and, next, the order of the judiciary.

2. The Emergency Law

71. The crisis referred to above continued to evolve and expand until major trouble became evident in late 2001. The Government of Argentina decided in that context to enact on January 6, 2002, Law No. 25.561 or the "Emergency Law", which has come to be at the heart of this and many other claims brought by foreign investors against the Argentine Republic.

72. The Emergency Law eliminated the right to calculate tariffs in U. S. dollars, converting tariffs to pesos at the fixed rate of exchange of one dollar to one peso. In addition, the Government was authorized under this Law to devalue the peso, which a few days later was fixed at a new rate of exchange of 1.40 pesos per dollar for certain transactions (mainly banking transactions) and the free market rate for all other transactions. A month later, the free market rate applied to all transactions. PPI adjustments were definitely abolished.

73. The Emergency Law also directed the Government of Argentina to begin a renegotiation process of public utility contracts affected by the measures indicated. The second quinquiennial review of gas tariffs that should have taken place in 2002 was paralyzed by ENARGAS. While the rights of licensees were expressly safeguarded under the arrangements first set up to undertake the renegotiation, gradually the Government conditioned the right to participate in this process to the abandonment of all claims (by the Licensees or their shareholders), either totally or partially according to the nature of the claim, before local courts or arbitral tribunals. Various bodies in charge of

renegotiation have been set up over time and the deadlines established have been regularly extended, the last extension leading to the end of 2007.

74. The renegotiation process has succeeded in respect of a number of public utility contracts and sectors[3], notably among them the gas producers, but has not made much progress in the gas transportation and distribution industry, except for one contract with a gas provider (GASBAN), signed in July 2005. Information about the later steps of presidential and congressional approval is not available in the record. It was explained at the hearing on the merits that this last renegotiation arrangement provides for a 27% tariff increase during the transition period and it is believed to consider a 120% increase thereafter[4].

75. Exchanges of correspondence with TGS have not borne fruit in respect of a negotiated settlement and preliminary proposals made by the Government have not met the expectations of the licensee. Claimants explain that this is due in part to the fact that the tariff adjustment proposed has been well below the minimum required by the industry and in part to the fact that none of the rights existing under the license would be reestablished and that no compensation would be paid for the losses incurred thus far. In addition, Claimants are required to withdraw legal actions and make the Government whole for any adverse decision.

76. The Claimants also explain that in spite of the fact that the Government, recognizing the difficulties many companies are going through, has on occasion been willing to authorize small emergency adjustments, these have been systematically blocked by court injunctions. The Bill on National Public Utilities introduced by the Government in Congress in 2004 has also been the cause of concern, it is maintained, because, if approved, it would result in the final and complete abandonment of the regulatory system

[3] Witness Statement of Jorge G. Simeonoff of July 5, 2005, paras. 57-66.

[4] Remarks of Ignacio Pérez Cortés, Hearing Transcript, Vol. 1, November 28, 2005, pp. 154-157.

and conditions governing the licenses. The Claimants also argue that a trusteeship arrangement established for the expansion of the gas transportation network, although involving a tariff adjustment, does not benefit the licensees but only new investors in such scheme.

77. The Respondent attaches an entirely different meaning to the developments outlined above. It first explains that the crisis that erupted in full force in late 2001 has been among the most severe in the world, with dramatic consequences in social well-being and increased poverty, deep recession, deflation and unemployment, all of it leading to political events characterized by instability and institutional collapse. In this context, it is further explained, the Government had no other option than to enact the Emergency Law and abandon the convertibility regime.

78. The pesification of contracts and financial obligations that followed, the Respondent asserts, was applied to the Argentine economic system as a whole and did not target foreign investors in utility companies in particular, and even less did it adversely discriminate against them. In any event, it is also argued, the Emergency Law was expressly declared by Congress as one of public order so that no individual could invoke alleged acquired rights against its provisions, and as a consequence superseded all prior rules that were inconsistent with the new law.

79. The Government of Argentina also explains that the renegotiation process is gradually advancing and that a good number of contracts have been successfully renegotiated. It is further asserted that international claims have been one obstacle to the more expedient progress of negotiations. In any event, it is explained, UNIREN, the government agency presently in charge of the renegotiations, has made various offers to TGS and this company participates in various expansion projects, including the trusteeship arrangement mentioned above and other partial agreements to this effect, all of which result in benefits to the company.

I. DAMAGING EFFECTS CLAIMED

80. The Claimants sum up the damaging effects of the measures described in two major areas of the business. The first is the inability to secure international financing as a result of TGS having been unable to restructure its debt of over US$1 billion and the ensuing default on the payments due. It is explained that as a consequence TGS was rated D (default) by Standard & Poor's credit rating[5].

81. The second area the Claimants explain has suffered major damages is that concerning the revenues and the value of the company. According to the Claimants, the unavailability of PPI adjustments for 2000-2001 alone led to a loss of revenue in the amount of US$15.8 million. The emergency measures, it is also maintained, have decreased the value of the regulated business of the company in more than US$1 billion, decreasing from a value of US$1.68 billion it had in December 2001 to US$651.3 million, less than the debt associated with the regulated business and thus resulting in a total loss of the equity value. It must be noted that the Claimants make a sharp distinction between the regulated part of the business and the non-regulated part of the business, a question that will be examined further below.

82. The Government of Argentina also believes differently in this regard. It is first argued that TGS must be considered as a business as a whole, including both the regulated sector of gas transportation and the non-regulated sector of production of Liquified Natural Gas (LNG), as both were subject to the privatization. The LNG Plant of *Complejo Cerri* (Bahía Blanca), as well as the midstream services provided in preparing gas for its injection in the gas transportation network and the construction, operation and

[5] Witness Statement of Eduardo Ojea Quintana of November 16, 2004, paras. 185-216.

maintenance of gas pipelines through subsidiaries, form an integrated whole and hence must also be computed in the value of TGS.

83. The Respondent explains that the revenues of the non-regulated sector alone have increased 420% in US dollars in the period 1993-2004, while its incidence in the total income of TGS has been constantly increasing. It is thus the case, it is further asserted, that TGS benefited from the devaluation, while its costs were pesified and international prices increased. Moreover, it is explained, TGS is the principal exporter of LNG in Argentina.

84. A second aspect that leads the Respondent to differ from the actual damages claimed is that since the outset TGS adopted an aggressive financial policy, which by 2001 meant that 50% of the company's assets had been financed with debt. This is contrasted with the tariff calculation which assumed that 33% of assets would be debt-financed, a figure that was increased in the first quinquiennial tariff revision to 36.6%. This policy, the Respondent argues, allowed the company to distribute generous dividends and pay significant fees, which totaled US$ 1,354 million or 97% of the accumulated earnings. ENARGAS duly warned, it is also explained, about the implications of this policy and about changes in depreciation periods. The result of it was, in the Respondent's view, that the crisis impacted on TGS more significantly than would have been the case with a prudent financial policy.

85. The Respondent concludes in this matter that TGS has today a value 40% higher than before the emergency measured on the stock market value of its shares, or US$668.29 million. In the Respondent's estimates, TGS earned approximately US$1.2 billion on the amount invested or 325%. The Government of Argentina also asserts that the indebtedness resulting from CIESA's financial policy noted above should be taken into account.

86. Some of the issues related to the discussion of damages have legal implications while all of them have valuation implications. These various aspects will also be discussed further below.

II. LEGAL CLAIMS AND DEFENSES

87. The Claimants maintain that the various measures complained of have resulted in the violation of specific commitments made to the investors and the contractual obligations the Government undertook under the License, all of it in a manner contrary to the applicable legal and regulatory framework and the specific guarantees provided under the Argentina-United States bilateral investment treaty. All such commitments and guarantees were determinative of the decision to invest in TGS, the Claimants also argue.

88. These commitments, the Claimants assert, include in particular the right to calculate the tariffs in US dollars, the semi-annual adjustment in accordance with the variation of the US PPI and the quinquiennial review of tariffs. In addition, the Claimants also maintain, the obligation not to freeze tariffs or subject them to price controls, or if done so to compensate the licensee, as well as the obligation not to alter the License without the consent of the licensee, were prominent guarantees under the License.

89. As all the measures complained of originate in actions of the Government of Argentina or attributable to it, the Claimants further state, a wrongful expropriation of the investment has ensued, both in the form of direct and of indirect or creeping expropriation. It is also claimed that fair and equitable treatment and legitimate expectations have been violated, arbitrariness and discrimination have characterized the measures adopted, and full protection and security have not been provided to the investors. It follows, in the Claimants' view, that all the guarantees provided under the Treaty have been breached.

90. The legal defense of the Respondent is principally based on the argument that the legal and regulatory framework governing the privatization provided only for the right of the licensee to a fair and reasonable tariff and that the right to the calculation of the tariffs in US dollars was a feature that could last only as long as the Convertibility Law was in force, but not if this law was abandoned at some point in time.

91. The Respondent also argues that if the investors relied on the information conveyed by private consulting firms, such as that contained in the Information Memorandum, this cannot be attributed to the Government which expressly disclaimed any responsibility for such information.

92. In addition, the Respondent explains, the Government has the duty to take into account the interests of the consumers in regulating a national public service such as the transportation of gas, a function which is within the ambit of discretionary Government powers.

93. In the view of the Government of Argentina, the legal and regulatory framework of Argentina has been strictly enforced in adopting the measures in question and none of it involves a breach of the Treaty. Moreover, it is also maintained, the Government's responsibility is excluded both under the Argentine legislation and jurisprudence on emergency and under the rules of international law governing the state of necessity, whether customary or contained in the bilateral investment treaty.

94. The legal claims put forth by the Claimants and the defenses opposed by the Respondent will be examined in the necessary detail in connection with each of the specific measures complained of.

III. THE PPI CLAIM

95. The first claim the Tribunal needs to consider is that concerning the semi-annual adjustment of tariffs in accordance with the US PPI, a claim which originates in the measures adopted in 2000-2001, continued under the Emergency Law and kept unchanged since.

96. The Claimants argue in this respect that this adjustment is a right guaranteed under Article 41 of the Gas Law, which provided for the adjustment of tariffs "in accordance with a formula based on international market indicators", and was further confirmed by the Basic Rules, which, as explained in the Information Memorandum invoked by the Claimants, was specifically related to the US PPI. As such, the Claimants assert, it is a vested right and was so recognized under Decree 669/00 noted above in describing this adjustment as a "legitimately acquired right". This adjustment mechanism, the Claimants maintain, was an essential feature of the tariff system devised for the privatization, as it would prevent erosion of the US dollar value of the tariffs, and its suspension and abandonment was related to purely political reasons, thus causing a substantial loss.

97. The Government of Argentina explains that the situation was different. Article 41 of the Gas Law, it is argued, expressly related the adjustment to the change in value of goods and services of the industry. The US PPI made sense, the argument follows, at the beginning of the privatization process when the US indexes were lower than those of Argentina, but lost any meaning when the situation in Argentina was reversed and the economy went into recession, and deflation. As noted above, the Respondent explains that any US PPI indexation would have resulted in higher tariffs at a time when the economy was experiencing serious difficulties and later ended up in a major crisis.

98. The Respondent also argues in this connection that the purpose of the US PPI adjustment was only to reflect the evolution of changes in costs and not to ensure a given value of tariffs in US dollars. The costs considered, in the Respondent's view, unlike what the

Claimants believe, include operational costs which are a part of the concept of fair and reasonable tariffs according to the Gas Law.

99. In any event, it is also maintained by the Respondent, the suspension of the adjustment was first agreed with the licensees and next ordered by the judicial injunction of August 2000, which came to be indirectly confirmed by the Argentine Supreme Court on May 24, 2005[6]. The fact that the Government appealed the injunction on arguments which were shared by the Claimants, it is also maintained, does not mean that the Government should at present ignore the decisions of the Argentine judiciary in dismissing the appeal and later in indirectly confirming such injunction, as it is its duty under the Argentine Constitution and administrative law[7].

100. The parties also differ on the meaning of the ENARGAS Resolution that ordered the observance of the judicial injunction of August 2000 (Resolution 3480/00). In the Claimants' view, such Resolution went beyond the judicial suspension which only referred to the adjustments embodied in the second agreement, that is those due as from July 1, 2000, but not to what had been agreed for the first semester in the first agreement. On these bases, the Claimants requested the reconsideration of the ENARGAS Resolution, but this request was denied. The Respondent explains that the Resolution in question only informed the Licensee that the injunction should be observed and the tariffs managed accordingly.

101. The Tribunal must first note that it is correct that Article 41 of the Gas Law, while providing for adjustment of tariffs in accordance with a formula based on international market indicators, also related this formula to the change in value of goods and services. The formula, however, was not defined under the Law. This task was left to the Basic Rules of the License, which provided in this connection that tariffs were to be adjusted

---

[6] Respondent's Exhibit no. 225.

[7] Legal Opinion of Julio Rodolfo Comadira of June 2005, para. 177.

semi-annually in accordance with the US PPI. This was also the information conveyed to investors by the Information Memorandum.

102. The Tribunal is persuaded that such understanding was also the Government's view at the time and for almost a whole decade. This explains that Decree 669/00, dealing specifically with this mechanism, referred to the adjustment under it as a "legitimately acquired right", thus involving an unequivocal recognition of the existence of such a right.

103. Even if the Information Memorandum was in fact prepared by private consultants and the responsibility of the Government was expressly disclaimed, if it had been in error in this respect, what is not quite likely in the case of highly prestigious consulting firms engaged by the Government to explain the privatization plan to prospective foreign investors, such error would not have passed unnoticed to competent government officials. In such case, moreover, the Government would have been under the duty to issue a clarification, as otherwise a false legitimate expectation would have been created. No such clarification was ever issued until the US PPI was first suspended and next discontinued under the Emergency Law. It is thus the conclusion of the Tribunal that the licensees had a right to the US PPI adjustment under both the regulatory framework and the License, confirmed by the context and the practice of the privatization.

104. This is not to say that the Government did not have the sovereign authority to change its mind later, as in fact it did. The rationale for this change might be perfectly reasonable in light of changing economic conditions in the country, a matter which is not for the Tribunal to judge. But even to this end, the Government had mechanisms available under the License and the regulatory framework, including the quinquiennial tariff revision. One such revision had already taken place ("RQT I") and one other was in preparation to govern the tariffs precisely as from 2002 ("RQT II"), but this was never finalized. If the Government decided to take a different route, this cannot be to the detriment of investors' rights and any ensuing damage must be compensated if legally justified.

105. The meaning of the ENARGAS Resolution adopted in connection with the judicial injunction of PPI adjustments must be understood in the context of what such injunction aimed at. While the Claimants are right in pointing out that the injunction did not refer to adjustments related to the first agreement, the fact of the matter is that the injunction in question sought to suspend the increase of tariffs in general. ENARGAS cannot be faulted for having so understood. It must be kept in mind that the undertakings of the first agreement would have also begun to materialize in the second semester of 2000, the period which the injunction was considering.

IV. THE CLAIM ABOUT THE CALCULATION OF TARIFFS IN US DOLLARS

1. The Claimants' argument

106. The central claim in this arbitration is that concerning the alleged right to calculate tariffs in US dollars. The Claimants argue in this respect that under the Gas Law, the Gas Decree and the Basic Rules of the License, key tariff-related guarantees were offered to investors, paramount among which were the calculation of tariffs in US dollars, the US PPI adjustment, the commitment not to freeze tariffs or subject them to price control without compensation, and the obligation not to amend the License without the consent of the licensees.

107. The Claimants maintain that such guarantees were at the heart of the protection offered against currency fluctuations and an essential feature to attract foreign investors to the privatization process. The Claimants further assert that their claim is not related to an issue of devaluation, and hence also unrelated to questions arising under the Convertibility Law as the Respondent argues, but based on the breach of guarantees made

available to investors so as to keep them free from the extreme fluctuations that had historically characterized the Argentine economy, including the period immediately preceding the privatization. The Claimants believe that if such guarantees were not available at the time they were needed because of renewed fluctuations, they would be entirely futile.

108. In support of their views, the Claimants invoke in particular Article 41 of the Gas Decree, which provides that "Transportation and Distribution Tariffs shall be calculated in Dollars" (Tribunal's English translation), just as Article 9.2 of the Basic Rules indicated that the "tariff has been calculated in US dollars". It would then be expressed in pesos at the time of billing. This understanding, it is further maintained, was confirmed by the minutes of a meeting of the Privatization Committee held on October 2, 1992, stating in connection with Article 9.2 of the Basic Rules that it "makes sufficiently clear that the tariffs are in dollars and that they are expressed in convertible pesos, and, therefore, in case of an eventual amendment to the Convertibility Law, they should be automatically re-expressed at the modified parity"; this understanding made it unnecessary to include additional rules in respect of this guarantee.

109. The Claimants further invoke in confirmation of this understanding, among a number of other provisions, the wording of Annex F of the Pliego to the effect that tariffs "shall be adjusted immediately and automatically in the event that parity varies", indicating to this effect that the "quantity of Argentine currency necessary to acquire a US dollar in the New York market shall be applied".

2. The Respondent's argument

110. The Government of Argentina holds a completely different view about the meaning of the Gas Law and related provisions on this issue. It believes first that the essential provision

of the Law is that embodied in Article 2 to the effect that tariffs shall be fair and reasonable, a provision that is also reflected in Article 2 (6) of the Gas Decree in terms of the obligations which ENARGAS must ensure. The concept of a fair and reasonable tariff is associated, the Government maintains, to the objective of covering operating costs, taxes and depreciation and earning a reasonable income, all of which within the framework of an efficient operation of a satisfactory service at the minimum cost and a return similar to other activities of comparable risk.

111. In the context of such concept, the Respondent argues, the reference to the calculation of tariffs in US dollars, and related PPI adjustment, could only be understood as inextricably related to the Convertibility Law. This is confirmed, the argument follows, by the very terms of Article 41 of the Gas Law when making express reference to the fact that tariffs shall be expressed in pesos convertible under Law 23.928 (the Convertibility Law) and taking into account the parity established in Article 3 of its Regulatory Decree (Decree No. 2.128/91), which was the one to one parity between the peso and the dollar. The Respondent finds further confirmation of this link to the Convertibility Law in Article 9.2 of the License, which also referred to Article 3 of the Regulatory Decree and its eventual modifications.

112. It is thus the case, the Respondent asserts, that the mechanism envisaged only the possibility of a modification of the relationship between the peso and the dollar under the Convertibility Law, but not the situation if the Convertibility Law was altogether abandoned. In the Respondent's view, the modification of the parity under the Convertibility Law is different from the abandonment of such Law. In this last scenario, the calculation of tariffs in US dollars no longer made any sense, the Respondent believes. The Respondent also explains that this was the understanding of the Privatization Committee, which recorded in its minutes of July 17, 1992 that the parity should be adjusted in accordance with the New York market and that "the adjustment proposed does

not consider the current exchange rate as the basis, but the currency board exchange rate", concluding that "as long as Argentina does not abandon the currency board system, no tariff adjustment will be required".

113. The Respondent also reads the minutes of the Privatization Committee of October 2, 1992 referred to above, as expressly conditioning the adjustment of tariffs in case of modification of the parity to the Convertibility Law. The Respondent argues that this is so particularly because when the Committee concluded that the License offered sufficient coverage in this respect, a proposal that would have provided for adjustment in case of abandonment of the convertibility was rejected. The Respondent further maintains that the Gas Decree makes no mention at all of the possibility of abandonment of the Convertibility Law.

114. Although Annex F of the Pliego, noted above, seems to convey a broader concept of tariff adjustment in case of modification of the parity, the Respondent points out that this Annex was held to be merely descriptive, just as the Information Memorandum, on which Claimants also rely, is a non-binding document that was not prepared by the Government, and any responsibility thereunder was expressly disclaimed. It is also explained that in any event the Memorandum was prepared before the regulatory framework was enacted.

3. Discussion of historical experience

115. The views of the parties also differ significantly in respect of this specific claim in light of arguments concerning the historical experience of the privatization of ENTEL, the national telecommunications company. This privatization, the Respondent asserts, confirms that calculation of tariffs in US dollars was inextricably related to the Convertibility Law.

116. ENTEL was privatized under the Law on the Reform of the State, but before the Convertibility Law was enacted; originally tariffs were set in "Australes", the Argentine currency at the time, and adjusted in accordance with the Consumer Price Index of Argentina (IPC). The Respondent explains that because the Convertibility Law froze tariffs and adjustments in pesos, the parties agreed to express tariffs in US dollars and to adjust them on the basis of the US PPI variations, but this, unlike the case of TGS, was done without specific reference to the Convertibility Law. The Respondent concludes in this respect that this evolving framework evidences that there was no exchange rate assurance given and that, consequently, the devaluation risk was not eliminated or shifted to the Government, as argued by the Claimants, and that the Respondent received no compensation for any such currency risk.

117. The Claimants reach an entirely different conclusion on this historical experience. It is first explained that the tariffs of ENTEL, even before any changes were made, included a US dollar component to temper devaluation effects that was automatically triggered if certain ratios were met, just as international services were set in Gold Francs. It is next maintained that the changes introduced after the Convertibility Law was enacted were made precisely to ensure that no adverse effects would ensue for the investors and to provide incentives for new investments.

118. In addition, the fact that the tariffs calculated in US dollars were to be billed in pesos at the exchange rate applicable at the time of billing, confirms in the Claimants' view that the system is not related to the Convertibility Law, as they also argue in the case of TGS. It is also explained, lastly, that underwriting arrangements made with banks and the placement of remaining shares in the New York and Buenos Aires markets, resulted in additional benefits to the Government that would not have been possible had the risk of currency fluctuation not been eliminated under the tariff system.

4. The discussion about country risk

119. The parties disagree also about another regulatory issue, namely whether tariffs were higher because they included a premium for the risk that convertibility might be abandoned at some point in the future. This the Respondent equates with country risk or default risk, and argues that if the licensees were guaranteed that US dollar tariffs would be converted to pesos at the prevailing exchange rate, they would be obtaining a double benefit as the tariffs already were set higher to offset this risk.

120. In the Respondent's view, the original tariffs were established taking into consideration debt bonds of the Argentine Republic (Bonex 1989), which resulted in a higher cost of debt of 9.50%. RQT I also considered a 6.17% country risk and RQT II had envisaged a figure of 7.40% to this effect, all of it leading to additional return over the invested capital. On the basis of these arguments, the Respondent concludes that the Claimants cannot pretend to charge higher tariffs for a risk, and later, if the risk materialized, argue that such risk should not be born by them.

121. The Claimants maintain that such an argument is wrong because country risk only relates to the default on sovereign debt, which is conceptually different from the risk concerning "pesification" and the freezing of tariffs. The latter was, in the Claimants' view, allocated to the Government through the License and the tariff system envisaged, for which it was rather the investors who paid more for shares benefiting from this guarantee.

5. Discussion about an incomplete regulatory framework

122. Still one other regulatory issue divides the opinion of the parties in connection with the meaning of the tariff system. In the Respondent's view, because the regulatory framework was incomplete and did not foresee what should be done in case the Convertibility Law

was abandoned, it falls upon the Government to adapt the licenses to the new situation. This was done, it is explained, by means of the pesification of the whole economy, the dollarization of export-related tariffs and the renegotiation of contracts and licenses.

123. This, the Respondent maintains, is the duty of the Government in respect of a public utility service, and such regulatory powers are exercised in a discretionary manner as it is accepted in economic theory and judicial decisions in both Argentina and other countries, particularly if the need for adaptation results from a major economic crisis. In the Respondent's opinion, the exercise of this regulatory power in such a context cannot be considered equivalent to a unilateral derogation or amendment of the tariff regime, as argued by the Claimants.

124. The Claimants deny that the regulatory framework might be considered incomplete because all the assurances given were specifically related to the possibility that the Convertibility Law might be abandoned in the future. The only meaning of the Emergency Law in this context, it is maintained, was to unilaterally change the tariff system and related aspects. Moreover, the Claimants argue, none of the mechanisms provided under the License to undertake a tariff revision were used.

125. The Claimants also point out that the Argentine legislation itself provides all the necessary guarantees in terms of fundamental safeguards of acquired rights and legitimate expectations. Even the regulatory powers recognized to governments in cases of changed circumstances, it is also argued, are limited and subject to specific conditions, and do not reach into questions of compensation and financial advantages, least of all alter the economic balance of the contract. The Claimants also assert that it was precisely in order to provide for a clear limit to these powers that the Government included in the License the guarantee that it could only be amended with the consent of the parties and that it could not be terminated except in very specific situations. The discussion of the pertinent legal arguments will be addressed by the Tribunal further below.

126. The Claimants also contest the Respondent's views about the meaning of the Emergency Law in this context as they believe it was adopted following political motivation in a climate of hostility towards investors and that the renegotiation process that followed has not been conducive to any solution for TGS, as discussed above. Issues relating to export contracts and the question of the non-regulated business of TGS will be discussed separately.

6. The Tribunal's findings on the US dollar calculation of tariffs

127. The Tribunal is grateful to counsel for the parties for the detailed arguments with which they have assisted the Tribunal in the examination of this claim. The Tribunal finds the Claimants' arguments about the existence of a right to the calculation of tariffs in US dollars persuasive.

128. This conclusion is based first on the examination of the legal and regulatory framework. If the Gas Decree and the Basic Rules of the License unequivocally refer to the calculation of tariffs in US dollars, and such feature was also explained in the same terms by the Information Memorandum, there cannot be any doubt about the fact that this is the central feature governing the tariff regime.

129. Given the emphasis that this regulatory framework placed on the stability of the tariff structure, it is not surprising that the calculation of tariffs in US dollars, as the PPI adjustment, were assigned a significant role therein. Whether devaluation could at some time intervene was not ignored, but hardly addressed in view of the fact that stability was the principal aim and, as will be explained, the problem would be corrected by means of the automatic adjustment of tariffs to the new level of exchange rate.

130. The Respondent has devoted particular attention to the link that in its view these clauses have with the Convertibility Law. It is maintained in this respect that if tariffs were set in

US dollars independently from the Convertibility Law this would have resulted in an unreasonable, unfair and unconstitutional legal regime[8], unsustainable in Argentine courts as it would be in the courts of the United States in light of the regulatory experience of that country. Sophisticated investors and their lawyers, it is also asserted, could not have relied solely on the information conveyed by unofficial documents, such as the Information Memorandum or Annex F of the Pliego, and if they did their claims should be now held inadmissible.

131. The Respondent also relies on a witness statement to the effect that if tariffs had been set in dollars independently from the Convertibility Law, the risk of devaluation would have been placed on the consumers, which were the less prepared to face such a risk[9].

132. The Claimants have also invoked in favor of their argument decisions of the Argentine Supreme Court holding that if for political or other reasons the Government decides to maintain tariffs lower than the cost and a reasonable profit, compensation should be granted, as otherwise the assets of the company or its profits would be destroyed[10]. Claimants have also distinguished the *Maruba* case[11], invoked by the Respondent to show that there was no entitlement to the original tariff but only to a reasonable rate of return, arguing that in such case the tariff system was different, was not established by contract and there were no provisions for its amendment.

133. It is true that the Gas Decree provides that tariffs calculated in US dollars shall be expressed in pesos convertible under the Convertibility Law and that reference is made to the need to take into account the parity established under Decree 2128/91, which regulated the convertibility regime.

---

[8] *Id.*, paras. 97, 106.

[9] Witness Statement of Cristian Folgar of March 5, 2005, para. 45.

[10] *Compañía de Tranvías Anglo Argentina v. Nación Argentina*, p. 569, as cited in Claimants' Reply, no. 186.

[11] *Maruba Empresa de Navegación Marítima v. Ministerio de Obras y Servicios Públicos*, Fallos 321:1784 of June 30, 1998, submitted as Respondent's Legal Authority no. 31.

134. The meaning of these provisions, however, can also be read differently. Convertibility, as the Claimants have argued, is different from the question of a given parity or exchange rate, as convertibility simply relates to the right to buy a certain foreign currency with local currency. It is the exchange rate that will determine how much local currency you will need to buy a unit of the foreign one. Because the Convertibility regime was aiming at the stabilization of the economy following a period of galloping inflation and continued devaluation of the currency, the Government of Argentina chose to do the two things at the same time. It first confirmed the right to the convertibility of the currency, which has remained unaffected. Simultaneously it pegged the peso to the US dollar at the one to one parity, while also prohibiting indexation in pesos. This fixed parity is the one no longer available following devaluation and the adoption of a floating rate system.

135. This difference is reflected in the regulatory framework with which the Tribunal is concerned. The Gas Decree indeed made a link to the first aspect in referring to pesos convertible under the Convertibility Law, but the reference to a given parity established under the Convertibility Decree was more qualified. In fact, Clause 9.2 of the License did take into account that the parity and the ratio could be amended in the future, as it expressly refers to the eventual modifications of Convertibility Decree 2128/91. Further references of the Pliego to the New York market exchange rate must be understood in the same context.

136. In reaching this conclusion the Tribunal is also mindful of the economic context in which convertibility and the ensuing privatization were introduced. Precisely because these measures were preceded by a long period of economic turmoil, investors would not be attracted to participate in the privatization process unless specific assurances were provided in respect of the stability of their arrangements. These were the specific guarantees envisaged in the calculation of tariffs in US dollars, the conversion in pesos of

the calculated amounts at the time of billing at the prevailing exchange rate and its US PPI adjustment, together with other stabilization mechanisms of contractual arrangements.

137. The distinction made by the Respondent between the modification of the convertibility regime and its abandonment is not persuasive. Guarantees and stability are meant precisely to operate when problems arise, not when business continues as usual. The tariff regime approved was devised as a permanent feature of the privatization, not a transitory one, and if it was intended to be transitory it should have also been clearly advised to prospective investors, but again nothing of the sort was done. The regulatory and contractual arrangements were thus not incomplete, as argued, and if such were the case it would certainly not have passed unnoticed to competent officials, businessmen and counsel and advisors.

138. The Tribunal must note that the discussion of the matter in the Privatization Committee was on occasions confusing. The Respondent, as noted, has invoked in favor of its argument the minutes of the Privatization Committee meeting of July 17, 1992, where few weeks after the enactment of the Gas Decree reference was made to adjustment of tariffs, not at the actual exchange rate, but at the convertibility rate, and that unless convertibility was abandoned there should be no adjustments on this basis. The minutes further added a reference to the adjustment of parity in the New York market and to an understanding of the Committee to the effect that if convertibility was abandoned licensees should be assured of adjustment according to a realistic exchange rate.

139. While these minutes could be read as allowing for adjustment under the convertibility regime and not if it were abandoned, a different reading is also justified. In fact, the Committee was discussing two different kinds of adjustment. It was first discussing the thought of an automatic adjustment in accordance with the variation of cost structure expressed in pesos, but this was ruled out as it meant an indexation forbidden under the Convertibility Law. It is in relation to this cost adjustment that reference was made to the

convertibility exchange rate and to the view that no adjustments on these bases should take place unless convertibility was abandoned and, if this was the case, a realistic exchange rate should then be found for the adjustment.

140. At the same time, the Committee was discussing an adjustment related to the parity and its eventual modifications, which was the one that finally the regulatory framework and the License included in its terms. This is the kind of adjustment that would follow the New York market exchange rate and was expressly referred to as the "adjustment for parity". This was what the Committee later addressed in the minutes of October 2, 1992, invoked by the Claimants in support of their own view, where the Committee decided to reject a proposal to the effect of expressly referring to the abandonment of the convertibility regime on the ground that Clause 9.2 of the License embodied a sufficient guarantee in connection with the adjustment at the modified exchange rate.

141. The Tribunal also wishes to consider on this point the witness statement of Mr. Patricio Carlos Perkins, who was a key official in the privatization process and the author of the initiative that the Committee addressed on October 2, 1992. In referring to the approach followed by the Government officials at the time, Mr. Perkins explains:

> "Although there was consensus in applying US Dollar-based tariff rates, the manner by which such criteria would be expressed in the official documents was a matter of some discussion.
> Government officials decided that expressing tariff rates in Convertible Pesos according to the Convertibility Act and its Regulatory Decrees was sufficiently clear and that it was not prudent to state in the official documents that Argentina could eventually abandon convertibility in the future. This was the criterion argued by Government representatives on the Committee. I wanted it stated clearly in the section of the license where the tariff rates, service terms and conditions were addressed that the tariff rates were established in US Dollars and invoiced in local currency at the exchange rate prevailing at the billing date.
> After much discussion, it was decided that the license would state that tariff rates have to be calculated in US Dollars and that invoicing would be made in Convertible Pesos […]
> Therefore, in order to attract many well-qualified bidders, the licensees were protected from this risk. It was established in item 7.1 of Annex F to the Pliegos, that in case of an eventual variation in the parity of the local

> currency to the US Dollar, tariff rates would be "immediately and automatically" adjusted."[12]

142. The Tribunal would have wished that Mr. Perkins had been examined and cross-examined on this and other aspects of his testimony, and also to put questions to him, but his participation in the hearing on the merits was regrettably prevented by an injunction issued by an Argentine judge on November 24, 2005 at the request of the Government. The Tribunal makes no inference of this situation, but decided in Procedural Order No. 5, dated December 2, 2005, that the witness' written statement was admissible and that, moreover, Mr. Perkins enjoyed and continues to enjoy the immunities provided under Articles 21 and 22 of the ICSID Convention. Quite different was the situation concerning the witness Mr. Roberto Kozulj, who after giving a written statement did not appear at the hearing providing the Tribunal with a rather vague and unsatisfactory explanation; as the witness could not be cross-examined, the Tribunal has not considered his testimony[13].

143. The conclusion of the Tribunal on this matter does not mean that it ignores economic reality and the crisis which has affected Argentina in the recent past. It is perfectly possible that economic conditions can change, as they dramatically did, and this can have a profound effect on the economic balance of contracts and licenses. In this context, the Respondent's argument that the Gas Law was principally concerned with a fair and reasonable tariff is not misconceived. To this effect, particularly if tariffs ceased to be fair and reasonable, the regulatory framework provided for specific adjustment mechanisms, tariff reviews on periodic basis and even the possibility of an extraordinary review. The issue then is not whether contracts should remain frozen forever, but whether they can be adjusted to such changing realities in an orderly manner as provided under the regulatory

---

[12] Witness Statement of Patricio Carlos Perkins of December 11, 2004, paras. 294-297.

[13] Remarks of R. Doak Bishop, Hearing Transcript, Vol. 1, November 28, 2005, pp. 9-10.

framework and the contract itself, including the negotiated modification of the license, or whether this will be done by unilateral action of the Government.

144. The real problem underlying the claims is that the unilateral action by the Government became the predominant feature of the process of adjustment. Broad as the regulatory authority of States and governments might be at present, it can only be exercised within the confines of the law and duly taking into account the rights of individuals. It will be seen further below that the Argentine legislation and the decisions of courts in that country have carefully set out the limits of government regulatory power in light of a long experience of economic crisis and emergency intervention.

145. In support of its view that the calculation of tariffs in US dollars is inextricably linked to the Convertibility Law, the Respondent also invokes arguments concerning the historical experience surrounding the privatization of ENTEL. The conclusions the Tribunal draws from that experience are not quite the same as those of the Respondent.

146. It is first an undisputed fact that because the Convertibility Law froze indexation in pesos and adopted other currency stabilization measures, the terms of the original privatization of ENTEL were no longer viable and had to be adapted to the new economic policy. All the changes introduced were done in agreement with the licensee, which is thus an entirely different situation from the present one. The ultimate meaning of this agreement was, as argued by the Claimants, to avoid adverse economic consequences for the licensees arising from the changed regulatory measures, which is also a proposition different from the instant case.

147. Without prejudice to the Claimants' argument that the original tariff structure included a US dollar component and other stable value references, the fact that the new agreement provided for US dollar-calculated tariffs without reference to the Convertibility Law, far from proving that those tariffs later were inseparable from that law, such as the Respondent alleges was the case of the gas tariffs, it rather proves the contrary. If tariffs

were calculated in US dollars and converted into pesos without reference to the Convertibility Law in the case of ENTEL, it can well be read as a confirmation of the conclusion that the reference to the Convertibility Law in later arrangements was not a guarantee conditioned on a given parity. On the other hand, the fact that ENTEL's tariff was not related to the Convertibility Law did not spare this company from the consequences of the Emergency Law and related measures.

148. The Tribunal is not persuaded either by the argument concerning the premium for a country risk. That such a premium was considered in the tariff structure and RQT I is not disputed. The issue is whether this premium and the guarantee of tariff adjustment in case of a changed parity with the US dollar are compatible or they should be considered as a kind of "double dipping" by the Claimants.

149. The Tribunal concludes in this respect that country risk or default risk is related exclusively to the risk of default of a given country on its foreign debt and as such it relates to the question of the financial structure of the investment, making borrowing more costly and being compensated by means of the additional premium. The currency devaluation is a different kind of risk and responds to a different rationale, as it concerns the level of income and revenues of the company as reflected in the tariff system and its eventual adjustments. While these risks may in some way interact, for example country risk increasing as a result of currency instability, they operate independently from each other and are subject to different safeguards.

150. In the end, there are two rather simple and practical considerations which the Tribunal must also keep in mind. If a premium was provided for the country risk and this risk was the same as the devaluation risk, why allow for an additional adjustment mechanism under the regulatory framework? The second consideration is still more elementary. If the meaning of the tariff structure was not to allow for adjustment in case the original parity would be abandoned, why then bother to establish a mechanism in US dollars when

peso-denominated tariffs would have accomplished the same result? The only logical answer is that if the risks considered were the same, none of these additional mechanisms of protection would have been necessary.

Claim concerning the breach of stability clauses of the License

151. The Claimants have also argued that the measures adopted by the Respondent resulted in other breaches of the License concerning some basic guarantees about the stability of this instrument. This claim refers in particular to Clause 9.8, which prohibits the freezing, administration or control of prices, and if because of controls prices would be lower that the level resulting from the tariff, the licensee shall be entitled to compensation for the difference. The claim also refers in particular to Clause 18.2 of the License, in the terms of which the Licensor shall not amend the Basic Rules of the License, in whole or in part, without the written consent of the Licensee.

152. Two aspects must, however, be clarified at the outset. The first is a jurisdictional argument which the Respondent has reiterated in the pleadings on the merits to the effect that the investors are not the licensees and, therefore, cannot invoke the terms of a contract to which they are not parties. The Tribunal has dealt with this question in its Decision on Jurisdiction.

153. The second issue is a novel one. The Respondent has argued that as the prohibition of Clause 18.2 refers to the License not being modified by the Licensor, and the Licensor is the Executive Branch of Government, any measures or effects arising from congressional action, such as the Emergency Law, or from judicial decisions, such as the US PPI

injunction, are not adopted by the Licensor and hence not envisaged in the prohibition of unilateral modification[14].

154. Ingenuous as this argument might be it is no more than a play of words because the Executive Branch binds the State in guaranteeing certain rights to foreign investors. Furthermore, quite evidently any State action, governmental, legislative or judicial, must respect the rights acquired under a contract. If contract rights were at the mercy of other branches of the State the rule of law, under both domestic and international law, would be seriously in jeopardy, a view which is not quite likely to be accepted in an arbitration which, at least in part, is governed by international law.

155. The Tribunal must also note that Clause 18.2 of the License, in prohibiting the modification of the License makes special reference to the fact that even if an authorized modification under the Service and Tariff Regulations results in a favorable or unfavorable alteration of the economic and financial balance existing before the modification, the Licensee will have the right to request the pertinent adjustment of the tariff. It is that economic balance what the whole tariff regime purported to ensure.

Regulatory economic and financial defenses

156. In addition to the specific arguments made by the Respondent in respect of each of the claims explained above, it has also raised a number of important questions touching on economic and financial aspects that are closely related to the regulatory framework governing the investment. These defenses will be examined next, without prejudice to what will be discussed as pertinent in connection with valuation issues further below.

[14] Respondent's Post-Hearing Brief, p. 10.

The question of leverage policy

157. The Respondent asserts that TGS has obtained an annual return of 33% over its investment and that its stock market value in Buenos Aires and New York is 40% higher in dollars than the value it had before the crisis, thus resulting in a situation that, far from meaning a drop of 78% in the value of the company, as claimed, has actually meant that the value has considerably increased.

158. The Respondent, as explained above, also maintains that the leverage policy followed by the company has had a negative impact on its equity value, which would otherwise be higher, and this is not something for which the Government is to be held liable, as the risk for having taken a large debt in foreign currency belongs to the Claimants. TGS, the Respondent believes, could have taken other more prudent options, such as debt in pesos or even in dollars in the local market, which were later pesified at a one-to-one parity, or could have diversified the risk of devaluation. This was not done, in the Respondent's view, in order to obtain higher dividends and benefit from tax advantages, an approach which was also allegedly followed by CIESA; time depreciation of assets would also have been modified in order to increase profits.

159. In this regard the Respondent argues that the tariff system envisaged under the Gas Law was geared to satisfy reasonable costs of operation, taxes, amortization and a reasonable return, but did not include financial costs, and required in addition an efficient service at the minimum cost for consumers.

160. The Respondent further asserts that the decisions of the Argentine courts have been at one in considering, in light of earlier devaluations, that the risk entailed in foreign currency obligations is a market business risk that cannot be transferred to the State. The Respondent also recalls in this respect that in accordance with Clause 2.4 of the Basic Rules the Government does not guarantee or ensures the return on the operation of the

business, and that more generally neither TGS nor the Claimants can exclude themselves from the effects of the crisis.

161. The Claimants oppose this defense on the basis that the leverage policy adopted was reasonable in light of the long-term optimal capital structure of the industry as a whole, and that it was not too different from the estimates used in RQT I and proposed for RQT II. The first envisaged a debt to capital ratio of 36.7% while TGS was at a ratio of 40.8%. The second considered 46% compared to 49.8%, respectively. It is also explained that the question of time depreciation followed the rules issued by ENARGAS, except at a point when this entity delayed the enactment of such rules.

162. In addition, the Claimants explain that the leverage of CIESA is irrelevant in this arbitration because they are claiming for their own losses and not for those of CIESA, and that, in any event, the dividend distribution policy was reasonable as it ranged between 15% and 35% of annual revenues, an approach that was never questioned by the Government when it was a shareholder of TGS.

163. The Claimants do not believe that there were relevant options to taking debt in foreign currency abroad, particularly since the Argentine financial markets did not have sufficient funds available, which was the very reason why the Government itself had to resort to foreign financial markets for its needs. Lastly, the Claimants assert that the value of TGS's shares is not representative of the value of the company, in part because the shares are extremely illiquid and its traded volumes are not significant, a question that will again be examined in connection with valuation.

164. The first question the Tribunal must address is whether the tariff included financial costs as part of their structure. There can be no doubt that this was the case. It must be recalled that Article 38(a) of the Gas Law specifically relates the income obtained to the sufficient recovery of, among other elements, depreciation (or "*amortización*"), just as Article 2(4) of the Gas Decree still more specifically provides for the recovery of all costs, "including

the cost of capital". The Tribunal is also mindful of the fact that also the very elements of RQT I and the proposed RQT II did envisage the question of leverage in calculating the tariff, just as the original tariff structure did.

165. Whether the leverage was reasonable is not something the Tribunal is called to decide on. While ENARGAS did discuss this matter with the licensees, no claim was made that the policy followed might be contrary to the regulatory framework or the License. This was essentially a company decision and the fact that tariff calculation was to be made in US dollars and adjusted in accordance with the US PPI did provide for a reasonable assurance allowing for the option of taking debt in dollars in the international financial markets. The Tribunal is also persuaded by the argument that sufficient financing was not available in Argentina for such a large operation, which aimed precisely at attracting foreign investments in the country.

166. If the claim before the Tribunal dealt with the question of devaluation, the Respondent's argument to the effect that devaluation falls within the sovereign prerogative of the State would be entirely appropriate. But this is not a claim about the devaluation and so has been expressly disavowed by the Claimants. It is a claim concerning the breach of the various aspects of the tariff system that have been explained above and the rights the investors have in that respect in light of the legal, regulatory and contractual commitments made.

167. The Tribunal must also conclude that the view of the Respondent to the effect that CIESA could not claim for the interest the investors had in TGS, if these were separately compensated, is correct, and if such eventual compensations were to be accumulated they would result in a "double-dipping" or double recovery. To the extent that the investors are compensated for their interest, that is the end of the matter in respect of such interest as far as the Respondent is concerned. This issue is also related to the discussion of what is precisely the interest the Claimants held in TGS, which will be addressed further below.

A. The question of export contracts

168. A second defense the Respondent raises is that TGS is a major exporter of gas in Argentina, and that Decree 689/02 expressly excluded from the pesification transportation and other contracts related to exports. It follows, in the Respondent's view, that the impact of devaluation on the company is much smaller than claimed as the tariffs in this area have been kept in US dollars and the US PPI continues to apply, with the result that such tariffs have increased by 15.89% since 2002 and returns have increased. This, the Respondent maintains, is a further confirmation that TGS, far from being affected by the abandonment of Convertibility, has benefited from it.

169. The Claimants oppose to such a defense the argument that, first, TGS's export-related revenue is insignificant as it amounts only to 1% of the total revenue of the company and, next, that the decision to exclude this activity from pesification was not taken to benefit the company but to ensure a greater flow of foreign currency into the country. It is also pointed out that ENARGAS, in rejecting a request by a foreign shipper to the effect that the PPI should not apply to export contracts, invoked arguments which are coincident with those of the Claimants, namely that transportation costs have increased as a consequence of devaluation and that investments cannot be recovered with frozen and pesified tariffs.

170. The meaning of the parties' arguments on this matter is not quite clear. The Respondent appears at some point to identify the export gas transportation business with the export of LNG, but at the same time Decree 689/02 applies to a broader range of export-related activities. On the other hand, it is not clear either whether the Claimants are addressing in this context also the revenue originating in the non-regulated sector of their business.

171. Be that as it may, the Tribunal must note that the Respondent's arguments about the meaning of the emergency are not quite consistent with Decree 689/02. By its very terms, this Decree provided that export-related tariffs would be adjusted in the manner established in the respective licenses, which is to say calculated in US dollars and adjusted by the US PPI. Thereby the Decree appears to confirm that such mechanisms did in fact survive as rights under the license in spite of the fact that the Convertibility Law had come to an end. On the other hand, if the Decree, as it is also argued, aimed at reestablishing a right which allegedly had been abrogated by the Emergency Law, it then appears to take up a certain legislative role. In any event, the Decree is certainly taking up a judicial role because it orders this reestablishment of rights as from August 2000 in spite of the fact that the judge did not so order under the injunction.

172. The Tribunal does accept the Respondent's view that the revenue originating in the export side of the business does contribute to mitigate the eventual damages arising from the measures discussed, and to that extent it should be reflected in the valuation of the company. But this is true only in respect of the regulated side of the business. To the extent that this revenue relates to the non-regulated sector it is then inseparable from the discussion about whether non-regulated business should be included in the overall valuation of the company, as argued by the Respondent, or kept entirely apart, as argued by the Claimants. The Tribunal will turn to this issue next.

B. Regulated and non-regulated business activities

173. The Respondent has also raised in its defense that if the claim for compensation refers to the Claimants' interest in TGS, such interest relates to the company as a whole, including all of its business, regulated or non-regulated, and that shares representing that interest

cannot be separated into different portions. This argument is in turn linked to the Respondent's view that the appropriate method of valuation is the value of shares in the stock market, among other reasons because when an investor purchases a share in a company it is considering the value of that share in connection with the business in its entirety.

174. The Respondent asserts in this matter that the shares transferred by the Government to TGS referred both to regulated activities, such as transportation, and to non-regulated activities, most notably the production of LNG in the plant of *General Cerri*. This decision was based, it is maintained, on the fact that technically one activity is inseparable from the other in light of both operational and geographical considerations[15], as this was expressly recognized by the Privatization Committee when discussing the proposal that the plant of *General Cerri* should be integrated into the southern transportation business unit ("*unidad de negocios de transporte del Sur*") and concluding that this recommendation was the most appropriate because of the "operational consequences of the geographical location of the plant of General Cerri"[16]. According to the Respondent's experts, it appears that such an integrated approach to the regulated and non-regulated sides of the business was also present in the debt restructuring of TGS[17], having also been explained that "the debt of the regulated and unregulated businesses are not separable"[18].

175. The Claimants believe differently. In their view, there are no physical or operational reasons why the plant in question should be included in TGS's assets and in fact neither the Privatization Committee nor TGS considered this possibility. The accounts of the non-regulated sector, it is further explained, are kept separately from those of the

---

[15] Witness Statement of Charles Joseph Massano, March 2, 2005, paras. 14-21; Testimony of Charles Joseph Massano, Hearing Transcript, Vol. 4, December 1, 2005, pp. 633-637.

[16] Minutes of the Privatization Committee Meetings of October 8 and 9, 1991, Respondent's Exhibit no. 32.

[17] Expert Report of García Sánchez, Casarín, and Sarria Allende ("GSCSA Expert Report") of June 2005, paras. 19, 170.

[18] Expert statement of Javier García Sánchez, Hearing Transcript, Vol. 6, December 3, 2005, pp. 915-916.

regulated sector, as required by the applicable rules. In any event, it is also argued, in spite of the fact that the non-regulated sector benefited from the devaluation and its revenue has increased, the financial profile of TGS was significantly damaged by the measures adopted by the Government.

176. The Tribunal realizes that there are two different approaches to this question. Looked at from the point of view of the value of equity as expressed in shares, the Respondent's argument has merit. In fact, shares are not divisible and represent an interest in a company as a whole. Their stock market transactions are priced considering this whole, for better or worse. If stock market valuation is chosen as the appropriate method to determine the value of the company and eventual compensation for losses, the integration of regulated and non-regulated activities is the natural consequence.

177. There is, however, another approach. The only purpose of the claims brought to the Tribunal is to obtain compensation for losses allegedly suffered as a consequence of government measures. These measures refer only to a sector of activity which is subject to regulation. It follows that if regulated tariffs were the source of the complaint, it is only the consequence of the measures in respect of such tariffs that should be compensated. Conversely, it is quite evident that if the non-regulated sector had been affected by government measures, a claim to the effect that tariffs of the regulated activity should be increased to compensate for that loss would not be admissible. Valuation methodologies do exist so as to measure the damage on an individual sector of the business.

178. Which of the two approaches is more convincing is the question the Tribunal must now address. Admittedly, the privatization process and the License were not quite clear in providing a precise answer to this question. On the one hand, the Privatization Committee did refer, as noted by the Respondent, to a business unit. The License, while defining the licensed service as that concerning gas pipeline transportation (Clause 1.1), appears to

narrow its scope to the regulated sector, but in fact the privatization undertaken included both sectors of activity simultaneously.

179. The intention of what was done is where the answer must then be found. The Tribunal is persuaded by two arguments the Claimants have made. As noted, TGS was instructed under the applicable rules to keep the accounts of the two sectors completely separate from each other. This was so decided so that the non-regulated sector would not end-up in any way affecting the transportation regulated sector. Annex XXVII of the Share Transfer Agreement stated that "The Licensee shall carry out the operation of General Cerri Plant keeping separate accounting records so that the results of said Plant operation and the respective costs do not affect the rendering of the transportation service. For this purpose, said Plant shall be organized as a branch, or a controlled company"[19].

180. This very intention was confirmed, the Claimants also explain, by ENARGAS Resolution 1660/2000. In instructing for separate accounting, this entity stated that this measure resulted from "the principle that cost distribution between activities and related companies should not amount to subsidies to non-regulated activities, thus avoiding users from being subject to higher tariffs –in benefit of other activities– than those that should pertain to the service provided"[20].

181. At the time, the Government was evidently thinking that the success of the regulated tariff system should not subsidize the non-regulated business and thus avoid that consumers pay tariffs higher than those relating strictly to transportation. Avoidance of cross-subsidization is the right economic principle applied by many companies that have various sectors of activity within their overall business. This is the same principle that applies the other way round. The success of the non-regulated business should not subsidize the losses of the regulated business and this is to be the criteria also guiding the

---

[19] Claimants' Post-Hearing Brief, p. 23, no. 101.

[20] *Id.*, p. 24, no. 102.

eventual determination of compensation. The Tribunal thus concludes that the regulated and the non-regulated sectors of TGS are to be kept separate and independent for the purpose of this claim.

C. The influence of renegotiation

182. The Tribunal has noted above the parties' views about the meaning of renegotiations currently before the UNIREN. The Respondent believes that following the emergency, renegotiation is in fact the only viable alternative and much progress has been made in a variety of sectors, including the gas transportation sector in terms of an agreed understanding with GASBAN S. A., while some other gas companies are also very advanced in the process of reaching an agreement.

183. The Respondent also asserts that in this context it is reasonable for the Government to require the discontinuance of arbitration claims as these are interfering with the progress of negotiations, particularly in the case of companies which have sold their interest in the licensed companies, as the Claimants in this arbitration have.

184. The Claimants do not share this optimistic view as they assert that no progress has been made in many years and that, in any event, the understandings reached are still subject to some further form of legislative and executive approval, which has not been forthcoming. The Claimants also explain that this question is in abeyance from another point of view, namely that the understandings reached only provide for a provisional adjustment of tariffs while the long-term tariff structure has not even been discussed.

185. The main points of disagreement, in the Claimants' view, continue to be the limited adjustment, the uncertainty about the long-term tariff and the question of discontinuance of arbitration claims, which they regard as simply another form of pressure in breach of

the investors' rights under the Treaty. Particularly troublesome, in the Claimants' argument, is the understanding that with or without renegotiation there does not appear to be any intention of compensating for past losses, as confirmed by Mr. Simeonoff, head of UNIREN, at the oral hearing when stating that "I understand that there is not going to be any compensation" for the freezing of tariffs and the elimination of PPI adjustments[21].

186. Whatever the virtues or shortfalls of the renegotiation process, the Tribunal is not called to pass judgment on any of its aspects as this depends exclusively on whether the parties agree or not on new contractual terms of the license. Any process of negotiation requires of course that the parties genuinely agree on the outcome and this cannot be imposed or forced upon one party. There are, moreover, two aspects originating in this discussion that are indeed the concern of the Tribunal. The Tribunal must first hold that the Claimants positively have a right to resort to arbitration under the Treaty and this cannot be curtailed by the terms of the renegotiation or in any other manner, except with the consent of the Claimants.

187. To the extent that this discussion also implies that there are measures arising from the emergency likely to extend beyond the temporary character that an emergency has by definition, the Tribunal must also consider this situation. This is so because temporary or permanent effects of a given measure have a different incidence on the legal consequences arising from such measures, a matter that will be discussed separately below.

D. The Trust Fund

[21] *Id.*, p. 8, with reference to Hearing Transcript, Vol. 3, November 30, 2005, p. 493.

188. As evidence that normalization is progressing, the Respondent explains that a Trust Fund was established in 2004 to facilitate new investments in the gas transportation and distribution with a view to the expansion and extension of the network. It is also explained that TGS accepted to participate in this Trust and has benefited from it in terms that licensees make their services available to a greater number of consumers and their sales and revenues increase.

189. The Claimants oppose this other defense on the ground that far from proving normalization the Trust Fund proves rather the opposite, that is that the licensee's tariff system has been dismantled and a new approach has been introduced in its place. The Claimants assert that under this new approach only new investors benefit from tariff increases related to the expansion and licensees are left in a situation which makes still more difficult the recovery of costs connected to investments under the license, with an evident result of adverse discrimination.

190. To the extent that TGS has consented to this Trust Fund and its operation, the Tribunal considers that the question cannot be a matter of complaint before it. Whatever the meaning and extent of the Trust Fund, it does not raise a question concerning the tariff system under the License. At the most it provides indirect and limited evidence about the organization of the industry after the emergency.

E. The Claimants' interest in TGS

191. The Tribunal has explained above the discussion the parties have had in respect of the interest the Claimants really held in TGS. In the Respondent's view, this interest is only 19.5%, and in the Claimants' view it is 35.5%. The discussion is related to the fact that

Enron financed part of its investment with a loan taken by CIESA in its own name, guaranteed by Enron.

192. The Respondent also maintains that the transactions made by the Claimants in 2005 resulted in the exchange of an indirect 35.5% holding in TGS for a direct 19.5% holding, while shortly thereafter, in 2006, they sold most of their holdings to another investor, which has a right to a further purchase of the balance, thus effectively withdrawing from both CIESA and TGS.

193. A distinction is made by the Respondent to this effect between the corporate rights of Enron in TGS, which the Respondent admits amount in fact to 35.5%, and the right to dividends that TGS distributes, which amount only to 19.5%. The latter right, it is argued, is the consequence of CIESA having taken a loan for financing part of Enron's investment, and thus having to apply such dividends first to payments to the lenders and then to Enron in proportion to their financial contributions. Mr. Fabián Bello, expert for the Respondent, explains this distinction in the following terms:

> "Enron holds 35.5 percent corporate rights in TGS, but it has no right from the economic viewpoint (…) to receive 35.5 of the dividends distributed by TGS […] when CIESA receives the dividends, it has to first pay the interest of the debt and then distribute the dividends"[22].

194. The Respondent and its experts maintain that claiming compensation for 35.5% assumes that the Claimants are taking charge of CIESA's debt on their behalf, which is not the case, thus resulting in depleting CIESA and impeding that creditors collect their debt[23].

195. The Claimants have explained that these transactions do not have any influence or consequence in respect of the damages claimed, an aspect that will be examined in the context of valuation. A witness for the Claimants also explains that during "my ten-year

---

[22] Respondent's Post-Hearing Brief, para. 111, with reference to the testimony of Fabián Bello, Hearing Transcript, Vol. 5, December 2, 2005, p. 877.

[23] Expert statement of Fabián Bello, Hearing Transcript, Vol. 5, December 2, 2005, p. 856; Expert statement of Javier García Sánchez, Hearing Transcript, Vol. 6, December 3, 2005, p. 904, pp. 982-983.

tenure with CIESA at each of the Board meetings and also in each of the statements we had to report, we had to present to the regulatory agency on the company's shareholders, the participation was based on the 35 percent participation…"[24].

196. There are, however, some legal issues in this regard that the Tribunal must consider now The first is a jurisdictional question that the Respondent has suggested in correspondence with the Tribunal, to the effect that the 2006 transaction would have decisive implications in this arbitration, presumably because the Claimants would no longer have any interest in CIESA or TGS.

197. The Claimants assert that this is not the case in light of ICSID Tribunal's jurisprudence, where it has been held that the Claimants' jurisdictional standing "is made by reference to the date on which such proceedings are deemed to have been instituted"[25] and that "Events that take place before that date may affect jurisdiction; events that take place after that date do not"[26].

198. The Tribunal is satisfied that this last view is indeed correct and that jurisdiction is not altered by later transactions. It should also be noted that the 2006 transaction expressly safeguarded the Claimants' rights in this litigation (Share Purchase Agreement, Schedule B). A different question arises in respect of the agreements themselves, as these will not necessarily be within the Tribunal's jurisdiction to the extent that they might refer to different matters or involve different parties.

---

[24] Testimony of Eduardo Ojea Quintana, Hearing Transcript, Vol. 2, November 29, 2005, p. 325.

[25] Claimants' Post-Hearing Brief, pp. 35-37, with reference to *Ceskoslovenska obchodni banka, a.s. (CSOB) v. Slovak Republic* (ICSID Case No. ARB/97/4), Decision on Objections to Jurisdiction of May 24, 1999, 14 *ICSID Rev.-FILJ* 251 (1999), para. 31.

[26] *Id.*, with reference to *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (ICSID Case No. ARB/97/3), Decision on Jurisdiction of November 14, 2005, paras. 60-62.

199. A separate issue arises from the Claimants' assertion that damages are not affected either by the 2005 or 2006 transactions as damages are measured as from the date of expropriation, at which time the Claimants owned a 35.5% interest in TGS[27].

200. While the principle that damages are specifically related under the Treaty to the date prior to the events giving rise to the claim is correct, this is not to mean that events taking place after that date are not relevant for a determination of compensation, as happens for example when a given transaction is made to minimize damages. This too will be considered by the Tribunal in the context of valuation.

201. A third issue concerns the situation of CIESA's debt on behalf of the Claimants. If the Claimants eventually obtain compensation for the whole of the 35.5% interest they claim to have in TGS, either they should take over the debt or otherwise make CIESA whole, either directly or through some other transaction. The Tribunal can assume that CIESA and its shareholders will make sure that the interest of the company is not affected by the transactions made, as it is already evident in the 2005 swap noted above.

202. If such interest was in any way affected, CIESA might have a claim against the Claimants, but not against the Respondent. On the other hand, if the Respondent reaches a negotiated agreement with TGS it will also make sure that its terms will take into account any compensation that might have been paid for an interest in the company; thus it cannot be assumed here either that double payment will occur. The specific influence of these considerations in the valuation of the claim will be discussed further below.

(a) The applicable law

[27] Claimants' letter to Secretary of the Tribunal of September 1, 2005; Claimants' letter to Secretary of the Tribunal of February 2, 2006.

203. The parties have also disagreed about the law applicable to this dispute. The Claimants hold the view that under Article 42(1) of the Convention, in the absence of agreement between the parties, the law of Argentina applies in this case, just as international law does in light of the second sentence of that Article. The Claimants assert, however, that domestic law is relevant primarily to factual matters only, such as the nature of the assurances made to the Claimants. In the Claimants' view, it is the Treaty that principally applies as *lex specialis* between the parties, while other rules of international law not inconsistent with the Treaty also have a role, including the rules on the interpretation of treaties and customary rules that provide for a minimum treatment of covered investments.

204. The Respondent believes that Article 42 has a different meaning as to the role of the various sources of law it enumerates. In its view, domestic law is not confined to factual matters but has a substantive role in defining the rights of the investor, particularly when property rights are involved in the dispute; these rights are not defined by international law but by the local law to which the investor has voluntarily submitted. More importantly, the Respondent also asserts, when the parties have agreed on a forum-selection clause giving jurisdiction to a domestic court, this choice cannot be ignored later by an international tribunal. It is further explained that this approach does not exclude the application of either the Treaty, in defining for example which investors are covered under its provisions, or general international law, which provides for rules on the treatment of investments.

205. The Tribunal must note that on this matter the discussion of the parties is largely theoretical. Article 42(1) of the Convention has provided for a variety of sources, none of which excludes a certain role for another. This is particularly evident in the case of complex disputes such as that presently before the Tribunal. As the issue of the choice of forum was discussed in the Decision on Jurisdiction, it shall not be considered again here. What matters now is the law applicable to the merits of the dispute.

206. The Respondent is right in arguing that domestic law is not confined to the determination of factual questions. It has indeed a broader role, as it is evident in this very case from the pleadings and arguments of the parties that have relied heavily on the Gas Law and generally the regulatory framework of the gas industry, just as they have relied on many other rules of the Argentine legal system, including the Constitution, the Civil Code, specialized legislation and the decisions of courts. The License itself is governed by the legal order of the Argentine Republic and it must be interpreted in its light[28].

207. So too, the Claimants are right in arguing about the prominent role of international law. Both the Treaty and international conventions have been invoked by the parties, as they have also discussed the meaning of customary international law in a number of matters. While on occasions writers and decisions have tended to consider the application of domestic law or international law as a kind of dichotomy, this is far from being the case. In fact, both have a complementary role to perform and this has begun to be recognized[29].

208. It must be noted also that the very legal system of the Argentine Republic, like many modern systems, provides for a prominent role of treaties under both Articles 27 and 31 of the Constitution. Treaties are constitutionally recognized among the sources considered "the supreme law of the Nation". It follows that in case of conflict between a treaty rule and an inconsistent rule of domestic law, the former will prevail. This is not just the consequence of the Constitution so providing, but also the solution dictated by Article 27 of the Vienna Convention on the Law of Treaties in that a State "may not invoke the provisions of its internal law as justification for its failure to perform a treaty". Consistent with this role of international law, regulatory instruments have also made specific reference to the protection of investments under the Treaty (Decree 669/00).

---

[28] License, Clause 16.1.

[29] *Wena Hotels Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), *Ad Hoc* Committee Decision on Application for Annulment of February 5, 2002, 41 *ILM* 933 (2002), para. 941.

209. The Tribunal must also note that in examining the Argentine law as pertinent to various issues disputed by the parties, it finds that there is generally no inconsistency with international law as far as the basic principles governing the matter are concerned. The Tribunal will accordingly apply both Argentine law and international law to the extent pertinent and relevant to the decision of the various claims submitted.

V. THE STABILITY OF CONTRACTS AND THE LICENSE UNDER ARGENTINE LAW

210. The Tribunal has concluded above that various rights the Claimants have under the license are no longer observed in light of the measures complained of. It is now necessary to examine the Argentine law governing contracts in order to determine whether liability exists under the domestic legal order.

211. The Respondent has raised again the objection that such rights, to the extent they exist, belong to TGS as the licensee and not to the Claimants. As noted, this question has already been decided in the decision on jurisdiction and it shall not be discussed again here. The Respondent adds on this point an argument on the merits concerning an issue of potential double recovery. In its view, if the Tribunal grants compensation to the Claimants and then the license is reconstituted in some way compensating TGS, consumers will end up paying twice in terms of increased tariffs.

212. The Respondent contends that this is contrary to the principle held in the *Chorzów* case[30], as the parties would not be put in the same position they would be in had the contract been observed. The Tribunal cannot provide an answer to a question which is in essence speculative. However, as noted above in respect of another argument concerning double recovery, it can only express the certainty that if the situation arises or its consequences

---

[30] *Case Concerning Certain German Interests in Polish Upper Silesia (Germany v. Poland) (Chorzów Case)*, Permanent Court of International Justice Proceeding, as referenced in Respondent's Post-Hearing Brief, no. 34.

would end up affecting the tariffs, able government negotiators or regulators would make sure that no such double recovery or effects occur.

213. Article 17 of the Argentine Constitution enshrines the basic principle that "property may not be violated and that no inhabitant of the Nation can be deprived of it except by virtue of a sentence based on law". The Constitution also provides in Article 28 that "the principles, guarantees, and rights recognized in the preceding articles shall not be modified by the laws that regulate their enforcement". Consistent with these provisions, Article 1197 of the Civil Code mandates that contractual rules must be observed as the law between the parties. Stability of rights and contracts is thus a central feature of the applicable domestic law.

214. This is not to say that contractual obligations must be kept unchanged forever irrespective of the circumstances. Article 1198 of the Civil Code addresses the case of extraordinary and unforeseeable events that could allow a party to the contract to request its termination for having become excessively onerous, thus recognizing the theory of "imprevisión" and seeking the rebalancing of the contractual benefits. *Force majeure* and unjust enrichment are also mechanisms that would allow for renegotiation and rebalancing of contractual obligations.

215. The Respondent's legal expert, Professor Julio Rodolfo Comadira, regrettably deceased before the hearing on the merits, explained that in his view, the theory of "imprevisión" applied in the context of this dispute as this theory relates mainly to administrative contracts and the events characterizing the greatest economic crisis in history could not have been foreseen[31]. The Respondent relies by reference on these legal arguments[32].

216. The parties discussed at various points whether the events underlying the claims had or not been foreseeable in light of the various meanings they tend to assign to insuring

[31] Legal Opinion of Julio Rodolfo Comadira of June 2005, para. 131.

[32] Respondent's Rejoinder, para. 608.

against country risk and whether it includes or not the devaluation risk and the risk concerning the freeze of tariffs, as they have discussed about who bears what risk. The Respondent is right in stating that to consider a risk is not the same as foreseeing that the events in question will necessarily take place. However, if the major features of the whole regulatory regime put in place under the privatization were based on taking cover against all kind of risks inspired by the economic history of the country and the instability of the 1980s, including country risk and devaluation, it is in itself indicating that the parties were quite aware of the dangers ahead. It would then make no sense if when the dangers materialized, as they did, the protection envisaged would not operate.

217. This question aside, however, it must be kept in mind that, at least as the theory of "imprevisión" is expressed in the concept of *force majeure*, this other concept requires, under Article 23 of the Articles on State Responsibility, that the situation should in addition be the occurrence of an irresistible force, beyond the control of the State, making it materially impossible in the circumstances to perform the obligation. In the commentary to this article it is stated that "*Force majeure* does not include circumstances in which performance of an obligation has become more difficult, for example due to some political or economic crisis"[33].

218. Important as this discussion is, the Respondent's principal argument has not relied on the theory of "imprevisión", but state of emergency. The courts of Argentina have on various occasions addressed recurring situations of emergency declared by Congress, conditioning their legal recognition to very precise terms[34]. The Supreme Court has held in connection with the Emergency Law presently in force that

> "…it is not useless to remind, as the Tribunal has done for long, that restrictions imposed by the State on the normal exercise of patrimonial

[33] James Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, p. 171, (ed., Cambridge University Press) (2002).

[34] Rubén S. Stiglitz: *Contratos Civiles y Comerciales* (1998), paras. 28-30.

> rights must be reasonable, limited in time, and constitute a remedy and not a mutation in the substance or essence of the right acquired by judicial decision or contract…”[35].

219. The Claimants have introduced an expert opinion of Dr. Alberto R. Bianchi which together with that of Professor Comadira offers a most learned, albeit differing, discussion of the state of Argentine law on the question of regulatory powers. In Dr. Bianchi's view, although "the emergency authorizes the use of extraordinary powers, it does not allow the exercise of unlimited powers. Police power in this case is limited in three senses: (i) it cannot result in a change in the substance or essence of a right acquired under a judgment or contract; (ii) measures are subject to a reasonability judicial review; and (iii) measures are temporary in essence"[36].

220. It is against this background that the Tribunal must examine the effects of the emergency measures enacted in 2002 on the obligations and commitments defined in the License. The License of course is not an ordinary contract since it involves the operation of a public service under the regulatory authority of the State, but even in this context the licensees enjoy specific rights which are subject to protection under the Constitution, the law and the provisions of the contract. As noted above, however strong the regulatory powers of the State might be they are still governed by the law and the obligation to protect the rights acquired by individuals.

First requirement: temporality

---

[35] Argentine Supreme Court, Judgment in the case *Provincia de San Luis c. P. E. N. –Ley 25561, Dto. 1570/01 y 214/02 s/ amparo*, March 5, 2003. (Translation by the Tribunal).

[36] Legal Opinion of Alberto B. Bianchi of October 11, 2005, para. 386.

221. The Tribunal can well understand the need to adopt emergency measures in the midst of the major crisis that has been noted. Yet this is not enough to validate these measures in light of the applicable law. A first question that must be examined in this respect is whether the measures adopted are temporal or permanent, a matter on which the parties' views also differ. The Respondent has repeatedly emphasized the temporal nature of the emergency measures and the fact that the Emergency Law expires on precise dates, which have been extended, it is argued, so as to ensure the orderly settlement of complex outstanding problems. The fact is, however, that year after year the expiry date has been extended and presently the Emergency Law is scheduled to end on December 31, 2007. This is the situation that gives rise to the Claimants' argument that the Emergency Law has in reality been turned into a permanent feature of the Argentine economy.

222. The Tribunal finds that this is a rather disquieting situation because in actual fact the crisis is largely over, although quite naturally aftershocks might still be felt for some time. An expert witness for the Claimants believes the crisis began to improve in 2003 at the time when the Central Bank was able to convince the public to buy its newly-issued financial instruments[37]. Another ICSID tribunal has set this date some time by the end of 2004 or beginning of 2005[38]. In any event, the fact that the Argentine economy has grown 35.5% in the period 2003-2006, with an average growth of 8.8%, and that the Government has prepaid its obligations to the International Monetary Fund, are evidence enough that the crisis is behind[39]. The argument about the temporary character of the emergency measures would thus seem not to be quite confirmed by the facts.

---

[37] Expert statement of Sebastián Edwards, Hearing Transcript, Vol. 7, December 6, 2005, pp. 1234-1235.

[38] *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Award of May 12, 2005, 44 *ILM* 1205 (2005).

[39] Economic Commission for Latin America and the Caribbean, *Statistics Yearbook of Latin America and the Caribbean 2006*, Economic Statistics, Table 2.1.1.1.

Second requirement: no essential mutation of rights

223. A second requirement the courts have set for the legal validity of the emergency measures is that the restrictions imposed must provide a remedy and not result in the mutation of the substance or essence of the rights acquired under a contract. A witness for the Respondent advanced a view that appears not to be consistent with this other requirement, namely that a good part of the emergency provisions, especially those on conversion to pesos and elimination of dollar clauses "were taken not on a transitory basis. They were adopted on a definitive basis"[40]. Such effects would mean in fact the permanent elimination of the rights under the License, at least in so far as the calculation of tariffs in US dollars and their PPI adjustment are concerned. Licensees might of course accept the terms of a new tariff regime in the context of a renegotiated contract; in such a case, the mutation would be validated by the agreement of the parties.

Third requirement: reasonableness

224. A third requirement the courts have indicated is that restrictions imposed under the emergency must be reasonable. The discussion on the tariff regime outlined above reveals profound disagreement between the parties about what is to be regarded as a just and reasonable tariff. While for the Claimants a tariff frozen for nearly five years and kept unadjusted for seven years cannot in any way be considered reasonable, for the Respondent this was the only measure possible in the context of crisis and deflation and is

[40] Witness Testimony of Eduardo Ratti, Hearing Transcript, Vol. 3, November 30, 2005, p. 555.

thus eminently reasonable. Costs, leverage, devaluation, returns and other issues examined are characterized by this same difference of opinions.

225. The Tribunal can only note in this respect that both the Government and the licensees of public services have repeatedly indicated that there is an inescapable need to attend to tariff adjustments and thereby ensure the continued operation of the companies and the necessary supply of energy and other services. The very emphasis the Respondent has put on the question of renegotiation is further evidence of this recognition. It follows that the prolongation of emergency measures without reestablishing or rebalancing the benefits of the License cannot be regarded as satisfying the legal requirement of reasonableness.

Unilateral determinations and consented adjustment

226. There is still one other aspect that does not help the Respondent's argument about the consistency of the emergency measures with the domestic legal order. If changes became necessary, they cannot be unilaterally decided by the Government or its regulators, competent as they may be. This is a decision that has either to be taken jointly by the parties, as in a successful renegotiation, or requested from a judge, as in Article 1198 of the Civil Code. In any event, even in the case of the regulatory authority entailed in a license, this decision is subject to judicial control.

227. It so happens that the domestic judicial control of the emergency decisions has for the most turned out adversely for the Respondent's justification, as in *Provincia de San Luis* noted above, but as judicial determinations are made on a case by case basis they have not been taken to mean that the measures as a whole might not be compatible with Argentine legislation.

228. It must also be noted that the licenses have carefully provided for a detailed adjustment mechanism so that tariffs would be revised periodically in order to take into account the true conditions of the industry, thus evidencing that the question of an eventual rebalancing of benefits was not ignored. The semi-annual adjustment under the PPI, an efficiency-related adjustment following the first quinquennial review, and an investment-related adjustment also applicable after the first five-year review, were some of the mechanisms envisaged to reflect the changes in the value of goods and services for the operator. The five-year review was another such mechanism. In addition, the possibility of an extraordinary review to correct tariffs considered inadequate, discriminatory or preferential was also included in the license terms; this review could be initiated either by ENARGAS or the licensees.

229. All such mechanisms could have resulted in an increase of tariffs or equally in a reduction. The interests of consumers could have been attended to and protected under these mechanisms, particularly if the tariffs became unrealistic and excessive in the context of a changed economic environment. Such changes would also have met the obligation under the License not to amend it without the agreement of the licensees as the latter had already given their consent by agreeing on the license terms. Yet, the Government chose not to use the alternatives provided under the license and resorted instead to the unilateral determination made under the emergency measures.

230. Even assuming that the implementation of any such mechanism would have taken some time and that the Government needed to react quickly in confronting an emergency situation, which is a perfectly understandable concern, such measures could have been taken for a limited time span while reviews were carried out. It is this unilateral determination, not the license corrections required, that ultimately resulted in the inconsistency of the measures taken with the domestic legal order.

Liability under Argentine law

231. The inescapable conclusion for the Tribunal to reach is that in considering the claims purely from the point of view of the Argentine legislation as one of the laws applicable to the dispute, the obligations which the Argentine Republic had and the commitments it undertook under the License were not observed. This is particularly significant in view that the License is expressly subject to Argentine law in some key respects, without prejudice to the effect that these legal arrangements have under the Treaty and international law. Liability is thus the consequence of such breach and there is no legal excuse under the Argentine legislation which could justify the non-compliance, as the very conditions set out by this legislation and the decisions of courts have not been met.

232. Yet, the Tribunal bears in mind that a major crisis indeed there was. While these unfortunate events do not in themselves amount to a legal excuse, neither would it be reasonable for the Claimants to believe they are not affected by some of the effects. The economic balance of the license was clearly affected by the crisis situation, and just as it is not reasonable for the licensees to bear the entire burden of such changed reality neither would it be reasonable for them to believe that nothing happened in Argentina since the License was approved. This is something the Tribunal will duly take into account in considering the compensation that follows such finding of liability and how the crisis period influences its determination.

The Treaty as the applicable law

233. The Tribunal must now examine the question of whether the breach of the License and its regulatory regime, in addition to its assessment under Argentine legislation, amounts to a breach of the Treaty guarantees.

1. The claim of expropriation

234. The principal claim made in this arbitration is that the measures adopted since early 2000, and particularly those following in 2002 under the Emergency Law, have expropriated the Claimants' investments, both directly and indirectly, in a manner contrary to the protection granted under Article IV of the Treaty. The Claimants argue that their investment comprises the equity in TGS, the capital contributed to this effect, the rights under the Technical Assistance Agreement and the specific rights related to the tariff regime of the License. The deprivation, the Claimants maintain, has been permanent, not merely ephemeral, and no prompt, adequate and effective compensation has been paid. In the Claimants' view, compensation must be paid irrespective of the purpose of the measures[41].

235. The Claimants assert that the Respondent has directly expropriated the rights to tariff adjustment and calculation they have under the License, as well as the right to be free from a tariff freeze, as all of it was expressly derogated by the Emergency Law. A transfer of revenues is also alleged to have taken place as a result. The Claimants also invoke in support of their argument on expropriation an OPIC "Memorandum of Determinations" of August 2, 2005, which concludes that expropriation in violation of international law has taken place with regard to this investment.

---

[41] *Compañia del Desarrollo de Santa Elena S.A. v. Republic of Costa Rica* (ICSID Case No. ARB/96/1), Award of February 17, 2000, available at <http://www.worldbank.org/icsid/cases/santaelena_award.pdf>, paras. 71-72.

236. Simultaneously, the Claimants maintain, the measures in question are "tantamount to expropriation", thus constituting an indirect or creeping expropriation unfolding in time and resulting in a cumulative substantial destruction of the value of the investment. This kind of measures includes various forms of regulatory action unreasonably interfering with the investor's property rights, the Claimants explain, just as the measures involve conduct inconsistent with legitimate expectation and with the assurances offered to induce the investment or the capacity for rational decision-making in the business.

237. The Respondent argues at the outset that the same measures complained of cannot give rise simultaneously to a claim of direct and indirect expropriation and that the wrong justification of the claim must lead to its rejection[42]. It is also argued as a preliminary point that in the Tribunal's Decision on Jurisdiction only equity participation was held to be an investment qualifying for protection, not other kinds of peripheral rights that the Claimants now untimely invoke in their argument on the merits[43].

238. The Respondent opposes the claim arguing that there has been no transfer of property rights to the benefit of the Government or the consumers and without redistribution there is no expropriation[44]; in these circumstances, if compensation for expropriation were paid there would be unjust enrichment of the service providers. The Respondent also asserts that temporary measures, particularly emergency measures, do not qualify as expropriation as they do not entail permanent deprivation of earnings or corporate rights and no such effects can be shown in the present dispute; that substantial deprivation of fundamental property rights must be established and that no such deprivation has taken place or been proven in this case; that losses must be significant, while the Claimants

---

[42] *Generation Ukraine Inc. v. Ukraine* (ICSID Case No. ARB/00/9), Award of September 16, 2003, 44 *ILM* 404 (2005), paras. 20, 22.

[43] Remarks of Jorge Alberto Barraguirre, Hearing Transcript, Vol. 1, November 28, 2005, pp. 121-124.

[44] *Ronald S. Lauder v. The Czech Republic*, UNCITRAL Arbitration Proceeding, Final Award of September 3, 2001, available at <http://ita.law.uvic.ca/documents/LauderAward.pdf>, para. 203.

continue to benefit from earnings or the sale of shares; that the value of the investment would have been further reduced had the measures not been adopted; and that a mere contract violation cannot be turned into a Treaty claim.

239. The Respondent also argues that the purpose of the measures is relevant to make a determination on an expropriation claim, particularly if such measures are adopted under the police power of the State and are proportional to the requirements of public interest. Moreover, the Respondent maintains, the Treaty does not protect legitimate expectations but only specific rights and in this case none of the measures questioned can be equated to those considered in other cases as being inconsistent with the guarantees offered to induce the investor or amounts to the destruction of the capacity for rational decision-making.

240. The Tribunal is again grateful to counsel for the parties for having undertaken a thorough explanation of their views on the issue of expropriation, invoking in support of their respective views a wealth of decisions, opinions of writers and other authorities that allow understanding the parties' arguments in all their meaning and differences.

241. The first question the Tribunal must address is that of the protected investment. The Respondent argues that the Tribunal in the jurisdictional stage held that the dispute was one related to investment in equity and that nothing else can now be considered in the merits This, however, has to be understood in the context of a determination about whether minority shareholders had a right to claim independently, as the Respondent itself recalls. In that context, the issue was whether an investment in equity so allows. The Tribunal must also recall that the reference paragraph 30 of the Decision on Jurisdiction made to a definition of investment is related to the very broad definition of the Treaty as reproduced in paragraph 29 of that Decision. Accordingly that broad definition is the one governing this discussion.

242. The equity investment was the vehicle through which a complex business relationship was developed and which can be affected in other of its elements by the measures

questioned. This is the case, for example, of the measures affecting the tariff regime envisaged in the License, which is the key factor determining the success or failure of the investment in the equity of TGS.

243. This discussion, in any event, turns out to be rather academic as the Tribunal is persuaded by the merit of the Respondent's argument on direct expropriation. In fact, the Tribunal does not believe there can be a direct form of expropriation if at least some essential component of property rights has not been transferred to a different beneficiary, in particular the State. In this case it can be argued that economic benefits might have been transferred to an extent from industry to consumer or from industry to another industrial sector, but this does not amount to affecting a legal element of the property held, such as the title to property.

244. The question of indirect or creeping expropriation is more complex to assess. The Tribunal has no doubt about the fact that indirect or creeping expropriation can arise from many kinds of measures and these have to be assessed in their cumulative effects. Yet, in this case, the Tribunal is not convinced that this has happened.

245. The list of measures considered in the *Pope & Talbot* case as tantamount to expropriation, which the Respondent has invoked among other authorities, is in the Tribunal's view representative of the legal standard required to make a finding of indirect expropriation. Substantial deprivation results in that light from depriving the investor of the control of the investment, managing the day-to-day operations of the company, arrest and detention of company officials or employees, supervision of the work of officials, interfering in the administration, impeding the distribution of dividends, interfering in the appointment of officials and managers, or depriving the company of its property or control in total or in part[45].

---

[45] *Pope & Talbot Inc. v. Canada*, NAFTA (UNCITRAL) Arbitration Proceeding, Interim Award of June 26, 2000, para. 100.

246. Nothing of the sort has happened in the case of TGS or CIESA or any of the related companies, so much so that the Claimants' interests in these companies have been freely sold and included in complex transactions, some involving foreign companies too, as evidenced by the 2005 and 2006 agreements already described. The Tribunal must accordingly conclude that the Government of Argentina in adopting the measures complained of has not breached the standard of protection established in Article IV(1) of the Treaty.

247. The Tribunal must also point out that although the OPIC "Memorandum of Determinations" referred to above reaches a different conclusion on this matter, it responds to a different kind of procedure and context that cannot influence or be taken into account in this arbitration.

248. The question of devaluation has also been discussed by the parties in the context of its influence on a finding of expropriation, particularly in light of the meaning each attaches to the *Himpurna* case.[46] However, as the Tribunal has explained above, this is not a dispute about devaluation, nor has so been claimed, but about allegedly breached rights under a regulatory framework and the License. This discussion thus does not alter the Tribunal's determination about expropriation.

249. The Tribunal's conclusion does not mean that the measures discussed are free from legal consequences under other Treaty standards, as will be seen below, or free from liability for compensation arising from the damage they may have caused.

250. The Respondent's argument about the inappropriateness of claiming simultaneously a direct and an indirect expropriation, as the Claimants have done, is also persuasive. In fact, if a given measure qualifies as a form of direct expropriation it cannot at the same time qualify as an indirect expropriation, as their nature and extent are different. The

[46] *Himpurna California Energy Ltd. v. Republic of Indonesia*, UNCITRAL Arbitration Proceeding.

converse is also true. This is not to conclude, like in *Generation Ukraine*, that the claim has to be rejected because the measures complained of were not described with precision and coherently, as here they have been competently substantiated.

2. *The claim concerning the standard of fair and equitable treatment*

251. The Claimants have argued that in addition to expropriation the Respondent has breached the standard of fair and equitable treatment established under Article II(2)(a) of the Treaty on various counts: failing to act in good faith, abusing its rights, repudiating assurances given, altering regulatory approvals and conditions, and failure to provide a stable and predictable legal environment.

252. Originating in the obligation of good faith under international law, the Claimants explain, this particular standard has gradually acquired a specific meaning in light of decisions and treaties, including a treatment compatible with expectations of foreign investors,[47] the observance of arrangements on which the investor has relied to make the investment[48] and the maintenance of a stable legal and business framework.[49]

253. The Respondent's argument on this matter is based on the premise that fair and equitable treatment is a standard not different from the customary international law minimum standard and that it is not for tribunals to set out its meaning or even less to legislate on the matter. The Respondent asserts that this view is confirmed by the NAFTA Free Trade

---

[47] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, 43 *ILM* 133 (2004), para. 115.

[48] *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL Arbitration Proceeding, Partial Award of September 13, 2001, available at <http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13Sept2001.pdf>, para. 611.

[49] *Occidental Exploration and Production Company (OEPC) v. Republic of Ecuador*, London Court of International Arbitration Administered Case No. UN 3467, Final Award of July 1, 2004, available at <http://www.asil.org/ilib/OEPC-Ecuador.pdf >, para. 183.

Commission[50] and the Chile-US Free Trade Agreement, in clarifying that fair and equitable treatment does not entail any treatment additional to or beyond that required by customary law,[51] as well as by a number of NAFTA and ICSID decisions and the opinions of learned writers.

254. In the Respondent's view what has been criticized by recent decisions is a kind of conduct that evidences inconsistency in State action,[52] radical and arbitrary modification of the regulatory framework[53] or endless normative changes to the detriment of the investor's business.[54] None of that, the argument follows, is present in the instant case where the measures adopted were eminently reasonable in light of the economic crisis described and the changes in the economic conditions of the country.

255. In particular, the Respondent maintains that devaluation was the result of market decisions and that the constant decisions of courts in other crises has reaffirmed the constitutionality of measures of this kind, most notably in the context of the United States' great depression. The *Thunderbird v. Mexico* decision has also been invoked by the Respondent in support of its view that the standard of fair and equitable treatment does not include the protection of legitimate expectation and it is not different from the international minimum standard[55].

256. The Tribunal notes that the Respondent is right in arguing that fair and equitable treatment is a standard none too clear and precise. This is because international law is not too clear and precise either on the treatment due to foreign citizens, traders and investors

---

[50] FTC decision, NAFTA Free Trade Commission, Interpretation of NAFTA Article 1105(1), July 21, 2001, available at < http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>.

[51] Chile-United States Free Trade Agreement of June 6, 2003, available at <http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/asset_upload_file1_4004.pdf>, Article 10.4.2.

[52] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case No. ARB/01/7), Award of May 25, 2004, available at <http://www.asil.org/ilib/MTDvChile.pdf>, para. 164.

[53] *Tecmed*, para. 154.

[54] *OEPC,* pars. 184-186.

[55] Respondent's Post-Hearing Brief, p. 13.

or with respect to the fact that the pertinent standards have gradually evolved over the centuries. Customary international law, treaties of friendship, commerce and navigation, and more recently bilateral investment treaties, have all contributed to this development[56].

257. The evolution that has taken place is for the most part the outcome of a case by case determination by courts and tribunals, as evidenced among many other investment treaty and NAFTA decisions by the *TECMED*, the *OEPC* and the *Pope & Talbot* cases[57]. This explains that, like with the international minimum standard, there is a fragmentary and gradual development. Such development however partly hinges on the gradual formulation – both in cases and legal writings – of 'general principles of law' (as understood under Article 38(1)(c) of the ICJ Statute) able to guide and 'discipline'[58] the evaluation of state conduct under investment treaty standards.

258. It might well be that in some circumstances where the international minimum standard is sufficiently elaborate and clear, fair and equitable treatment might be equated with it. But in other more vague circumstances, the fair and equitable standard may be more precise than its customary international law forefathers. This is why the Tribunal concludes that the fair and equitable standard, at least in the context of the Treaty applicable to this case, can also require a treatment additional to, or beyond that of, customary law. The very fact that recent FTC interpretations or investment treaties have purported to change the meaning or extent of the standard only confirms that those specific instruments aside, the standard is or might be a broader one.

---

[56] Stephen Vasciannie, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, BYIL, Vol. 70, 1999, para. 100.

[57] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003; *Occidental Exploration and Production Company (OEPC) v. Republic of Ecuador*, London Court of International Arbitration Administered Case No. UN 3467, Final Award of July 1, 2004; *Pope & Talbot Inc. v. Canada*, NAFTA (UNCITRAL) Arbitration Proceeding, Interim Award of June 26, 2000.

[58] *ADF Group Inc. v. United States of America* (ICSID Case No. ARB(AF)/00/1), Award of January 9, 2003, 18 *ICSID Rev.—FILJ* 195 (2003); 6 *ICSID Rep.* 470 (2004), para. 124.

259. The Tribunal is bound to interpret Article II(2)(a) of the Treaty "*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of the object and purpose*" as required by Article 31 of the Vienna Convention. The Tribunal gives weight to the text of the Treaty's Preamble, which links the standard to the goal of legal stability: '*fair and equitable treatment of investment is desirable in order to maintain a stable framework for the investment and maximum effective use of economic resources.*'

260. Thus, the Tribunal concludes that a key element of fair and equitable treatment is the requirement of a '*stable framework for the investment*', which has been prescribed by a number of decisions[59]. Indeed, this interpretation has been considered '*an emerging standard of fair and equitable treatment in international law*'[60].

261. This Tribunal notes, however, that the stabilization requirement does not mean the freezing of the legal system or the disappearance of the regulatory power of the State. As noted by the tribunal in *CMS*:

> It is not a question of whether the legal framework might need to be frozen as it can always evolve and be adapted to changing circumstances, but neither is it a question of whether the framework can be dispensed with altogether when specific commitments to the contrary have been made. The law of foreign investment and its protection has been developed with the specific objective of avoiding such adverse legal effects[61].

262. The protection of the '*expectations that were taken into account by the foreign investor to make the investment*'[62] has likewise been identified as a facet of the standard. The *Tecmed*

---

[59] *OEPC*, paras. 190-191; *CMS*, paras. 274-276; *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability of October 3, 2006, available at <http://www.worldbank.org/icsid/cases/pdf/ARB021_LGE-Decision-on-Liability-en.pdf>, para. 124.

[60] *LG&E*, para. 125.

[61] *CMS*, para. 277.

[62] *Tecmed*, para. 154.

approach has been consistently adopted by subsequent decisions[63]. *Tecmed* described such expectations as '*basic*'[64], while in the context of NAFTA, tribunals have qualified them as '*reasonable and justifiable*'[65]. What seems to be essential, however, is that these expectations derived from the conditions that were offered by the State to the investor at the time of the investment[66] and that such conditions were relied upon by the investor when deciding to invest[67].

263. The Tribunal observes that, as acknowledged by previous arbitral tribunals, the principle of good faith is not an essential element of the standard of fair and equitable treatment and therefore violation of the standard would not require the existence of bad faith[68].

264. The measures in question in this case have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented. Argentina in the early 1990s constructed a regulatory framework for the gas sector containing specific guarantees to attract foreign capital to an economy historically unstable and volatile. As part of this regulatory framework, Argentina guaranteed that tariffs would be calculated in US dollars, converted into pesos for billing purposes, adjusted semi-annually in accordance with the US PPI and sufficient to cover costs and a reasonable rate of return. It further guaranteed that tariffs would not be subject to freezing or price controls without compensation. Foreign investors were specifically targeted to

---

[63] *MTD*, para. 114.; *OEPC*, para. 185; *Eureko B.V. v. Poland*, *Ad Hoc* Proceeding, Partial Award of August 19, 2005, available at <http://www.investmentclaims.com/decisions/Eureko-Poland-LiabilityAward.pdf>, para. 235; *LG&E*, para. 127.

[64] *Tecmed*, para. 154.

[65] *International Thunderbird Gaming Corporation v. United Mexican States*, NAFTA (UNCITRAL) Arbitration Proceeding, Award of January 26, 2006, available at <http://www.iisd.org/pdf/2006/itn_award.pdf>, para. 147.

[66] *Southern Pacific Properties (Middle East) Limited (SPP)* v. Arab Republic of Egypt (ICSID Case No. ARB/84/3), Award of May 20, 1992, 32 *ILM* 1470 (1993), para. 82; *LG&E*, para. 130.

[67] *SPP*, para. 82; *CME*, para. 611; *Tecmed*, para. 154; *Thunderbird*, para. 147; *LG&E*, para. 127.

[68] *Mondev International Ltd. v. United States of America* (ICSID Case No. ARB(AF)/99/2), Award of October 11, 2002, 42 *ILM* 85 (2003), para. 116; *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (ICSID Case No. ARB(AF)/98/3), Award of June 26, 2003, 42 *ILM* 811 (2003), para. 32; *OEPC*, para. 186; *Tecmed*, para 153; *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/98/2), Award of June 2, 2000, 40 *ILM* 56 (2001), para. 93; *CMS*, para. 280; *LG&E*, para. 129.

invest in the privatization of public utilities in the gas sector. Substantial foreign investment was undertaken on the strength of such guarantees, including the investment made by Enron in TGS.

265. The Tribunal observes that it was in reliance upon the conditions established by the Respondent in the regulatory framework for the gas sector that Enron embarked on its investment in TGS. Given the scope of Argentina's privatization process, its international marketing, and the statutory enshrinement of the tariff regime, Enron had reasonable grounds to rely on such conditions.

266. A decade later, however, the guarantees of the tariff regime that had seduced so many foreign investors, were dismantled. Where there was certainty and stability for investors, doubt and ambiguity are the order of the day. The long-term business outlook enabled by the tariff regime, has been transformed into a day-to-day discussion about what comes next. Tariffs have been frozen for almost five years. The recomposition of the tariff regime is subject to a protracted renegotiation process imposed on the public utilities that has failed to provide a final and definitive framework for the operation of business in the energy sector.

267. The Respondent might be right in distinguishing this case from the factual scenarios that recent decisions have faced, but this does not mean that Argentina's acts are consistent with the meaning of the protection under the Treaty. It is clear that the 'stable legal framework' that induced the investment is no longer in place and that a definitive framework has not been made available for almost five years.

268. Even assuming that the Respondent was guided by the best of intentions, which the Tribunal has no reason to doubt, there is here an objective breach of the fair and equitable treatment due under the Treaty. The Tribunal thus holds that the standard established in Article II(2)(a) of the Treaty has not been observed and that to the extent that it results in a detriment to the Claimants' rights it will give rise to compensation.

3. The claim concerning the breach of the umbrella clause

269. The Claimants have also brought to this Tribunal a claim for an alleged breach of the obligations the Respondent entered into with regard to the investment, in light of the "umbrella clause" of Article II(2)(c) of the Treaty. This aspect of the claim is built on the premise that the protection envisaged is an expression of the obligation to observe the principle *pacta sunt servanda*. The Claimants cite in this context the view of Judge Higgins to the effect that such principle and acquired rights "emphasize the protection that the private party has been given against either a later change of mind by the State or against the exercise of the State's regulatory powers"[69].

270. The Claimants argue that the clause applies to obligations arising from a contract or from broader undertakings contained in the State's own law and that the Respondent's measures breached every commitment made in the Gas Law, the Gas Decree and the License, with particular reference to the tariff regime and the commitment not to amend the License without TGS's consent.

271. The Respondent opposes this claim arguing that it did not undertake any specific obligation with regard to the investment or Enron in the Treaty, the investment legislation or the legislation regulating the License. In addition, it alleges that under customary law, violations of contracts cannot be equated with a treaty breach and thus do not engage the international responsibility of the State[70], and that, as held in *SGS v. Pakistan*, contract

---

[69] Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 Recueil des Cours 267, 347 (1982), as cited in Claimants' Memorial, para. 316.

[70] *Noble Ventures, Inc. v. Romania* (ICSID Case No. ARB/01/11), Award of October 12, 2005, available at <http://www.investmentclaims.com/decisions/Noble-Ventures-Final-Award.pdf>, para. 53.

claims do not qualify as BIT claims[71]. Moreover, the Respondent maintains the Tribunal in *SGS v. Philippines*, while disagreeing with some aspects of the *Pakistan* decision, still held that the umbrella clause only comprises obligations undertaken with respect to a specific investment and thus the clause does not extend to ordinary contractual breaches that must be taken to the contract forum.

272. In any event, it is also asserted that because the commitments were made in respect of TGS they cannot be invoked by the Claimants and the License does not qualify as an investment agreement. The Respondent relies upon the *Noble Ventures v. Romania* decision insofar as it would limit the application of the umbrella clause to investment contracts. Claimants oppose such an interpretation because that decision, in their view, referred to contracts made with regard to an investment[72].

273. The Tribunal recalls that the text of Article II(2)(c) reads "*[e]ach party shall observe any obligation it may have entered into with regard to investments*", a text which should be interpreted "*in good faith in accordance with the ordinary meaning to be given to the terms of the treaty"* as indicated by Article 31(1) of the Vienna Convention.

274. Under its ordinary meaning the phrase 'any obligation' refers to obligations regardless of their nature. Tribunals interpreting this expression have found it to cover both contractual obligations such as payment[73] as well as obligations assumed through law or regulation[74]. 'Obligations' covered by the 'umbrella clause' are nevertheless limited by their object: '*with regard to investments*'.

---

[71] *Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction of August 6, 2003, available at http://www.investmentclaims.com/decisions/SGS-Pakistan-Jurisdiction-6Aug2003.pdf.

[72] Claimants' Post-Hearing Brief, para. 17.

[73] *Fedax N.V. v. Republic of Venezuela* (ICSID Case No. ARB/96/3), Award of March 9, 1998, 37 *ILM* 1391 (1998), para. 29; *Société Générale de Surveillance S.A. v. Republic of the Philippines* (ICSID Case No. ARB/02/6), Decision of the Tribunal on Objections to Jurisdiction of January 29, 2004; 8 *ICSID Rep.* 518, paras. 127-128.

[74] *SGS v. Islamic Republic of Pakistan* para. 166; *LG&E*, para. 175.

275. Through the Gas Law and its implementing legislation, the Respondent assumed '*obligations with regard to investments'*: tariffs calculated in US dollars converted to pesos for billing purposes, linked to the US PPI and sufficient to provide a reasonable rate of return were intended to establish a tariff regime that assured the influx of capital into the newly privatized companies such as TGS and ensured the value of such investment. The dismantling of these guarantees would suffice to establish a violation of the obligations entered into by the Respondent with regard to the Claimants' investment.

276. In addition, the prohibition of price controls without indemnification and the prohibition of License amendments without consent, although contained in the License were also approved by decree[75] and formed part of the implementing legislation that established the tariff regime. The obliteration of these commitments likewise entails a violation of obligations entered into by the Respondent with regard to the Claimants' investment.

277. The Tribunal concludes accordingly that the breach of the obligations noted undertaken both under contract and law and regulation in respect of the investment have resulted in the breach of the protection provided under the umbrella clause of Article II(2)(c).

4. The claim about arbitrariness and discrimination

278. The Claimants assert that there has also been a breach of Article II(2)(b) of the Treaty because the measures adopted are both arbitrary and discriminatory. The claim of arbitrariness is based on the argument that such measures destroyed the rights and reasonable expectations of the Claimants, lacked proportionality and were in violation of the law. The claim of discrimination relies on the view that the measures fell

[75] Obligations undertaken in the License were initially approved by Decree 2255/92 (Model License) and later specifically ratified with regard to TGS by Decree 2458/92.

disproportionately on the largely foreign-owned gas sector. A long list of specific measures is given by the Claimants in respect of each of these aspects.

279. The Respondent opposes this claim asserting that the measures were consistent with the law and aimed at continuing the operational income and earnings of the companies, while at the same time being proportionate to the purpose sought, reasonable and, in any event, lacking in any intention to breach the rule of law or affect judicial propriety, as required by numerous judicial and arbitral decisions.

280. Neither is there discrimination, the Respondent maintains, because the regulated gas sector is very different from other sectors operating in a competitive market, such as banking, and the entities involved are far from being in a similar or even comparable situation, thus not being discriminated if treated differently in light of each individual or sector requirement. Least of all is there any capricious, irrational or absurd differential treatment of the Claimants, who are not even among those who have suffered the most severe consequences of the measures adopted.

281. After examining the detailed arguments of the parties and their supporting authorities and decisions, the Tribunal is not persuaded by the Claimants' view that there is here arbitrariness or discrimination. The measures adopted might have been good or bad, a matter which is not for the Tribunal to judge, and as concluded they were not consistent with the domestic and the Treaty legal framework, but they were not arbitrary in that they were what the Government believed and understood was the best response to the unfolding crisis. Irrespective of the question of intention, a finding of arbitrariness requires that some important measure of impropriety is manifest, and this is not found in a process which although far from desirable is nonetheless not entirely surprising in the context it took place.

282. The Tribunal reaches a similar conclusion in respect of discrimination. There are quite naturally important differences between the various sectors that have been affected, so it

is not surprising either that different solutions might have been or are being sought for each, but it could not be said that any such sector has been singled out, in particular either to apply to it measures harsher than in respect of others, or conversely to provide a more beneficial remedy to one sector to the detriment of another. The Tribunal does not find that there has been any capricious, irrational or absurd differentiation in the treatment accorded to the Claimants as compared to other entities or sectors.

283. The Tribunal accordingly concludes that the Respondent has not breached the protection provided under Article II(2)(b) of the Treaty.

5. The claim about failure to give full protection and security

284. Lastly, the Claimants argue that there has been a failure to give full protection and security to the Claimants' investment, as required under Article II(2)(a) of the Treaty. The Claimants rely to this effect on the broader interpretation of this requirement made particularly in *CME*, where the standard was related not just to physical security but also to the legal protection of the investment.

285. The Respondent believes differently, arguing first that the standard only relates to physical protection and security, as evidenced in *AAPL* and *AMT* where installations were destroyed, and asserting next that *CME* does not mean that the interpretation it made of the standard is the accepted definition under international law, so much so that it was at the same time contradicted by the opposite conclusion in *Lauder*.

286. There is no doubt that historically this particular standard has been developed in the context of physical protection and security of the company's officials, employees or facilities. The Tribunal cannot exclude as a matter of principle that there might be cases where a broader interpretation could be justified, but then it becomes difficult to

distinguish such situation from one resulting in the breach of fair and equitable treatment, and even from some form of expropriation.

287. In this case no failure to give full protection and security to officials, employees or installations has been alleged. The argument made in general about a possible lack of protection and security in the broader ambit of the legal and political system is not in any way proven or even adequately developed. The Tribunal accordingly rejects this claim and finds that no breach of Article II(2)(a) of the Treaty has taken place.

The alternative plea of emergency

288. In case the Tribunal would find that a breach of the Treaty has taken place, the Argentine Republic has pleaded in the alternative exemption from liability in light of national emergency or state of necessity under domestic law, general international law and the Treaty, all of it based on the severity of the crisis that affected the country as from 2000.

289. The Respondent explains in detail the severity that characterized the crisis affecting the country, which threatened in its view the very existence of the State and its independence. The Respondent explains in particular that the significant decrease of the Gross Domestic Product, consumption and investment during the crisis period, together with deflation and the reduction in value of Argentine corporations, resulted in widespread unemployment and poverty, with dramatic consequences in health, malnutrition and social policies. In addition, public institutions were no longer functioning.

290. With a view to overcome such difficulties there was an urgent need to resort to emergency, described by the Respondent as a severe form of necessity, which materialized in the 2002 Emergency Law. The Respondent explains in this respect that

the Emergency Law was not the cause of the unfolding economic emergency but the normative consequence of a situation that had become manifest in world financial markets. The measures adopted, the Respondent maintains, were the remedy recommended by distinguished economists and led to the gradual recovery that is noticeable at present.

1. Necessity and emergency under the Argentine Constitution

291. The Respondent explains that the Argentine Constitution provides for various kinds of emergency measures, including most prominently economic emergency, which in this case was declared by Congress, and that as a public act on emergency measure benefits from a presumption of legality, subject to constitutional control by the judiciary. The emergency legislation, the Respondent maintains, meets the requirements laid down by judicial decisions to the extent that there exists a state of necessity, the rules are aimed at attending to public interest, the remedy introduced is proportional to the emergency and its time frame is reasonable and related to the causes of the emergency. So too, the Respondent asserts, the measures enacted by the Government acting on powers delegated by Congress observe the legal requirements of emergency as provided under the Constitution.

292. In the Claimants' view, the Respondent has not demonstrated that the degree of threat required to invoke the defense of necessity has been met, particularly because the existence of the State has not been imperiled as if it had faced a military threat, nor has it demonstrated that the derogation of the specific guarantees and obligations disputed was justified.

293. The Tribunal has examined above the situation of the measures complained of in the context of the Argentine legislation. While there can be no doubt that emergency has been continuously invoked and recognized in Argentina, precisely because of that the courts have been careful in stating the conditions under which emergency may be exercised and legally validated. In the context of the present emergency, the Tribunal is mindful of the specific requirements laid down in *Provincia de San Luis*, and these, as concluded, have not been met by the emergency legislation. It follows that the very constitutional provisions that were subject to judicial control and led to the definition of those conditions cannot be invoked to preclude the wrongfulness of the measures adopted if they do not comply with the conditions indicated.

2. The plea of state of necessity under customary international law

294. The Respondent maintains in this respect that state of necessity is consolidated under international law as a concept precluding wrongfulness of the measures adopted in its context and exempting the State from international responsibility. The *Neptunus* case and the *Gabcíkovo-Nagymaros* judgment, as well as Article 25 of the International Law Commission's Articles on State Responsibility, are invoked in support of this conclusion.

295. The Respondent argues in particular that it has not contributed to the situation of necessity as most of the intervening factors were exogenous; that the measures adopted were the only means to safeguard an essential interest against a grave and imminent peril because otherwise the situation would have gone out of control; that no essential interest of other States beneficiaries of the obligation or of the international community as a whole have been seriously impaired; and that the Claimants or TGS have not been treated differently from other investors in this sector.

296. In answering to arguments advanced by the Claimants, the Respondent distinguishes the *Himpurna* case from its own situation on the ground that in that case the State company PLN had expressly waived in the contract the possibility of invoking *force majeure* in justification of non performance and that the alleged events had not been proven, thus explaining the decision of the Tribunal not to admit economic emergency. So too, the Respondent distinguishes *Socobelge* where the financial situation of Greece never got to be considered by the Permanent Court of International Justice.

297. The Respondent emphasizes in particular that in the view of experts Argentina had no other option than to undertake the pesification of the contractual relations as every other remedy was unviable[76] and that, as noted, Argentina did not contribute to the situation of necessity because the main difficulties originated in external shocks, including the Asian and Russian crises, devaluation in Brazil and strengthening of the US dollar. An expert for Argentina concludes that "the Argentine currency board was not sustainable and had to be abandoned given the external and other shocks that hit the economy […] Also, the only really feasible and desirable exchange rate regime after the collapse of the peg was a floating exchange rate regime such as the one adopted by the local economic authorities in Argentina; alternatives such as dollarization were undesirable and/or unfeasible."[77]

298. Following the *Gould* case, the Respondent concludes that in view of the existence of a state of necessity damage caused is not attributable to the State as it originates in "social and economic forces beyond the power of the state to control through the exercise of due diligence."[78] Compensation thus is not due, the Respondent maintains.

299. While the Claimants share the Respondent's view that Article 25 of the Articles on State Responsibility reflects customary international law in this matter, they believe the case

---

[76] Expert Opinion of Nouriel Roubini of February 24, 2005, para. 50.

[77] *Idem*.

[78] *Gould Marketing Inc., as successor to Hoffman Export Corporation v. Ministry of National Defense of Iran*, 3 Iran-US C.T.R. 147, submitted as Respondent's Legal Authority no. 228.

has not been proven. Specifically the Claimants maintain that Argentina has not demonstrated that it was threatened by a grave and imminent peril, that the measures adopted were the only way to safeguard against that peril, that the obligation in question does not exclude the defense of necessity and that it did not contribute to the situation of necessity. The *Himpurna* and *Socobelge* cases are relied on by the Claimants in support of their assertions.

300. The Claimants emphasize that, contrary to the Respondent's assertion, the crisis finds its origins in endogenous factors which in the view of another expert are almost entirely the result of Argentina's own policy failures,[79] particularly the failure to implement structural reforms in the 1990s ensuring fiscal discipline, labor market flexibility, open foreign trade and the maintenance of the credibility of the currency board. The Claimants also argue that options other than pesification were available and thus this measure was not the only way to address the crisis; among the options discussed there was the structural reforms indicated, the agreed restructuring of its debt, dollarization and devaluation without pesification. Such alternative plans have worked in other countries, such as Uruguay, the expert explains.

301. The expert opinion of Professor Sebastián Edwards summarizes its conclusions on the following main points: Argentina itself primarily caused its economic crisis by making policy mistakes prior to 2001 and a series of additional mistakes in 2001; external shocks played a limited role in the Argentine economic crisis; and the country had a number of options available throughout the 1990s and during 2000 and 2001, and even after devaluation Argentina did not have to pesify.[80] A rebuttal opinion by Professor Nouriel

[79] Expert Opinion of Sebastián Edwards of April 27, 2005, paras. 33-82.

[80] *Id.*, paras. 126-137.

Roubini was introduced by the Respondent in opposing the Claimants' views and its expert's analysis.[81]

302. The conclusion the Claimants reach, as indicated in Article 27 of the Articles on State Responsibility, is that even in the case of state of necessity the preclusion of wrongfulness is without prejudice to, first, the compliance with the obligation concerned and, next, the question of compensation for any material loss caused by the measures adopted, thus not allowing for the permanent repudiation of rights or to ignore the necessary compensation.

303. The Tribunal's understanding of Article 25 of the Articles on State Responsibility to the effect that it reflects the state of customary international law on the matter, is not different from the view of the parties in this respect. This is not to say that the Articles are a treaty or even a part of customary law themselves; it is simply the learned and systematic expression of the development of the law on state of necessity by decisions of courts and tribunals and other sources along a long period of time. Article 25 states:

> 1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
>
> *(a)* Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
> *(b)* Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.
>
> 2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:
>
> *(a)* The International obligation in question excludes the possibility of invoking necessity; or
> *(b)* The State has contributed to the situation of necessity.[82]

---

[81] Expert Opinion of Nouriel Roubini of June 24, 2005.

[82] Article 25, ILC's Articles on Responsibility of States for Internationally Wrongful Acts.

304. There is no disagreement either about the fact that state of necessity is a most exceptional remedy subject to very strict conditions because otherwise it would open the door to elude any international obligation. Article 25 accordingly begins by cautioning that the state of necessity "may not be invoked" unless such conditions are met. Whether in fact the invocation of state of necessity in the Respondent's case meets those conditions is the difficult task the Tribunal must now undertake.

305. The first condition Article 25 sets out is that the act in question must be the only way for the State to safeguard an essential interest against a grave and imminent peril. The Tribunal must accordingly establish whether the Argentine crisis qualified as affecting an essential interest of the State. The opinions of experts are sharply divided on this issue, ranging from those that consider the crisis had gargantuan and catastrophic proportions to those that believe that it was not different from many other contemporary situations of crisis around the world.

306. The Tribunal has no doubt that there was a severe crisis and that in such context it was unlikely that business could have continued as usual. Yet, the argument that such a situation compromised the very existence of the State and its independence so as to qualify as involving an essential interest of the State is not convincing. Questions of public order and social unrest could be handled as in fact they were, just as questions of political stabilization were handled under the constitutional arrangements in force.

307. This issue is in turn connected with the existence of a grave and imminent peril that could threaten that essential interest. While the government had the duty to prevent the worsening of the situation and could not simply leave events to follow their own course, there is no convincing evidence that the events were out of control or had become unmanageable.

308. It is thus quite evident that measures had to be adopted to offset the unfolding crisis. Whether the measures taken under the Emergency Law were the "only way" to achieve

this result and no other alternative was available, is also a question on which the parties and their experts are profoundly divided, as noted above. A rather sad world comparative experience in the handling of economic crises, shows that there are always many approaches to address and correct such critical events, and it is difficult to justify that none of them were available in the Argentine case.

309. While one or other party would like the Tribunal to point out which alternative was recommendable, it is not the task of the Tribunal to substitute for the governmental determination of economic choices, only to determine whether the choice made was the only way available, and this does not appear to be the case.

310. Article 25 next requires that the measures in question do not seriously impair the interest of State or States toward which the obligations exists, or of the international community as a whole. The interest of the international community does not appear to be in any way impaired in this context as it is rather an interest of a general kind. That of other States will be discussed below in connection with the Treaty obligations. At that point it will also be discussed whether the Treaty excludes necessity, which is another condition peremptorily laid down under the Article in comment.

311. A further condition that Article envisages is that the State cannot invoke necessity if it has contributed to the situation of necessity. This is of course the expression of a general principle of law devised to prevent a party taking legal advantage of its own fault. Although each party claims that the factors precipitating the crisis were either endogenous or exogenous, the truth seems to be somewhere in between with both kind of factors having intervened, as in the end it has been so recognized by both the Government of Argentina and international organizations and foreign governments.

312. This means that to an extent there has been a substantial contribution of the State to the situation of necessity and that it cannot be claimed that the burden falls entirely on exogenous factors. This has not been the making of a particular administration as it is a

problem that had been compounding its effects for a decade, but still the State must answer as a whole.

313. The Tribunal must note in addition that as held in the *Gabcíkovo-Nagymaros* decision, with reference to the work of the International Law Commission, the various conditions discussed above must be cumulatively met, which brings the standard governing the invocation of state of necessity to a still higher echelon. In light of the various elements that have been examined, the Tribunal concludes that the requirements of the state of necessity under customary international law have not been fully met in this case.

3. The plea of necessity under Article IV(3) of the Treaty

314. The Respondent also justifies the invocation of necessity in the terms of Article IV(3) of the Treaty. This Article provides:

> Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events shall be accorded treatment by such other Party no less favorable than that accorded to its own nationals or companies or to nationals or companies of any third country, whichever is the more favorable treatment, as regards any measures it adopts in relation to such losses.[83]

315. The Respondent, following the decision in *Gabcíkovo-Nagymaros* in that it held that the essential interest of the State cannot be reduced to questions of the existence of the State but extends also to other matters such as a grave danger to ecological preservation,[84] asserts that in the present case, with every more reason, the fact that human life was endangered in the crisis context justifies the inclusion of this type of event under the

[83] Article IV(3) of the Argentina-U.S. BIT.

[84] *Gabcíkovo-Nagymaros Project* (Hungary/Slovakia), International Court of Justice, Judgment of September 25, 1997, para. 53.

terms of Article IV(3), and concludes that accordingly the invocation of necessity is not excluded by the Article in comment, thereby meeting the requirement that Article 25 of the Articles on State Responsibility also envisages to this effect.

316. The Respondent also relies to this effect on the expert report of Dean Anne-Marie Slaughter and Professor William Burke-White, where it is concluded that the measures adopted by Argentina are fully consistent with the terms of Article IV(3). [85]

317. The Claimants oppose this other justification on the ground that Article IV(3), far from reducing Argentina's obligations, adds to them by requiring national treatment and most favored nation treatment of the investors as compared to the treatment of other companies in light of the measures adopted to offset any losses. It is also argued that the decisions in *AMT* and *AAPL* upheld the liability of the host State in spite of situations of war and civil disturbance being invoked under the provisions of the respective applicable treaties.

318. In the Claimants' view, Article IV(3) applies only to the measures adopted in response to a loss, such as compensation, but not to the measures that cause the loss and, moreover, do not apply to economic emergencies but only to "war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events". In any event, the Claimants conclude, this Article does not exempt Argentina from liability and the duty to pay compensation.

319. An expert opinion of Professor José Alvarez is relied upon by the Claimants in support of their arguments, as the expert concluded that the Article in question provides further assurances to foreign investors and is not "a further exception permitting derogations from the treaty."[86]

320. The Tribunal must note that the only meaning of Article IV(3) is to provide a minimum treatment to foreign investments suffering losses in the host country by the simultaneous

---

[85] Legal Opinion of Anne-Marie Slaughter and William Burke-White of March 2, 2005, paras. 58-59.

[86] Legal Opinion of José E. Alvarez of April 20, 2005, para. 70.

interplay of national and most favored nation treatment, and this is only in respect of measures the State “adopts in relation to such losses”, that is corrective or compensatory measures.

321. While there is no reason to exclude from this Article economic emergency measures in given circumstances of particular gravity, it still would not allow derogation from rights under the Treaty as it refers to a different matter. Even less so can it be read as a general escape clause from treaty obligations and thus does not result in excluding wrongfulness, liability and eventual compensation. Accordingly, the Tribunal concludes that state of necessity cannot be justified under this Article in the terms that the Respondent has invoked it.

4. The plea of necessity under Article XI of the Treaty

322. The discussion of Article XI of the Treaty has been particularly complex in this proceeding given the wealth of arguments of the parties and of authorities and materials brought to the attention of the Tribunal. The Tribunal is once more grateful to counsel for the parties and to the experts that have written learned opinions, in particular Dean Anne-Marie Slaughter, Professor William Burke-White and Professor José Alvarez.

323. Article XI of the Treaty reads as follows:

> This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.[87]

324. The Respondent, relying on the opinion of Dean Slaughter and Professor Burke-White, asserts that public order and national security exceptions have to be interpreted broadly in

[87] Article XI of the Argentina-U.S. BIT.

the context of this Article, including economic security and political stability; moreover, this Article was understood to be self-judging to the extent that each party will be the sole judge of when the situation requires measures of the kind envisaged by the Article, subject only to a determination of good faith by tribunals that might be called upon to settle a dispute on this question. In the Respondent's view, the gravity of the crisis faced amply justifies resorting to such measures which can only be considered as adopted in good faith.

325. The Respondent also explains that in application of this Article Argentina has been able to maintain public order, has protected its essential security interests and has recomposed with great difficulty the relations with the international economic system, all of which while treating foreign investors like any other investor.

326. The Respondent assigns particular significance to the self-judging character of this Article, which the Respondent maintains has been reaffirmed by the interpretation of the United States in a number of bilateral investment treaties and statements before Congress, all of which allow Argentina to benefit from the same understanding on the basis of reciprocity[88]. The experts assert that "Argentina and the United States negotiated and signed a BIT that allowed either party to take measures otherwise inconsistent with their obligations under the treaty if that party deemed it necessary to protect its national security interests."[89]

327. The Claimants do not share the same understanding, and neither does Professor José Alvarez. It is first argued that Article XI is not self-judging and that judicial review is not limited to a good faith determination but has to examine the facts and whether they qualify under the requirements of state of necessity. It is also maintained that a self-judging clause is an extraordinary exception that has to be clearly stated, as has been done

[88] Legal Opinion of Anne-Marie Slaughter and William Burke-White of July 1, 2005.

[89] Legal Opinion of Anne-Marie Slaughter and William Burke-White of March 2, 2005, para. 63.

in Article XXI of the GATT and confirmed by the International Court of Justice in the *Nicaragua* case in rejecting an argument of the United States similar to that of Argentina here, just as it has been expressly included in some bilateral investment treaties, most notably the U.S.-Russia BIT Protocol, but nothing of the sort was done in the Treaty here applicable.

328. The expert opinion of Professor Alvarez summarized its conclusions on the meaning of Article XI stating that this essential security/public order clause "(1) is not self-judging; (2) does not apply to 'economic emergencies', except in the most extraordinary and so far unprecedented circumstances; and (3) even when it does apply (for example, in the event of war or insurrection), is not the equivalent of a 'denial of benefits' or termination clause in a treaty, and so does not negate state responsibility to pay compensation for actions that harm investors." [90]

329. The Claimants do not believe that exchanges between the U.S. Government and Congress in different contexts and to a very limited extent could be taken to mean that a self-judging interpretation was intended for the Treaty here applied.[91] In fact it is asserted that the opposite is true because at the time the U.S. Government explained that the Treaty "contains an absolute right to international arbitration of investment disputes."[92]

330. The Claimants further argue that, in any event, Article XI does not apply to economic emergencies but only to internal security, just as international peace and security were interpreted to mean the obligations under the Charter of the United Nations, nor does it relieve Argentina from paying compensation. A self-judging interpretation, the Claimants

---

[90] Legal Opinion of José E. Alvarez of April 20, 2005, para. 8.

[91] *Id.*, paras. 16-17.

[92] Letter of Submittal of the U.S.-Argentina BIT, January 13, 1993.

conclude, would result in creating a broad and sweeping exception to the obligations under the Treaty and would eviscerate the very purpose and object of this kind of treaty.[93]

331. In examining this discussion, the Tribunal must first note that the object and purpose of the Treaty is, as a general proposition, to apply in situations of economic difficulty and hardship that require the protection of the international guaranteed rights of its beneficiaries. To this extent, any interpretation resulting in an escape route from the obligations defined cannot be easily reconciled with that object and purpose. Accordingly, a restrictive interpretation of any such alternative is mandatory.

332. While there is nothing that would prevent an interpretation allowing for the inclusion of economic emergency in the context of Article XI, to interpret that such a determination is self-judging would be definitely inconsistent with the object and purpose noted. In fact, the Treaty would be deprived of any substantive meaning.

333. The Tribunal notes that the Treaty does not define what is to be understood by essential security interest, just as it does not contain either a definition concerning the maintenance of international peace and security. The specific meaning of these concepts and the conditions for their application must be searched for elsewhere. In respect of international peace and security this task is rendered easier by the fact that the parties themselves agreed that its meaning is to be found in the context of the obligations under the Charter of the United Nations, as provided in Article 6 of the Protocol to the Treaty. The situation is more complex in respect of security interests because there is no specific guidance to this effect under the Treaty. This is what makes necessary to rely on the requirements of state of necessity under customary international law, as outlined above in connection with their expression in Article 25 of the Articles on State Responsibility, so as to evaluate whether such requirements have been met in this case.

---

[93] Legal Opinion of José E. Alvarez of April 20, 2005, para. 54.

334. The expert opinion of Dean Slaughter and Professor Burke-White expresses the view that the treaty regime is different and separate from customary law as it is *lex specialis*[94]. This is no doubt correct in terms that a treaty regime specifically dealing with a given matter will prevail over more general rules of customary law. Had this been the case here the Tribunal would have started out its considerations on the basis of the Treaty provision and would have resorted to the Articles on State Responsibility only as a supplementary means. But the problem is that the Treaty itself did not deal with these elements. The Treaty thus becomes inseparable from the customary law standard insofar as the conditions for the operation of state of necessity are concerned. As concluded above, such requirements and conditions have not been fully met in the instant case.

335. As explained by Dean Slaughter, the position of the United States has been gradually evolving towards the support of self-judging clauses in respect of national security interests and some bilateral investment treaties reflect this change, albeit not all of them. Yet, this does not necessarily result in the conclusion that such was the intention of the parties in respect of the Treaty here relevant. Truly exceptional and extraordinary clauses such as a self-judging provision normally must be expressly drafted to reflect that intent, as otherwise there can well be a presumption about it not having that meaning in view of its exceptional nature. In the case of the Treaty nothing was said to this effect and the elements invoked in support of a self-judging character originate for the most part in congressional discussions in the United States concerning broader issues or indirect interpretations.[95]

336. The discussion noted about the GATT and the *Nicaragua* decision, just as the *Oil Platforms* case, confirm that the language of a provision has to be very precise in order to lead to a conclusion about its self-judging nature and in all those cases language

---

[94] Legal Opinion of Anne-Marie Slaughter and William Burke-White of July 1, 2005, paras. 43-47.

[95] Respondent's Post-Hearing Brief, pp. 19-20.

differences turned out to be crucial for the rejection of arguments favoring such exceptional character. So too, the International Court of Justice held in the *Gabcíkovo-Nagymaros* case, referring to the conditions defined by the International Law Commission, that "the State concerned is not the sole judge of whether those conditions have been met."[96]

337. Not even if this was the interpretation given to the clause today by the United States would this necessarily mean that such interpretation governs the Treaty. What is relevant is the intention the parties had in signing the Treaty and this does not confirm the self-judging interpretation. Even if this interpretation were shared today by both parties to the Treaty, it would still not result in a change of its terms. States are of course free to amend the Treaty by consenting to another text, but this would not affect rights acquired under the Treaty by investors or other beneficiaries.

338. As an English court has recently held in respect of a claim of non-justiciability relating to a State challenge to the *OEPC* award, the fact that a treaty is concluded between States cannot derogate from rights that belong to private parties, in the instance concerning dispute settlement, and as a consequence the doctrine of non-justiciability could not apply.[97]

339. In light of this discussion, the Tribunal concludes that Article XI is not self-judging and that judicial review in its respect is not limited to an examination of whether its invocation or the measures adopted were taken in good faith. The judicial control must be a substantive one as to whether the requirements under customary law or the Treaty have been met and can thereby preclude wrongfulness. As the Tribunal has found above that the crisis invoked does not meet the customary law requirements of Article 25 of the

---

[96] *Gabcíkovo-Nagymaros*, paras. 51-52.

[97] *Republic of Ecuador v. Occidental Exploration and Production Company (OEPC)*, Queen's Bench Application of April 29, 2005, available at <http://www.investmentclaims.com/decisions/Occidental-Ecuador-QueensBenchApplication-29Apr2005.pdf>, para. 85.

Articles on State Responsibility, thus concluding that necessity or emergency are not conducive to the preclusion of wrongfulness, there is no need to undertake a further judicial review under Article XI as this Article does not set out conditions different from customary law in this respect.

340. Judicial determination of the compliance with the requirements of international law in this matter should not be understood as if arbitral tribunals might be wishing to substitute for the functions of the sovereign State, but simply responds to the duty that in applying international law they cannot fail to give effect to legal commitments that are binding on the parties and interpret the rules accordingly, unless this derogation is expressly agreed to[98].

341. The Tribunal explained above that it would consider the requirement of Article 25 of the Articles on State Responsibility as to the act not seriously impairing an essential interest of the State towards which the obligation exists in the context of the Treaty obligations. In light of the discussion above about changing interpretations, it does not appear that the invocation by Argentina of Article XI, or state of necessity generally, would be taken by the other party to mean that such impairment does arise.

342. Be that as it may, in the context of investment treaties there is still the need to take into consideration the interests of the private entities who are the ultimate beneficiaries of those obligations, as explained by the English court case in *OEPC* noted. The essential interest of the Claimants would certainly be seriously impaired by the operation of Article XI or state of necessity in this case.

5. Temporality and Compensation

---

[98] *See* discussion in Charles Leben, *L'état de nécessité dans le droit international de l'investissement*, CAHIERS DE L'ARBITRAGE, 2005/3, pp. 47-52.

343. There are still two other aspects of state of necessity the Tribunal needs to discuss. There is first the question that necessity is a temporal condition and, as expressed in Article 27 of the Articles on State Responsibility, its invocation is without prejudice to "(a) compliance with the obligation in question, if and to the extent that the circumstance precluding wrongfulness no longer exists". Confirmed by international decisions, this premise does not seem to be disputed by the parties, although the Respondent's argument to the effect that one thing is the temporal nature of the emergency and another the permanent effects of its measures, discussed above, does not seem to be easily reconciled with the requirement of temporality. This in turn results in uncertainty as to what will be the legal consequences of the end of the Emergency Law.[99]

344. The second question is that Article 27 also provides that necessity is without prejudice to "(b) the question of compensation for any material loss caused by the act in question". Again confirmed by international decisions, this other premise has been much debated by the parties as noted above. The Respondent does not share this premise because, as was also noted above, the record shows that eventually there would be no compensation for past losses or adverse effects originating in the emergency measures in the context of renegotiations undertaken.[100]

345. The Respondent's view appears to be based on the understanding that Article 27 would only require compensation for the damage that arises after the emergency is over and not for that taking place during the emergency period. Although that Article does not specify the circumstances in which compensation should be payable because of the range of possible situations, it has also been considered that this is a matter to be agreed with the affected party[101], thereby not excluding the possibility of an eventual compensation for

---

[99] Witness Testimony of Gustavo Simeonoff, Hearing Transcript Vol. 3, November 30, 2005, pp. 481-482.

[100] *Id.*, p. 493.

[101] James Crawford,*op. cit.,* p. 190.

past events. In the absence of a negotiated settlement between the parties, this determination is to be made by the Tribunal to which the dispute has been submitted.

D. Remedies and Compensation

1. The Parties' Submissions

346. The Claimants request relief under three heads. Firstly, the Claimants submit that under Article IV of the Treaty the expropriation they have suffered requires the payment of full compensation in accordance with the fair market value of the expropriated investment. The Claimants also explain that their damages experts ("LECG") have used two dates to this effect in their calculations: August 31, 2000, at which time the first injunction concerning the US PPI had been just issued, and December 31, 2001, the date just before the enactment of the Emergency Law. Full compensation is, according to Claimants, also to be paid for the other Treaty breaches claimed, including fair and equitable treatment.

347. Secondly, the Claimants claim the management fees due under the Technical Assistance Agreement (TAA), arguing that they constitute a "*delayed compensation and should be included in computations of historical profitability or damages.*" [102] Thirdly, the Claimants require that compensation be paid for the loss of revenue derived from the unavailability of US PPI adjustments for 2000-2001.

348. Under these three heads, the Claimants' methods and related estimations of damage are as follows. To calculate the fair market value of the expropriated investment, the Claimants explain that LECG used three methods: the Discounted Cash Flow approach (DCF), book

[102] Claimants' Reply, para. 677.

value, and unjust enrichment.[103] Under DCF, the experts value the equity damage of the Claimants as of August 31, 2000 at US$243,775,916. With a valuation date of December 31, 2001, the Claimants' damages are estimated at US$272,722,850 and updated through November 2004 at US$382,016,802. Using the book value approach these figures are respectively US$337,549,800 and US$472,823,217. The unjust enrichment approach results in amounts for December 31, 2001, ranging from US $579,475,694 to US $582,018,216, depending on whether a "purchase price" or a "wealth transfer" variant is adopted.

349. Regarding damages related to management fees under the TAA, the Claimants contend that DCF is the only valid method given that the expected future cash flow from management fees to Enron is not reported in TGS financial statements. LECG estimates damages to Enron under this head at US$34.8 million of December 2001, and US$48.7 million updated to November 2004.

350. Finally, Claimants estimate damages from outstanding PPI adjustments at US$ 15.8 million based on the sum of the adjustments denied. LECG notes that this loss – while included in the August 2000 valuation - was written off from TGS books and is thus not taken into account for the valuation at December 2001.

351. The experts evaluate the overall damages to Claimants as of August 31, 2000 at US$278,722,689, and updated through November 2004 at US$495,217,600. With a valuation date of December 31, 2001, damages are estimated at US$323,399,817, which updated through November 2004 amount to US$453,002,615. Using the book value approach these figures are US$388,226,768 and US$543,809,030, respectively.

[103] The DCF and the Book Value methodologies are used to calculate what LECG identifies as 'Damage to Claimants as Equity Holders' or 'Equity Damage' to which management fees and PPI damages are subsequently added. The Unjust Enrichment approaches seem not to differentiate between these items.

352. The Claimants also request pre-award interest at commercially reasonable rates, compounded quarterly, as they also request the award of all costs and expenses of the arbitration, including legal fees.

353. The Respondent opposes the claim for compensation on various grounds. Firstly, it makes the following three objections of general nature: (i) that the claim is illusory given the towering return on investment obtained by the Claimants prior to the crisis and the current stock market value of TGS; (ii) that the damages were the result of the aggressive financial policy of TGS and CIESA, in particular their high leverage and TGS' indebtedness in foreign currency; and (iii) that country risk included in the calculation of tariffs has already compensated Claimants' alleged losses.

354. Secondly, the Respondent disagrees with a number of methodological assumptions underpinning the Claimants' valuation. The Respondent argues that (i) Enron's participation in TGS is not 35.5% but should be reduced to 19.5% considering the debt taken by CIESA on behalf of the Claimants; and (ii) that both the regulated and the non-regulated business should be considered together for the purpose of valuation since damages to the regulated business cannot be estimated without accounting for the return obtained in the same period by the non-regulated business.

355. The Respondent objects to the use of DCF to calculate the value of equity damage as a matter of principle and formulates specific objections to the results obtained by the Claimants. The inputs taken into account are also discussed by the Respondent's experts, as will be examined further below.

356. The Respondent also objects to the payment of compensation for the fees of the Technical Operator, among other reasons because the TAA was transferred to Petrobras for an undisclosed amount in 2004.

357. Likewise, the Respondent opposes the claim for PPI damages arguing that this ignores the existence of the agreements signed in January and June 2000 suspending PPI adjustments

and never challenged by the Claimants. If any damage were to be awarded on this ground, it should cover only marginal benefits derived from the July agreement.

358. These various submissions by the parties and their experts will be examined below in connection with the specific issues concerning valuation and compensation.

2. The Applicable Standard of Reparation

359. The Treaty does not specify the damages to which the investor is entitled in case of breach of the standards of treatment different from expropriation, *i.e.*, fair and equitable treatment or the breach of the umbrella clause. Absent an agreed form of restitution by means of renegotiation of contracts or otherwise, the appropriate standard of reparation under international law is compensation for the losses suffered by the affected party, as was established by the Permanent Court of International Justice in the *Chorzów Case*:

> The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.[104]

360. Various tribunals have applied this principle in deciding damages for breach of "fair and equitable treatment."[105] As noted by *SD Myers*, the silence of the treaties, in that case of NAFTA, indicates the intention of the drafters "*to leave it open to tribunals to determine a measure of compensation appropriate to the specific circumstances of the case*."[106] The Tribunal added that: "*whatever precise approach is taken, it should reflect the general*

---

[104] *Chorzów*, Judgment No. 13 (Claim for Indemnity - The Merits) of September 13, 1928, available at: <http://www.worldcourts.com/pcij/eng/decisions/1928.09.13_chorzow1/>, para. 47.

[105] *S.D. Myers, Inc. v. Canada*, UNCITRAL Arbitration Proceeding, Partial Award of November 13, 2000, paras. 311-315; *Metalclad Corporation v. United Mexican States*, (ICSID Case No. ARB(AF)/97/1), Award of August 30, 2000, para. 122; *MTD*, para. 238.

[106] *S.D. Myers*, para. 309.

principle of international law that compensation should undo the material harm inflicted by a breach of an international obligation."[107]

361. The present Tribunal finds that the appropriate approach in the instant case is that of compensation for the difference in the 'fair market value' of the investment resulting from the Treaty breaches. The notion of 'fair market value' is generally understood as the price at which property would change hands between a hypothetical willing and able buyer and an hypothetical willing and able seller, absent compulsion to buy or sell, and having the parties reasonable knowledge of the facts, all of it in an open and unrestricted market.

362. Fair market value is indeed the applicable Treaty guideline for measuring damages in cases of expropriation. However, and as other tribunals in the past[108], this Tribunal is faced with the problem of whether a standard mainly related to expropriation, such as fair market value, can be applied to situations not amounting to expropriation.

363. On occasions, the line separating indirect expropriation from the breach of fair and equitable treatment can be rather thin and in those circumstances the standard of compensation can also be similar on one or the other side of the line. Given the cumulative nature of the breaches that have resulted in a finding of liability, the Tribunal believes that in this case it is appropriate to apply the fair market value to the determination of compensation.[109]

3. The Tribunal's finding

---

[107] *Id.*, para. 315.

[108] *Marvin Feldman v. The United Mexican States* (ICSID Case No. ARB(AF)/99/1), Award of December 16, 2002.

[109] *See* also *CMS*, para. 410. In the absence of guidance regarding the standard of compensation for the breach of fair and equitable treatment in the US-Argentina BIT, the tribunal in the case of *Azurix Corp. v. The Argentine Republic* (ICSID Case No. ARB/01/12), Award of July 16, 2006, para. 424 concluded that: "*compensation based on the fair market value of the Concession would be appropriate.*"

364. The Tribunal wishes to express its appreciation to the expert appointed by it, Mr. Luis Hernán Paul, who has assisted the Tribunal in understanding essential technical information to arrive at the conclusions that follow. The Tribunal also expresses its appreciation to LECG, Dr. Fabián Bello and the experts for GSCSA, all of whom have provided important views and comments in support of their respective findings. The Tribunal has also considered with particular attention the comments made by the parties to both the preliminary and the final report of the Tribunal's expert.

365. In analyzing the parties' contentions on damages the Tribunal will proceed as follows. Firstly, it will address the arguments of general nature raised by the Respondent – described in paragraph 353. Secondly, it will address Claimants' claims following the approach proposed by the Claimants' experts and consisting in dividing damage claims into the following categories: (i) damages as equity holders – covering the loss in value of the Claimants' equity (*equity damage*) and the loss in value derived from the suspension of the PPI adjustments (*PPI damages*); and (ii) damages as technical operator (*operator damages*).

366. In conducting this analysis, the Tribunal will first deal with methodological issues before proceeding to calculate the quantum of the compensation for each of the Claimants' claims. It will conclude with the calculation of consolidated damages.

A. Respondent's general arguments opposing liability

i) Historical return on investments

367. The Respondent and both Mr. Bello and GSCSA have argued against compensation being awarded in this case because the historical return that the Claimants obtained on the investment was allegedly significantly higher than that considered in the determination of tariffs in connection with the cost of capital. According to the Respondent, the Claimants'

actual capital contribution to TGS was minimal since most of the funds originated in the loan made by the Chase Manhattan Bank to CIESA. In addition, GSCSA suggests that there are numerous errors in the Claimants' calculations relating to the rate of return on investments, dividends and fees.

368. The Claimants allege that the Respondent's estimates of Claimants' returns on equity are flawed because they miscalculate the initial contribution and inflate TGS' and Claimants' earnings. Moreover, these estimates are irrelevant for damage calculation since damages are a direct result of the measures introduced since 2002 on a forward-looking basis.[110]

369. The Tribunal must reject Respondent's arguments. Firstly, as noted by the Claimants, their claims refer to the impact of the measures on the value of their investments. The calculation of such value is based on reasonable estimates of future demand, revenue and expenditures and excludes consideration of past performance or returns. Historical return on investment is therefore irrelevant for determining damages.

370. Secondly, LECG is right in observing that differences between the estimated rate of return and the actual return are inherent to the price-cap system under which TGS operates. Under such system recouping extra profits between tariffs reviews will depend on the company's efficiency. Without analyzing the calculations presented by both parties at this stage, the Tribunal notes that even if Claimants' actual returns were higher than those estimated by the ENARGAS, such returns will not disallow claims for compensation of Treaty breaches. Neither historic nor estimated returns have been retained as a valid ground to oppose compensation under international law.

ii) The question of leverage

[110] LECG Expert Report of May 2005, para. 82.

371. As noted above under ¶¶ 158-167, the Respondent has also raised the issue of CIESA's and TGS' reliance on financial leverage as an objection to liability. The Respondent and its experts, in particular Mr. Bello, argue that TGS' aggressive leverage policy considerably increased TGS vulnerability to changing economic conditions. Such vulnerability was compounded by TGS' "double leverage" following CIESA's own recourse to debt. TGS' declaration of default and its subsequent loss in value is therefore directly linked to financial policy decisions and cannot be attributed to Respondent's measures.

372. The Claimants note that TGS' financial policies were reasonable and followed normal standards for the gas transportation industry.[111] In the absence of the Respondent's measures, TGS leverage would not have represented a potential liquidity or financial problem for the firm since historical performance and cash flows perspectives were sufficient to cover the typical financial ratio covenants considered by lenders.[112] Finally, Claimants observe that CIESA's financing is irrelevant for damage computation since damages should be computed only once by looking at Claimants' stake in TGS.

373. The Tribunal agrees with the Claimants' approach. TGS' leverage was reasonable by industry standards and close to that advised by the regulator. The difference between the optimal leverage considered by ENARGAS and the actual leverage of TGS was not significant: respectively 36.7% as compared to 40.8% in RQT I (1996), and 46% as compared to 49.8% in RQT II (2001).[113] It may also be noted that none of the debt holders expressed any concern regarding the level of leverage before the measures were taken.

---

[111] *Id.*, para. 64.

[112] *Idem.*

[113] *Id.*, para. 63; Expert Opinion of Fabián Bello of February 28, 2005, para. 28.

374. The argument made by the Respondent as to the need to take into account the market capitalization of TGS shows that the value of TGS' stock was constantly and significantly positive before the measures were adopted, thus suggesting that the stock market did not consider such leverage as endangering the company prior to the measures.

375. It was only after the pesification of tariffs that the company defaulted on its debt and the stock exchange price decreased dramatically.[114] Consequently, the decrease in value was generated by the measures and not by the leverage.

376. The Tribunal notes that CIESA's debt in this context is irrelevant. However, it will play an important role in defining the actual investment of the Claimants in TGS, as will be analyzed below.

iii) Country risk

377. The Tribunal has extensively considered in its examination of liability above under ¶¶ 119-121; 148-150 the question of whether the country risk premium reflected in the tariff includes the risk of devaluation or the risk of tariff freeze and pesification, which the Respondent has raised in opposition to any claim of liability concerning such measures. According to the Respondent, any finding to the contrary would result in granting the Claimants double compensation for the same risk.

378. As mentioned, the Tribunal believes that the 'country risk' does not include the risk of freeze and pesification of tariffs, which was separately and specifically protected under the Regulatory Framework. Claimants have therefore not been compensated for these measures. Consequently, the valuation will consider the effect of freeze and pesification of the tariffs on the investment and this shall be reflected in the resulting compensation.

[114] *See* GSCSA Expert Report of June 2005, para. 138, for stock exchange price.

B. Claimants' claims regarding damages

i) Equity damage: methodological issues

379. The equity damages correspond to the loss in value of Claimants' investment in TGS derived from the measures, in particular from the *pesification* of tariffs. In estimating these damages, the Tribunal recalls that "*compensation should undo the material harm inflicted by a breach of an international obligation*."[115] In this case, as noted above, the breach concerns the fair and equitable treatment and the umbrella clause.

380. To "*undo the material harm*" in this case, the Tribunal considers that it needs to compare the value of Claimants' investment before the measures were adopted and its value at present. To determine the value of the investment at these periods, the Tribunal will apply the principle of fair market value, as described above.

381. The parties disagree, however, on the appropriate method for establishing the fair market value. While the Claimants have relied to this effect on the DCF and other methods (*i.e.*, book value and unjust enrichment), the Respondent has favored the stock exchange valuation of the shares. The Respondent's expert, Mr. Fabián Bello, has also explained that market capitalization offers an additional method with which DCF assessments can be verified and corrected. In the instant case, shares in TGS are normally traded in both the Buenos Aires and New York stock exchanges. Claimants have rejected the use of the stock market value alleging principally (i) the illiquidity of TGS share; (ii) the effects of thin markets like Buenos Aires, namely, the disconnection between stock prices and real values and the volatility of share values due to erratic macro economic performance.

[115] *S.D. Myers*, para. 315.

382. The Tribunal is not persuaded by the use of book value or unjust enrichment in this case because these methodologies do not provide an adequate tool for estimating the market value of TGS's stake. The book value of TGS stake is by definition valid for accounting purposes but, as noted by LECG, fails to incorporate the expected performance of the firm in the future.[116] The unjust enrichment method does not provide a value of the company; it computes damages by looking at the extent of unfair enrichment by the Government. The estimation of the unfair enrichment would then be determined on the basis of the price paid for the license or the wealth transferred to the entity benefiting from the enrichment.

383. With regard to stock market value, the Tribunal accepts Claimants' point that when markets are illiquid or the volume of transactions is limited, market capitalization might provide distorted valuation indications. However, it is still possible to rely on this approach if longer periods of time are taken into consideration so as to determine relevant averages as suggested by the Tribunal's expert.

384. In view of the fact that TGS is a "going concern", the Tribunal believes that its fair market value should include the measure of its future prospects.[117]

385. Since DCF reflects the companies' capacity to generate positive returns in the future, it appears as the appropriate method to value a "going concern" as TGS.[118] Moreover, there is convincing evidence that DCF is a sound tool used internationally to value

---

[116] LECG Expert Report of May 2005, para. 157.

[117] This accords with established international practice. Such an approach was adopted in the following decisions: *Amco Asia Corporation and Others v. Republic of Indonesia* (ICSID Case No. ARB/81/1), Award in Resubmitted Case of June 5, 1990, 1 ICSID Reports (1993); *Liberian Eastern Timber Corp. (LETCO) v. Republic of Liberia* (ICSID Case No. ARB/83/2), Award of 31 March 1986, 2 ICSID Reports (1994), pp. 372-377; *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1), Award of August 30, 2000 available at http://www.worldbank.org/icsid. Consideration of future prospects also features in the following decisions of the US-Iran Tribunal: *Starett Housing Corp. v. Islamic Republic of Iran*, Award No. ITL 32-24-1 of December 19, 1983 and *Phillipps Petroleum Company Iran v. Islamic Republic of Iran*, Award No. 425-39-2 of June 29, 1989.

[118] The DCF method is widely endorsed, both by financial institutions and international jurists. *See* for example *Legal Framework for the Treatment of Foreign Investments:* Volume II: Guidelines (Washington D.C., The International Bank for Reconstruction and Development / The World Bank) (1992).

companies[119], albeit that it is to be used with caution as it can give rise to speculation. It has also been constantly used by tribunals in establishing the fair market value of assets to determine compensation of breaches of international law.[120]

386. In light of these considerations, the Tribunal is persuaded that the DCF method offers a reliable approach in this case. The Tribunal finds, in addition, that Mr. Bello's initial submission of verifying DCF results in accordance with the valuation that market capitalization might reflect is a useful tool to which the Tribunal will have recourse.

387. In the present case there is yet another aspect that must be considered. Market transactions have taken place in respect of the Claimants' participation in TGS, both in connection with the swap that took place with Petrobras and the later sale of shares to an investment fund. Willing sellers and willing buyers in this case are thus no longer hypothetical but real enough, a situation that has turned to be meaningful in the Tribunal's findings. In fact, these transactions and in particular the sale of the Claimants' 15.2% stake in TGS to D.E. Shaw and the option to purchase the remaining 4.3% participation in TGS are an accurate reflection of the current market value of the company.

388. LECG uses DCF for establishing both the value before the measures were taken and the current value of the Claimants' participation in that business, the difference between one and the other being the estimated losses, subject to some adjustments. While the Tribunal finds nothing wrong in that approach, which is commonly used and has been applied by other tribunals,[121] it involves some degree of uncertainty in the assumptions taken into account. Because there are in this case specific transactions concerning the Claimants' participation in TGS, the Tribunal considers that the real value obtained in these transactions better reflects the current value of such participation. This is a value which is

---

[119] LECG Expert Report of May 2005, para. 159, no. 131.

[120] *See* for example: *Amco (Resubmitted Case)*, pp. 616-617; *LETCO*, pp. 372-377; and *CMS*, para. 411.

[121] *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Award of May 12, 2005.

certain and arises from market transactions. Moreover, such transactions were specifically made with the intention of mitigating losses.

389. Consequently, the Tribunal will apply DCF to estimate the value of TGS and of Claimants' investment (*i.e.*, their equity participation in TGS) before the measures were adopted, in particular, before pesification took place. To estimate the current value of TGS and of Claimants' investment, the Tribunal will use the sale transaction with D.E. Shaw. Both results would then be contrasted with the stock market value. Next, the Tribunal will establish the difference between these two values to calculate the damages suffered by the Claimants as shareholders of TGS. Finally, the Tribunal will consider *operator damages* and *PPI damages* (if any) to establish the overall compensation to the Claimants' for the Treaty breaches incurred by the Respondent.

390. Before moving to the quantum of equity damages, the Tribunal will address the Respondent's disagreements with regard to two important issues for the estimation of the equity damage: (i) the question of the Claimants' actual participation in TGS, including the discussion of CIESA's debt; and (ii) the question of regulated and non-regulated business.

a) The question of the Claimants' actual participation in TGS and the incidence of CIESA's debt

391. One of the most difficult questions that the Tribunal has had to address is that concerning the true participation of the Claimants in TGS, namely whether it amounts to a 35.5%, as the Claimants argue, or only to a 19.5%, as the Respondent believes. As noted, this difference arises from the fact that the Claimants' participation in TGS was in part financed by a loan that CIESA took on their behalf. The Tribunal must note for the sake of clarification that these figures have been used by the parties so as to simplify the

arguments made; in fact, each figure is the aggregate result of various shareholdings, some direct and some indirect.

392. The Tribunal notes that the financing of the parent company's (*i.e.*, Enron) final investment (*i.e.*, TGS) through the indebtedness of the holding company (*i.e.*, CIESA) is a normal investment practice. Such practice will as a rule not affect the determination of the value of the shareholding for compensation purposes. In fact, because the parent company shall normally be liable for such debt, it would be entitled to recover the entire equity interest. In the present case, however, the situation is different. While the parent company at first guaranteed CIESA's debt and was liable for it, it then became the debt of CIESA alone. Eventually the parent company assumed and swapped its share of this debt for its own equity in TGS thereby diluting its final investment. The approach to compensation must therefore also be different.

393. Indeed, the swap executed with Petrobras in connection with CIESA's debt restructuring in 2005 transformed Enron's initial indirect participation of 27.65% in TGS into a direct participation of 11.65% in that company.[122] In exchange, the Claimants' liability for CIESA's debt was proportionally reduced.[123]

394. Upon completion of the swap Enron is to hold a direct stake of 19.5% in TGS (the initial 7.85% direct participation plus 11.65% following the swap). However, Enron sold shares representing 15.2% of TGS to the investment fund D.E. Shaw in January 2006. Subject to the completion of the second stage of the swap, leaving Enron an additional direct participation of 4.3%, D.E. Shaw also has the option of purchasing this additional stake.

---

[122] The 7.85% remaining direct interest of Claimants in TGS (through Enron's subsidiaries other than CIESA) was kept aside the swap transaction but was later included in the sale and option agreement entered into by Enron with D.E. Shaw.

[123] The swap comprised two stages. First, EACH and EPCA, Enron's subsidiaries, transferred to a trustee indicated by Petrobras their 40% stake in CIESA; Petrobras in turn transferred to Enron's subsidiaries 7,35% of its direct stake in TGS. Second, EACH and EPCA would transfer their remaining 10% stake in CIESA to Petrobras; Petrobras in turn, approved the transfer by CIESA of 4.3% of its stake in TGS to Enron's subsidiaries. This second stage is awaiting ENARGAS approval.

395. While this second stage is pending Enron remains proportionally liable for CIESA's debt. The Tribunal assumes, however, the success of the second stage of the swap leading to the extinction of the remaining liability. The Tribunal will accordingly consider the effects of the swap agreement as a whole.

396. Before entering into the analysis of the effects of the circumstances mentioned above, the Tribunal wishes to recall that the disposal of Enron's participation in TGS does not affect its jurisdiction to decide in this case. As discussed above, ICSID jurisdiction is determined on the date the arbitration is instituted and subsequent changes in their ownership of TGS does not affect jurisdiction.[124]

397. How do Enron's guarantees and assumption of CIESA's debt affect the determination of its participation in TGS and eventually the calculation of damages?

398. Firstly, following the swap operation as a whole, Enron's initial indirect participation of 27.65% in TGS is reduced to 11.65%. Enron is further released from its obligations as guarantor of CIESA's debt. The 11.65% therefore represents the net asset value of Claimants' participation in CIESA, *i.e.*, the book value of Enron's assets in CIESA (which represented 27.65% of TGS stake) less liabilities (50% of CIESA's debt). The pre-existing 7.85% TGS stake directly owned by Enron should be added to this value to obtain the net asset value of Enron's overall participation *i.e.*, 19.5%. This stake corresponds to the sale agreed with D.E. Shaw.

399. Secondly, CIESA's original debt should be taken into account when determining the value of Enron's investment prior to the measures. Claimants are correct in affirming their right to claim for their initial 35.5% participation in TGS. However, when valuing that stake, one cannot ignore the underlying debt burden if the latter is linked to the investor by the guarantee and subsequently serves to dilute the very same stake. As a

---

[124] *CSOB*, para. 31; *Vivendi*, paras. 60-62.

matter of accounting principle therefore, comparing the current value of Enron's investment (as determined by the sale to D.E. Shaw) requires calculation of the net asset value of the Claimants' investment as of December 2001 obtained by deducting Claimants' participation in CIESA's debt.

400. It can then be concluded that Argentina will compensate the Claimants for the full value of their investment, which for the reasons explained does not include the portion of the investment financed by CIESA's indebtedness.

401. The Tribunal will accordingly use the 35.5% participation in TGS as the starting point of valuation, will deduct from such amount the Claimants' share in CIESA's liabilities, for which they no longer have any responsibility, and attain a net value, which is to be compared with the net present value of the sale to D.E. Shaw.

b) The question of the regulated and non-regulated business

402. As noted above under ¶¶ 173-181, the parties have discussed the question whether valuation should take into account only the damages affecting the regulated business of TGS, as argued by the Claimants, or should off-set against any such losses the positive results of the non-regulated business, as argued by the Respondent. For the reasons explained, the Tribunal believes that both kinds of business should be kept separate and distinct. Accordingly, only the regulated business of TGS will be taken into account in the considerations that follow.

ii) Equity damage: the quantum of compensation

403. The Tribunal turns next to estimating the quantum of compensation for equity damages. In light of the considerations made above, only the regulated business of TGS will be

taken into account to this effect. As noted, pesification of tariffs beginning in 2002 is the central factor in determining compensation as it has the higher incidence on the difference in value in December 31, 2001, before the measures were adopted, and the net present value.

404. As concluded above, the Tribunal will compare the value of the Claimants' participation in the regulated business of TGS before pesification and the current value of such participation. While the first value will be established using DCF, the current value will be based on the sale price to D.E. Shaw on January 18, 2006, taking into account only the value attributable to the regulated business.

The DCF value at December 31, 2001

405. The Tribunal will start from the premise that the figures and assumptions used by LECG in their expert valuation of damages at December 31, 2001 are correct. The Tribunal notes that while two dates have been discussed by the Claimants as relevant to valuation (August 31, 2000 and December 31, 2001), most of the experts' work has dealt with the latter date. While another ICSID tribunal has used August 17, 2000 as the appropriate date to this effect,[125] the Tribunal finds appropriate to follow in this case the experts' approach as the most serious damages arose in connection with the Emergency Law.

406. There are, however, specific comments and criticism made by the Respondent and its experts, as well as by the Tribunal's expert, to the LECG figures, criticism that has been taken into account by the Tribunal to reach a conclusion in this respect. The valuation done by LECG has been tested under different scenarios so as to check for accuracy and reasonableness. In this respect, the Tribunal finds that a number of variables require

---

[125] *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Award of May 12, 2005.

adjustment, with particular reference to the tariff base, the Weighted Average Cost of Capital ("WACC") and the period over which tariff adjustment should realistically take place. These adjustments will be explained next.

407. Such adjustments reflect the reality of the crisis that took place in Argentina and the specific influence it has in connection with valuation and compensation, a matter which, as the Tribunal has explained, necessarily has to be reflected in this context. It is here where the difference with a normal business scenario will become evident.

The tariff base

408. The tariff base used by LECG for December 31, 2001, or US$1,789 m., has been criticized by Mr. Bello as being excessive in light of the work done by ENARGAS and the participating consultants in preparation for the RQT II, which gave a lower end amount. The Respondent's expert considers that the base suggested by the Claimants should be reduced by US$225 m.

409. Taking into consideration this criticism and other adjustments that had been considered by ENARGAS, the Tribunal's expert proposed as the appropriate tariff base an amount of US$1,669.4 m.

410. The Tribunal's expert has accepted the reductions made by the ENARGAS consultants, with the exception of the exclusion of the working capital, which he considers must be included in the tariff base because it is as necessary as the investment in fix assets in order to develop the business. The Tribunal considers this to be a reasonable proposition and will accordingly follow its expert best estimate for a tariff base in the amount of US$1,669 m., a figure which is lower than that suggested by LECG and higher than that suggested by the Respondent.

The WACC

411. The experts also disagreed about the appropriate WACC that should be applied in this case. While LECG has used a WACC of 12.24% for December 31, 2001, GSCSA has discussed a WACC of 14.86%. The Tribunal's expert considers it is appropriate to use a higher premium for risk than those used by LECG and proposes a 12.6% WACC, based on the WACC considered by ENARGAS for RQT II (10.4%) plus an adjustment for inflation.

412. The Tribunal finds that the ENARGAS figure constitutes an objective and realistic calculation since it would have been the actual cost of capital applied by the regulator in the calculation of tariffs if the RQT II had not been aborted. While the ENARGAS did not reach a final determination on this matter, the figures discussed at the time reflected the options available and its most likely outcome. The adjustment for inflation is necessary to make it consistent with the nominal values used by LECG.

413. In light of these considerations the Tribunal considers that the figure proposed by the Tribunal's expert is reasonable and should also be retained for the calculation of compensation.

Period of tariff adjustment

414. LECG applied the whole tariff adjustment beginning in 2002 in a single year, using to this end an increase of 144%. The Tribunal believes this is not a realistic scenario in a crisis context and has accordingly, as argued by Mr. Bello, chosen to extend the period of tariff adjustment to six years, resulting in an increase of 20.8% for each year of such period with a total adjustment of 211%.

415. Such change is not significant in respect of the effect on demand that could result from one or the other choice because of the stable contractual commitments used in the gas transportation industry, and thus its effect on compensation will not be significant either. Yet, the Tribunal considers reasonable to allow for a longer period over which the tariff adjustment will take place. Tariff adjustment over a period of six years allows in fact for a better spread of the WACC indicated as the average return of the business.

Efficiency adjustment

416. The experts also discussed the question of the application of an efficiency factor in the determination of tariffs (Factor X). While for Mr. Bello this factor should be considered and would result in a lower tariff adjustment, LECG has explained that it is implicit in the cash flow estimates on which the initial tariff adjustment is based.

417. In the Tribunal's view, whether this factor is taken into account in an explicit or an implicit manner, the end result will not be different. The Tribunal will accordingly retain the figures used to this effect by LECG.

Percentage attributable to the regulated business

418. In determining the value of the regulated and the non-regulated business of TGS, LECG, following the same approach as the ENARGAS, has used the percentage each business has in the total fixed assets of the company, which results in 86% for the regulated business and 14% for the non-regulated business in 2001. In LECG's view, this percentage is the same resulting from the earnings of each business before taxes. The Respondent insists that such separation is artificial and unviable for damage calculation.

419. The Tribunal's expert has considered more reliable to this effect the use of the operational income for each business, as reflected in TGS' statements, which results in 88% for the regulated business and 12% for the non-regulated business for 2001. The Tribunal sees no reason to depart from this approach.

Value of the regulated business in 2001

420. The Tribunal, as explained above, will use for establishing the value of the regulated business of TGS at December 31, 2001, the figures given by LECG with the following adjustments: the tariff base is reduced from US$1,789 m. to US$1,669 m.; tariff adjustment will spread over a period of six years with an annual increase of 20.8% and a total of 211%; WACC is increased from 12.24% to 12.6% and the participation in the regulated business is increased from 86% to 88%.

421. The value resulting from the above adjustments in light of DCF is US$1,574 m., which, after deducting the debt of the regulated business or US$934 m., yields an asset value of US$639.7 m. The Claimants' 35.5% participation is thus US$227.1 m.

422. Because of the reasons explained before, the Tribunal will take into consideration the situation of the Claimants' participation in CIESA's debt. CIESA's total debt at December 31, 2001 amounts to US$223.3 m.; the Claimants' participation in this debt is 50%, which if considered only in the percentage attributable to the regulated business (88%) results in an amount of US $98.1 m.

423. The total net value of the Claimants' participation in the regulated business at December 31, 2001 is, therefore, US$227.1 m. minus US$98.1 m. corresponding to their share in the debt, or a net figure of US $129 m.

Verification using stock exchange value

424. The Tribunal has noted above that the value of market capitalization is a relevant element to verify the outcome of the DCF method so as to establish whether the variables used in the latter reflect reasonable assumptions. The use of market capitalization is intended only as a reference value and not as valuation tool in itself.

425. The Tribunal has first concluded in this respect that to use the stock value of December 2001 would result in grave distortions since at that point the unfolding crisis had led to wide speculation. In fact, as explained by GSCSA, the stock market was used to obtain and transfer dollars by means of the purchase of American Depository Receipts (ADR's).[126] Arbitrage of currencies to bypass the *"corralito"* by means of ADR transactions became a common practice at the time, which badly affected the reliability of stock market prices. It should be noted that the average stock market value of TGS for December 2001 (US$867 m.) was paradoxically higher than that of the precedent months November 2001 (US$749 m.) and October 2001 (US$781m.). It was also higher than the average for the period September-November 2001 (US$835 m.). The Tribunal will accordingly exclude the figures for the month of December.

426. Applying the percentages determined above, the stock value of the regulated business of TGS ranges from US$658.1 m. for November 2001 and US$734.3 for the period September-November 2001.These figures are not too different from those resulting from LECG's analysis (US$768 m.). Because the Tribunal has used a lower tariff base for the reasons explained, the difference increases in respect of the figures used by the Tribunal (US$639.7 m.), but it is still within an acceptable range and does not result in a disproportionate outcome.

---

[126] GSCSA Expert Report of June 2005, para. 136.

427. Stock exchange prices for TGS would result systematically in values higher than those determined by the Tribunal's expert applying DCF, not only considering the averages for 2001 but also the result of longer periods of time. If, for example, the average for 1999-2001 is used, the value of the regulated business is US$1,094 m. The same holds true for any average corresponding to 2001. As noted, if December 2001 is used as a reference point, values will also be higher.

428. The Tribunal is accordingly satisfied that the figures resulting from DCF do not show unreasonable differences with those resulting from the verification done in light of the stock market value.

Current value of the regulated business

429. The Tribunal has found above that the transactions with respect to the sale of TGS shares to D.E. Shaw provide an accurate and realistic base for the estimate of the current fair market value of the company. Having a market transaction of such characteristics is then preferable, in the instant case, to the use of DCF that implies a number of uncertainties derived from assumptions on the future that may turn out to be true or not.

430. D.E. Shaw bought the Claimants' 15.2% in TGS for US$114.6 million. It further took an option to purchase the Claimants' remaining 4.3% participation in TGS. Although the approval of this transaction is still pending, for the sake of a complete calculation the Tribunal includes the purchase price included in the 'Option Agreement' of US$33.9 m. The total current value is accordingly of US$148.5 m.

431. The participation of the regulated and the non-regulated business in this last figure has now to be determined. Applying the same criterion of the operational earnings used for 2001, this time for 2005, as reflected in TGS' statement for that year, the regulated

business has a 42% participation in the total business, while the non-regulated business has 58%.

432. In its comments to the final report of the Tribunal's expert, the Claimants have argued that the approach taken by the expert as to the allocation of 42.5% of the 2006 transaction equity value to the regulated segment assumes that also only 42.5% of TGS' outstanding debt as of 2005 corresponds to that regulated segment. In the Claimants' view, this result does not reflect the reality because the vast majority of that debt had been contracted prior to 2002 to finance the regulated sector business. So as to avoid an implicit cross-subsidy between the regulated and the non-regulated business, the Claimants assert that the same debt allocation of 88% made in 2001 should be applied in 2005, while 42.5% is used for the allocation in respect of the firm value.

433. The Tribunal has examined with great attention this argument as it also believes that the correct principle to apply is that there should be no cross-subsidies between those segments. However, the Tribunal must also note that unrealistic results would emerge from the Claimants' proposals noted above. In fact, if the allocation proposed by the Claimants for 2001 is kept, only US$16.5 m. out of the equity value of US$753.9 m., that is about 2% of the equity value implied in the D.E. Shaw transaction could be attributed to the regulated business in 2005, while 98% would be allocated to the non-regulated sector. In light of current valuation of other business operating in the regulated area of gas transportation, this is not a reasonable outcome.

434. Moreover, the Claimants' experts had suggested for the allocation of participation in 2001 the asset value of the regulated and non-regulated segments. This was also the approach considered by ENARGAS for the determination of tariffs. If this same approach is followed in 2005, not only for the debt but also for the firm value as Claimants request, the results obtained do not seem quite reasonable. In fact, it is estimated that 85% (percentage of assets attributable to the regulated business in light of the financial

statements for 2005) of the total equity value resulting from the D.E. Shaw transaction would pertain to the regulated business under this scenario.

435. The Tribunal does not question that the different methodological approaches discussed above might be conceptually valid. Given that such approaches lead to extreme results of 2% in one scenario and 85% in the other, both arising from the arguments of the same party, the Tribunal believes that the suggestion made by the Tribunal's expert is more balanced and realistic. Moreover, the allocation of debt between one segment and the other was never explicitly argued before the Tribunal.

436. The Tribunal concludes accordingly that it will keep the allocation suggested by the Tribunal's expert. It follows that of the total current value of US$148.5 m., the value of the regulated business is US$62.5 m. as at January 2006. Expressing this value in 2001 currency value the Claimants' participation amounts to US$38.6 m.

Verification of the current value using stock exchange value

437. If extrapolated, the 2006 transaction would result in a value of US$761.5 m. for the whole of TGS' business. This is less than the stock exchange value of the company at the time, which was US$855 m. The Tribunal does not believe, however, that this difference reflects an abnormal result and may well be explained by the fact that the price of the sale was agreed in 2004 and came to be executed in 2006.The stock market value of TGS fluctuated in 2004 between US$589 m. and US$869 m, and thus the value of US$761.5 m. falls well within this range.

438. The difference between the value of the Claimants' participation in the regulated business of TGS in 2001 US$129 m., prior to the measures, and the value of the 2006 transaction expressed in 2001 currency US$38.6 m., results in an amount of US$90.4 m. in respect of the pesification of tariffs.

439. The Tribunal will proceed to decide on the operator and PPI damages to finally add up all relevant concepts to estimate overall compensation for the Claimants.

i) Operator damages

440. The Claimants have requested the award of damages relating to the Technical Assistance Agreement ("TAA") between TGS and EPCA, dated 28 December 1992[127]. Under its terms, EPCA receives compensation for its role as "Technical Operator" of TGS' gas transportation system, and its annual compensation is the higher of: (1) US$3 million, or (2) 7% of TGS' EBIT minus US$3m. The Claimants' experts have calculated that the after-tax value of the TAA to Enron was US$46.4 million as of December 2001.[128]

441. According to the Claimants, the substantial reduction of TGS' revenue stream caused by the freeze of tariffs damaged the Technical Operator.[129] Moreover, the Claimants allege that their returns as Technical Operator are a form of delayed return from the risks it took under the privatization.[130]

442. The Respondent disputes the claim concerning the TAA explaining that such fees could not be considered a part of delayed compensation to be counted as damages because the Agreement was devised to remunerate specific know-how made available to TGS for a limited duration. In addition, since 2000, the operator fees are not included in the calculation of tariffs as decided by ENARGAS.[131] Finally, the Respondent argues that the TAA was transferred to Petrobras for an undisclosed amount in 2004.

---

[127] Claimants' Exhibit n. 40.

[128] Claimants' Memorial, para. 87; Claimants' Reply, paras. 672-677.

[129] Claimants' Reply, para. 674.

[130] *Id.,* para. 677.

[131] Respondent's Counter-Memorial, paras. 40-50; Respondent's Rejoinder, paras. 810-816.

443. The Tribunal is persuaded by the Respondent's arguments to the effect that the TAA claim should not be admitted. The Claimants have not proven convincingly that the fees under the TAA are a form of delayed compensation and therefore should be included in computations of profitability or damages. While the Claimants' damages experts have included this claim in the losses suffered by the Claimants related companies,[132] the TAA nor any other contemporaneous document show that the management fees were deferred compensation for Claimants' investment. To the contrary, Article 2.5 of the TAA refers to "compensation for the *performance* by Enron Argentina of its obligations *hereunder*" (emphasis added).

444. The Tribunal must also note in reaching its conclusion in respect of this claim that the TAA was transferred to Petrobras on July 15, 2004, which transfer was approved by Enargas in 2004. Claimants refer to a "transfer of the fee to Petrobras,"[133] but have not produced a copy of the transfer agreement nor have they quantified the amount that Petrobras would have paid for the transfer.

ii) PPI Damages

445. The freeze of tariff adjustment in accordance with the US PPI for 2000 and 2001 also needs to be measured in the context of valuation. While the freeze also has effects after 2001, these are included in the damage arising from pesification.

446. LECG has calculated the Claimants' damage arising from this claim in the amount of US$ 15.8 m. at December 2001. The Respondent contested this claim late in the proceedings in its second comments to the expert report (letter of 9 November 2006) by arguing that the existence of the agreements signed in January and June 2000 suspending

---

[132] LECG Expert Report of November 2005, para. 205; and of May 2005, para. 104.

[133] Claimants' Reply, para. 673.

PPI adjustments, although not challenged by the Claimants, was ignored. In addition, according to the Respondent, if any damage was to be awarded on this ground, it should only include marginal benefits derived from the July agreement.

447. The Tribunal finds no merit in Respondent's arguments. TGS and other Licensees agreed on suspension of the PPI adjustments in January and June 2000 on the basis that the amounts not collected as a result of the suspension would be recouped later and with interests. With the abolition of the PPI adjustments by Law 25,561 such recouping is no longer available.

448. The Respondent has failed to provide an alternative calculation on the basis of its allegations. Thus, LECG calculation as used by the Tribunal's expert will be applied by this Tribunal in the determination of compensation.

C. The amount of overall compensation

449. The amount of equity damages in respect of the pesification of tariffs calculated of US$90.4 m. needs to be increased by the damages corresponding to the freeze of tariffs in accordance with the US PPI, calculated at US$15.8 m.

450. It follows that the damage for pesification US$90.4 m. plus the damage for freeze of tariffs US$15.8 m. results in a total amount of damages of US$106.2 m. As, for the reasons explained above, the Tribunal will not be considering compensation for the damages of the Technical Operator, this last figure is the total amount of damages awarded, subject only to the application of interest as determined below.

D. Interest

451. The Claimants' experts calculated the amount of damages at 31 December 2001 and then proceeded to update such value to the date of submission of their initial Report, *i.e.*, November 2004, using their WACC. In addition, the Claimants expressly requested the application of interest at "commercially reasonable rates" (*i.e.*, compound interest on a quarterly basis) through the date of the award so as to compensate for "the time value of money and the lost opportunity to earn a reasonable rate of return."[134]

452. While the experts' technical approach is many times used for the updating of a value, and was also suggested by the Tribunal's expert, the Tribunal believes that once the amount of damage and compensation has been determined at a given date it is more appropriate that such amount should bear interest as from such date. Moreover, any risk of double recovery is thereby avoided. The Tribunal will therefore order the payment of interest at the 6 month average LIBOR rate plus 2 per cent for each year, or proportion thereof, for the period beginning on January 1, 2002 and, as requested by the Claimants, until the date of dispatch of the Award. Interest shall be compounded semi-annually. The Tribunal considers this to be a reasonable interest for the period envisaged.

E. Costs

453. Considering the decisions regarding the various issues in this case, each party shall bear the legal costs incurred by it in connection with the present arbitration and the arbitration costs shall be borne in equal shares by the parties.

---

[134] Claimants' Memorial, para. 378.

NOW THEREFORE THE ARBITRAL TRIBUNAL

DECIDES AND AWARDS AS FOLLOWS

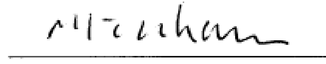
1. The Respondent breached its obligations to accord the investor the fair and equitable treatment guaranteed in Article II(2)(a) of the Treaty and to observe the obligations entered into with regard to the investment guaranteed in Article II(2)(c) of the Treaty.
2. The Respondent shall pay the Claimants compensation in the amount of US$106.2 million.
3. The Respondent shall pay the Claimants interest at the 6 month average LIBOR rate plus 2 per cent for each year, or proportion thereof, beginning on January 1, 2002 until the date of dispatch of the Award. Interest shall be compounded semi-annually.
4. Each party shall pay one half of the costs of the arbitration and bear its own legal costs.
5. All other claims are hereby dismissed.

Made in Washington D.C., in English and Spanish, both versions equally authentic.

Profesor Albert Jan van den Berg

Arbitro

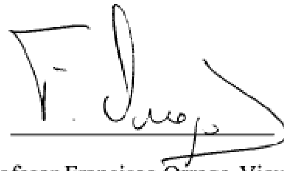
Fecha: 07 MAYO 2007



Sr. Pierre-Yves Tschanz

Arbitro

Fecha: 09 Mayo 2007



Profesor Francisco Orrego-Vicuña

Presidente

Fecha: 15 de Mayo de 2007

ANNEX 18

Date of dispatch to the parties: September 28, 2007

INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES
WASHINGTON, D.C.

IN THE PROCEEDING BETWEEN

SEMPRA ENERGY INTERNATIONAL
(CLAIMANT)

AND

ARGENTINE REPUBLIC
(RESPONDENT)

CASE NO. ARB/02/16

AWARD

Members of the Tribunal

Professor Francisco Orrego Vicuña, President
The Honorable Marc Lalonde P.C., O.C., Q.C., Arbitrator
Dr. Sandra Morelli Rico, Arbitrator

Secretary of the Tribunal
Mr. Gonzalo Flores

Representing the Claimant:

Mr. R. Doak Bishop
Mr. Craig S. Miles
Mr. Roberto Aguirre Luzi
Mr. Wade Coriell
King & Spalding LLP
Houston, Texas 77002

Representing the Respondent:

Dr. Osvaldo César Guglielmino
Procurador del Tesoro de la Nación Argentina
Procuración del Tesoro de la Nación Argentina
Buenos Aires-Argentina

THE TRIBUNAL

Composed as above,

After deliberation,

Makes the following Award:

A. Introduction

1. The Claimant, Sempra Energy International (Sempra), is a company established under the laws of the State of California, United States of America. It is represented in this proceeding by:

Mr. R. Doak Bishop
Mr. Craig S. Miles
Mr. Roberto Aguirre Luzi
Mr. Wade Coriell
King & Spalding LLP
1100 Louisiana, Suite 4000
Houston, Texas 77002

2. The Respondent Argentine Republic (Argentina) is represented in this proceeding by:

Dr. Osvaldo César Guglielmino
Procurador del Tesoro de la Nación Argentina
Procuración del Tesoro de la Nación Argentina
Posadas 1641
CP 1112 Buenos Aires
Argentina

3. On July 19, 2007 the Secretary of the Tribunal informed the parties that the Tribunal had declared the proceeding closed in accordance with Rule 38(1) of the

ICSID Rules of Procedure for Arbitration Proceedings (Arbitration Rules). This Award contains the Tribunal's Award on the merits rendered in accordance with Arbitration Rule 47, as well as a copy of the Tribunal's Decision on Objections to Jurisdiction. In rendering its Award, the Tribunal has taken into account all pleadings, documents and testimony in this case insofar as it considered them relevant.

B. Summary of the Procedure

1. Procedure Leading to the Decision on Jurisdiction

4. On September 11, 2002, the International Centre for Settlement of Investment Disputes (ICSID or the Centre) received from Sempra a Request for Arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Convention) against Argentina. The Request concerned Sempra's investment in two natural gas distribution companies, together serving seven Argentine provinces, and a number of measures adopted by the Argentine Republic which, in the Claimant's view, modified the general regulatory framework established for foreign investors under which Sempra made its investment.

5. Sempra invoked in its request the provisions of the 1991 bilateral investment treaty between the United States of America and the Argentine Republic (hereinafter the "Argentina-U.S. bilateral investment treaty" or "the BIT").[1]

6. On September 12, 2002, in accordance with Rule 5 of the Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (Institution Rules), the Centre acknowledged receipt of the Request and, on September 13, 2002, sent copies thereof to the Argentine Republic and to the Argentine Embassy in Washington, D.C.

7. By letter of October 25, 2002, the Centre asked Sempra to provide additional information in connection with references made in the Request to claims being disputed

[1] Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments, signed on November 14, 1991, which entered into force on October 20, 1994.

before fiscal agencies and the Argentine Federal Supreme Court. Sempra responded by letters dated October 28 and November 5, 2002.

8. On December 6, 2002, the Acting Secretary-General of ICSID registered the Request pursuant to Article 36(3) of the ICSID Convention. On the same date, the Acting Secretary-General, in accordance with Institution Rule 7, notified the parties of the registration of the Request and invited them to proceed to constitute an Arbitral Tribunal as soon as possible.

9. On March 4, 2003, the parties agreed to constitute a single tribunal to hear Sempra's claims together with another request for arbitration submitted by Camuzzi International S.A. ("Camuzzi"),[2] also a shareholder in the gas distribution companies in which Sempra had invested. The proceeding instituted by Camuzzi has been suspended by agreement of the parties thereto, communicated to the Centre on June 7, 2007 and approved by the Tribunal on June 21, 2007. The parties also agreed that this tribunal would comprise one arbitrator appointed jointly by Sempra and Camuzzi, one arbitrator appointed by the Argentine Republic, and a third arbitrator, who would serve as the President of the Arbitral Tribunal, who would be appointed by the Secretary-General of ICSID.

10. On March 10, 2003, Sempra appointed The Honorable Marc Lalonde P.C., O.C., Q.C, a Canadian national, as an arbitrator. By letter dated April 3, 2003, Argentina appointed Dr. Sandra Morelli Rico, a Colombian national as an arbitrator. After consultation with the parties, Professor Francisco Orrego Vicuña, a national of Chile, was appointed as President of the Arbitral Tribunal by the Acting Secretary-General of ICSID.

11. On May 5, 2002, the Acting Secretary-General, in accordance with Arbitration Rule 6(1), notified the parties that all three arbitrators had accepted their appointments and that therefore the Tribunal was deemed to have been constituted and the proceedings to begun on that date. On the same date, pursuant to ICSID Administrative

---

[2] Camuzzi's Request for Arbitration was registered by the Acting Secretary-General of ICSID on February 27, 2003 as ICSID Case No. ARB/03/2.

and Financial Regulation 25, the parties were informed that Mr. Gonzalo Flores, Senior Counsel, ICSID, would serve as Secretary of the Tribunal.

12. The first session of the Tribunal with the parties was held on July 3, 2003, at the seat of the Centre in Washington, D.C. At the session the parties expressed their agreement that the Tribunal had been properly constituted in accordance with the relevant provisions of the ICSID Convention and the Arbitration Rules and that they did not have any objections in this respect.

13. During the first session, the parties agreed on a number of procedural matters reflected in written minutes signed by the President and the Secretary of the Tribunal. Also during the first session, the Tribunal, after ascertaining the views of the parties on the matter, fixed the following time limits for the written phase of the proceedings: Claimant would file a memorial within ninety (90) days from the date of the first session; Respondent would file a counter-memorial within ninety (90) days from its receipt of the Claimant's memorial; Claimant would file a reply within forty-five (45) days from its receipt of the Respondent's counter-memorial; and Respondent would file a rejoinder within forty-five (45) days from its receipt of the Claimant's reply.

14. During the first session, the Tribunal noted that, in accordance with the applicable ICSID Arbitration Rules, the Respondent had the right to raise any objections to jurisdiction it may have no later than the expiration of the time limit fixed for the filing of its counter-memorial. For the case that Argentina were to raise objections to jurisdiction, a further schedule was agreed upon: Claimant would file a counter-memorial on jurisdiction within sixty (60) days from its receipt of the Respondent's memorial on jurisdiction; Respondent would file a reply on jurisdiction within thirty (30) days from its receipt of the Claimant's counter-memorial; and finally, Claimant would file a rejoinder on jurisdiction within thirty (30) days from its receipt of the Respondent's reply.

15. In accordance with the agreed time limits, the Claimant submitted to the Centre a memorial on the merits, with accompanying documentation, on September 3, 2003. As agreed, the memorial comprised both the claims of Sempra and Camuzzi.

16. On December 31, 2003, the Respondent filed a memorial with objections to the Centre's jurisdiction and the competence of the Tribunal. By letter of January 14, 2004, the Tribunal confirmed the suspension of the proceedings on the merits in accordance with Arbitration Rule 41(3).

17. Respondent received a copy of the Claimant's counter-memorial on jurisdiction and accompanying documentation on March 18, 2004. On May 6, 2004, the Claimant received a copy of the Respondent's reply on jurisdiction, with accompanying documentation. On June 3, 2004, the Respondent received a copy of the Claimant's rejoinder on jurisdiction, with accompanying documentation. All these pleadings were made jointly with the concurrent case in respect of Camuzzi.

18. On July 1, 2004, Mr. Francisco Ceballos, ICSID, replaced Mr. Gonzalo Flores as Secretary of the Tribunal. Mr. Ceballos having left ICSID in March 2005, Mr. Flores was reappointed as the Secretary of the Tribunal.

19. The Tribunal, having reviewed the parties' pleadings on jurisdiction, considered necessary holding a hearing, which, with the agreement of the parties, took place in Paris on November 29 and 30, 2004. The Claimant was represented at the hearing by Messrs. R. Doak Bishop and Craig S. Miles (King & Spalding LLP, Houston). Mr. Santiago F. Albarracín was also present on behalf of Sempra. The Argentine Republic was represented by Ms. Cintia Yaryura, Ms. Gisela Makowski and Mr. Gabriel Bottini, from the Procuración del Tesoro de la Nación Argentina. The hearing encompassed the parallel cases of Sempra and Camuzzi.

20. During the hearing, Messrs. Bishop and Miles addressed the Tribunal on behalf of the Claimant. Ms. Yaryura, Ms. Makowski and Mr. Bottini addressed the Tribunal on behalf of the Respondent. The Tribunal posed questions to the representatives of the parties, in accordance with Rule 32(3) of the ICSID Arbitration Rules.

21. On May 11, 2005, the Tribunal, after due deliberation, issued its unanimous Decision on the Objections to Jurisdiction raised by the Argentine Republic. In its Decision, which forms part of this Award, the Tribunal rejected all of the Respondent's

objections, concluding that the dispute fell within the jurisdiction of the Centre and the competence of the Tribunal, in accordance with the ICSID Convention.

22. Certified copies of the Tribunal's decision were distributed to the parties by the Secretary of the Tribunal. A copy of the Tribunal's Decision on Jurisdiction is attached to the present Award as an integral part of such.

2. Procedure Leading to the Award on the Merits

23. On May 11, 2005, the Tribunal, following its Decision on Objections to Jurisdiction, issued, in accordance with Rules 19 and 41(4) of the Arbitration Rules of the Centre, Procedural Order No. 1 on the continuation of the proceeding on the merits. In that Procedural Order the Tribunal referred to the time table fixed during the July 3, 2003 first session of the Tribunal with the parties, directing the parties to file their remaining written pleadings on the merits of the dispute, as follows: Respondent to file a counter-memorial on the merits within forty-five (45) days from the date of the Order; Claimant to file a reply on the merits within forty-five (45) days from its receipt of Respondent's counter-memorial; Respondent to file a rejoinder on the merits within forty-five (45) days from its receipt of Claimant's reply.

24. The Order further contemplated that the Tribunal would shortly propose a date for a hearing on the merits.

25. On May 12, 2005, the Argentine Republic requested an extension for the filing of its counter-memorial on the merits of at least 60 days. By letter dated May 18, 2005, Claimant opposed to this request. The Tribunal, after careful consideration of the parties' positions in this regard, by letter from the Secretary of the Tribunal dated June 2, 2005, granted Argentina a 45-day extension for the filing of its counter-memorial on the merits. By same letter, the Tribunal informed the Claimant that if it wished to avail of a similar extension for the filing of its reply on the merits, the Tribunal would be prepared to consider such request.

26. On August 1, 2005, the Respondent filed its counter-memorial on the merits.

27. On August 2, 2005, the Tribunal, having consulted with the parties, fixed a date for the hearing on the merits.

28. On September 28, 2005, the Claimant filed its reply on the merits.

29. By letter dated October 24, 2005, the Argentine Republic requested the production of certain documents by the Claimant and requested that the time limit for the filing of its rejoinder on the merits begin to run upon receipt of said documents.

30. By letter dated October 28, 2005, the Claimant submitted observations to Argentina's request for production of documents.

31. By letter from the Secretary of the Tribunal dated November 2, 2005, the Tribunal informed the parties of its decision on (a) Argentina's request for production of documents; and (b) Argentina's request for a recalculation of the time limit for the filing of its rejoinder on the merits. In its decision, the Tribunal also addressed a request by the Argentine Republic, included in its counter-memorial on the merits, to exclude the testimony of three witnesses enclosed with Claimant' memorial and reply on the merits. This decision provides as pertinent:

> "The Tribunal has carefully considered the Argentine Republic's requests and the Claimants' objections thereof. After due deliberation, the Tribunal has decided as follows:
>
> > […]
> >
> > (5) In regard to Argentina's request for the exclusion of the testimonies of Messrs. Perkins, Mairal and Peacock, the Tribunal, in accordance with ICSID Arbitration Rule 34, decides to admit the witnesses' statements filed by the Claimants. The Argentine Republic will have the opportunity to cross-examine these witnesses during the hearing on the merits. The Tribunal will inform the parties shortly on the manner in which cross examination will be conducted. This decision does not prejudge the question of the probative value of such testimonies, which will be determined by the Tribunal in due time."

32. By letter dated November 10, 2005, the Secretary of the Tribunal confirmed the parties' agreement to hold the hearing on the merits in this case in Santiago de Chile.

33. On December 5, 2005, the Argentine Republic filed its rejoinder on the merits.

34. On December 22, 2005, the Claimant filed a request for provisional measures regarding the oral testimony of two of its witnesses.

35. On December 29, 2005, the Argentine Republic filed, upon the Tribunal's invitation, observations to the Claimant's request for provisional measures.

36. On January 16, 2006, the Claimant raised a number of challenges to the document entitled "Evaluación empresas Camuzzi Gas Pampeana S.A. y Camuzzi Gas del Sur S.A." submitted by Argentina on December 13, 2005, and requested further documentation from the Respondent.

37. On January 16, 2006, the Tribunal, through letter from the Secretary, informed the parties of its decision on the Claimant's request for provisional measures of December 22, 2005, as follows:

> 1. The Tribunal has carefully reviewed the Claimants' request of December 22, 2005, including the attached documentation (i.e. injunction rendered on November 24, 2005 by the Federal District Court in Civil and Commercial Matters No. 8 of the Argentine Republic, regarding the provision of witness statements by Mr. Patricio Carlos Perkins in this and other ICSID proceedings).
>
> 2. The Tribunal has taken note that the above referred injunction specifically states that Mr. Perkins should:
>
>> 'refrain from making written statements or giving testimony at hearings in cases filed against the Argentine Republic before the International Centre for Settlement of Investment Disputes (ICSID), or regarding any other dispute which, directly or indirectly, results in the disclosure of data, information, investigation, conclusion, recommendation or report included within the scope of the confidentiality obligation set forth in clause 11.2 of the Consulting Agreement entered into between YPF, acting on behalf of the *Subsecretaría de Combustibles* and the firm "Patricio C. Perkins y Asociados S.A. and/or related to his position as Executive Director regarding the privatization of Gas del Estado.'(Translation into English provided by counsel for the Claimants on December 29, 2005).
>
> 3. The Tribunal has also carefully reviewed the Argentine Republic's observations on this matter of December 29, 2005. The Tribunal notes that Argentina has stated for the record:
>
>> a. That Mr. Perkins was duly notified of the injunction, that he accepted such notice and that he did not raise any objection at the time of the notice;

b. That the injunction seeks compliance with the obligations set forth in a confidentiality contract concluded by Mr. Perkins and the Argentine Government, which remain valid today;

c. That the Argentine Republic has opposed to Mr. Perkins' testimony from the outset of these proceedings;

d. That any reference to Mr. Mairal's testimony are speculative; and

e. That Articles 21 and 22 of the ICSID Convention could not apply to the relationship between Mr. Perkins and the Argentine Republic.

4. The Tribunal notes that, by letter of January 6, 2006, the Argentine Republic indicated its desire to cross-examine Mr. Hector Mairal during the forthcoming hearing on the merits. The Tribunal thus understands that the Argentine Republic will avoid any conduct that may impair Mr. Mairal's ability to provide oral testimony in these proceedings;

5. The Tribunal notes that, under Articles 21 and 22 of the ICSID Convention, witnesses shall enjoy immunity from legal process with respect to acts performed by them in the proceedings irrespectively of their nationality;

6. The Tribunal also notes that, pursuant to Article 26 of the ICSID Convention, consent of the parties to arbitration shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy;

7. Finally, the Tribunal notes, in accordance with, ICSID Arbitration Rule 34(3) the parties shall cooperate with the Tribunal in the production of the evidence;

In light of the above, the Tribunal has accordingly decided to adopt the following Order:

1. Mr. Perkins' written statement is admissible;

2. The Argentine Republic shall adopt the necessary measures to ensure full compliance with the ICSID provisions referred to above;

3. In particular, the Argentine Republic shall refrain from any conduct or omission that may, in any way, impair Mr. Perkins' ability to provide oral testimony in these proceedings;

4. The compliance with this Order shall be assessed by the Tribunal in due course."

38. By letter dated January 17, 2006, the Claimant informed the Tribunal its decision to withdraw the testimony of two of its witnesses.

39. By further letter of January 30, 2006, the Tribunal also informed the parties of its decisions on the series of issues raised by them in the correspondence exchanged from January 23 through 26, 2006, as follows:

"I write on instructions of the President of the Tribunal in connection with the parties' recent exchange of correspondence regarding the arrangements for the forthcoming hearing on the merits in the present case.

The Tribunal, having reviewed the Argentine Republic's letter of January 23, 25 and 26, 2006 and Claimants' letter of January 23, 24 and 26, 2006, has decided as follows:

i. The testimony of Professor Diego J. Dzodan is admissible, as the Tribunal wishes to have all the information pertinent to issues of valuation;

ii. Because of the late filing of Professor's Dzodan expert report, Claimants' request to examine the expert Abdala and/or Spiller for one hour after the Respondent's experts, including Professor Dzodan, is admitted;

iii. The Tribunal wishes to invite the parties to include in any post-hearing brief they may agree to produce, a brief final discussion of valuation issues;

[…]

vi. Production by the parties of witness or expert transcripts made at other hearings is not admissible as contrary to the principle of confidentiality of proceedings."

40. The hearing on the merits was held, as scheduled, from Monday, February 6 through Tuesday February 20, 2005, in Santiago de Chile. Present at the hearing were:

Members of the Tribunal:

Prof. Francisco Orrego Vicuña, President

The Hon. Marc Lalonde, P.C, O.C., Q.C., Arbitrator

Dr. Sandra Morelli Rico, Arbitrator

ICSID Secretariat:

Mr. Gonzalo Flores, Secretary of the Tribunal

On behalf of the Claimant:

R. Doak Bishop (King & Spalding LLP)

Craig S. Miles (King & Spalding LLP)

Roberto Aguirre Luzi (King & Spalding LLP)

Wade Coriell (King & Spalding LLP)

Martin Gusy (King & Spalding LLP)

Carol Tamez (King & Spalding LLP)
Zhennia Silverman (King & Spalding LLP)
Luis Lucero (Fortunati & Lucero)
Esteban Leccese (Fortunati & Lucero)
Ramón Lanus (Fortunati & Lucero)

Dave Smith (Sempra Energy International)

Luigi Predieri (Camuzzi International S.A.)
Juan Rimoldi Fraga (Camuzzi International S.A.)

On behalf of the Respondent:

Osvaldo César Guglielmino, Procurador del Tesoro de la Nación Argentina
Adolfo Gustavo Scrinzi (Procuración del Tesoro de la Nación Argentina)
Jorge R. Barraguirre (Procuración del Tesoro de la Nación Argentina)
Gabriel Bottini (Procuración del Tesoro de la Nación Argentina)
Ignacio Torterola (Procuración del Tesoro de la Nación Argentina)
Florencio Travieso (Procuración del Tesoro de la Nación Argentina)
Adriana Busto (Procuración del Tesoro de la Nación Argentina)
Pablo Fernández Lamela (Procuración del Tesoro de la Nación Argentina)
Tomás Braceras (Procuración del Tesoro de la Nación Argentina)
Nicolás Stern (Procuración del Tesoro de la Nación Argentina)
María Victoria Vitali (Procuración del Tesoro de la Nación Argentina)
Carlos Winograd (Procuración del Tesoro de la Nación Argentina)
Alicia Federico (Procuración del Tesoro de la Nación Argentina)
Fernando Risuleo (Procuración del Tesoro de la Nación Argentina)

41. The hearing began, as scheduled, on Monday February 6, 2006 at 9:30 a.m. Messrs. Bishop, Miles and Coriell made opening statements on behalf of the Claimant. Messrs. Scrinzi, Travieso and Barraguirre made opening statements on behalf of the Argentine Republic.

42. During the hearing, testimony was heard from Mr. George Morgan, Mr. Santiago Albarracín, Prof. José Álvarez, Mr. Héctor Mairal, Mr. Manuel Abdala, Prof. W. Michael Reisman, Prof. Sebastián Edwards and Mr. Martín Juan Blaquier for the Claimant. Testimony was heard from Mr. Jorge Gustavo Simeonoff, Mr. Eduardo Ratti, Mr. Walter Kunz, Mr. Horacio Vera, Mr. Cristian Folgar, Prof. Gabriel Bouzat, Mr. Daniel Chudnovsky, Dr. Diego J. Dzodan, Prof. William Burke White and Prof. Nouriel Roubini for the Argentine Republic.

43. As scheduled, closing arguments were presented by the parties at the closing session of the hearing on February 14, 2006. Messrs. Bishop, Coriell and Miles addressed the Tribunal on behalf of the Claimant. Messrs. Guglielmino and Barraguirre addressed the Tribunal on behalf of the Argentine Republic.

44. By letter dated February 15, 2006, the Tribunal informed the parties of its decision on a number of matters raised during the February 6-14 hearing, as follows.

> "I write on instructions of the President of the Tribunal as a follow-up to the hearing on the merits in the above proceedings, held in Santiago, Chile on February 6 through 14, 2006.
>
> The Tribunal has taken note of Messrs. Patricio Carlos Perkins', Raúl D. Bertero's and Juan Carlos Fassi's nonattendance of the hearing. The Tribunal has also taken note of Mr. Bertero's letter dated February 3, 2006, accompanied by counsel for the Claimants during the hearing and of Mr. Fassi's letter dated February 8, 2006, accompanied by the Argentine Republic during the hearing.
>
> In this connection and as anticipated during the hearing, the Tribunal, having heard from the parties and after due deliberations, has decided as follows:
>
> > i. Notwithstanding Messrs. Bertero's and Perkins' absences, their written testimony is admitted, as their absence is due to circumstances beyond their control;
> >
> > ii. In the case of Mr. Fassi, his written expert testimony (the P.A. Consulting Group report) is also admitted, as the Tribunal considers this expert testimony necessary to have a full view of the parties' position on valuation of damages.
>
> At the closing of the hearing, the Argentine Republic asked the Tribunal to dismiss the testimony of Mr. Santiago Albarracin and the expert testimony of Professor José Álvarez. As agreed by the parties, Argentina will submit its arguments in support of this request by Tuesday, February 21, 2006, and Claimants will file their response by Tuesday, February 28, 2006.

> Also, in accordance with the parties' agreement, post hearing briefs will be filed, simultaneously, by the parties on Monday, April 3, 2006. The post hearing briefs will not exceed 35 pages.
>
> Finally, the Tribunal has taken note of the parties' *Agreement on the Discontinuance of the Treatment of Certain Claims* of February 3, 2006, accompanied by the parties during the hearing. In light of this agreement, the Tax Claims described in Chapter VI, Section F of the Claimants' Consolidated Memorial on the Merits are discontinued in the terms described in the *Agreement*. The Award will also take note of this discontinuance in due course."

45. In accordance with the Tribunal' instructions, the Argentine Republic submitted its arguments on its request to dismiss the testimony of Mr. Santiago Albarracín and the expert testimony of Professor José Álvarez on February 21, 2006. Claimant filed, as directed by the Tribunal, its response on February 28, 2006.

46. On April 3, 2006 the parties filed their post-hearing briefs.

47. By letter of April 3, 2006, the Tribunal informed the parties of its decision regarding Argentina's request for the dismissal of the testimony of Mr. Santiago Albarracín and of the expert testimony of Professor José Álvarez. By same letter, the Tribunal informed the parties of its decision to retain independent expert advice so as to better understand the underlying assumptions and methodology relied upon in the valuation reports offered by the parties' experts. The Tribunal's decision in this regard follows:

> "I write to you, on instruction from the President of the Tribunal, in connection with some pending matters in the above proceedings:
>
> > i. In regard to the testimony of Dr. Santiago Albarracín and the expert testimony of Professor José Alvarez:
> >
> > The Tribunal has carefully reviewed the parties' arguments on this matter, set forth in their letters of February 21, 2006 (Respondent) and February 28, 2006 (Claimants). After due deliberation, and in accordance with ICSID Arbitration Rule 34, the Tribunal has decided as follows:
> >
> > (a) Dr. Santiago Albarracín was presented as a factual witness by the Claimants. As such, Dr. Albarracín provided written testimony of what he considered to be true facts. In his oral testimony, Dr. Albarracín added understandings and qualifications to his recollection of the facts. The Tribunal, considering the capacity in which Dr. Albarracín has testified, has decided to admit his testimony only insofar as it refers to facts he claims to have witnessed. The Tribunal will disregard all the qualifications and

> understandings made by Dr. Albarracín during his oral testimony, as they exceed the scope of the testimony he was called to provide;
>
> (b) The Tribunal has also decided to admit Prof. José Alvarez' expert testimony. The Respondent's arguments have not persuaded the Tribunal that there is a legal impediment for Prof. Alvarez to provide expert testimony in these proceedings."

48. By letter dated June 29, 2006, on instructions from the President of the Tribunal, the Secretary sent to the parties a list of the documents in the record provided to the independent evaluation expert for the preparation of his report.

49. On July 25, 2006, the Secretariat transmitted to the parties a *Preliminary Methodological Report* prepared by the independent evaluation expert. By that same letter the Tribunal invited the parties to file their observations on the preliminary report by August 16, 2006. By letter dated July 25, 2006, the Argentine Republic asked for a 30-day extension for the filing of its observations on the preliminary report. Claimants opposed such request by letter dated July 26, 2006.

50. On October 30, 2006, the Secretary, on instructions from the President of the Tribunal, transmitted to the parties a copy of the independent evaluation expert's final report. By same letter, the parties were invited to submit observations by November 14, 2006.

51. On November 2, 2006, the Secretary, on instructions from the President of the Tribunal, transmitted to the parties a copy of a revised final report by the independent evaluation expert. By same letter, the Tribunal extended the deadline for the parties' observations to November 17, 2006.

52. By letter dated December 12, 2006, the Tribunal requested the parties to submit additional information regarding the tariff base being considered by Argentina's Ente Nacional Regulador del Gas (ENARGAS) by the end of 2001 (Second Quinquennial Tariff Review of RQT II). Claimant filed the requested information on December 18, 2006. On that same date, the Argentine Republic's representatives informed the Tribunal that it had asked ENARGAS for the requested information and that it would

provide it to the Tribunal upon receipt. The documents were received by the Centre on December 28, 2006, and shortly thereafter transmitted to the Tribunal and the Claimant.

53. On February 9, 2007, the Argentine Republic submitted to the Secretariat copies of a decision on liability issued in another pending ICSID case.[3] The Claimant opposed to this submission by letter dated February 22, 2007. On February 28, 2007, the Tribunal informed the parties on its decision on this matter as follows:

> "I write to you, on instructions from the President of the Tribunal, in connection with the Argentine Republic's letter dated February 9, 2007 and counsel for the Claimants' response thereof dated February 22, 2007.
>
> The Tribunal has carefully considered the parties' submissions above and, after due deliberation, has decided, in accordance with Rule 34 of the ICSID Arbitration Rules, not to admit the documents enclosed with Argentina's February 9, 2007 letter. The Tribunal will also disregard Claimants' observations included in their February 22, 2007 letter that go beyond the question of the admissibility of Argentina's submission.
>
> The Tribunal is mindful of the parties' wish and right to fully present their cases. The Tribunal also understands its duty to conduct the proceedings in an orderly and efficient manner. The Tribunal is confident that the parties in these proceedings have been given plenty of opportunities to fully present their arguments on each issue in dispute. Accepting Argentina's non-invited submission at this late stage of the proceedings would open the door for a never ending exchange of arguments, unduly burdening both parties.
>
> Having reached its conclusion for the reasons set above, the Tribunal does not consider necessary to review the relevance of the decision enclosed with Argentina's submission, which was rendered by a different tribunal, over a distinctive set of facts and in view of a likely different set of arguments and evidence.
>
> The parties are invited to refrain from filing any further non-invited submission in these proceedings."

54. By letter dated March 8, 2007, the Argentine Republic proposed the disqualification of the President of the Tribunal. In its letter, Argentina made reference to the February 28, 2007 decision of the Tribunal rejecting its submission of the decision on liability issued in the *LG&E* case. In its letter, Argentina also requested the President of the Tribunal to indicate which of his coarbitrators have joined him in this decision.

---

[3] LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic (ICSID Case No. ARB/02/1); Decision on Liability of October 3, 2006.

55. By letter dated March 12, 2007, the Claimant objected to the Argentine Republic's disqualification of the President of the Tribunal.

56. By letter dated March 13, 2007, the President of the Tribunal declined Argentina's request, referring to ICSID Arbitration Rule 15(1).

57. By letter dated March 16, 2007, the Argentine Republic proposed the disqualification of all Members of the Tribunal in accordance to Article 57 of the ICSID Convention.

58. By letter of March 22, 2007, the Secretary of the Tribunal invited the Members of the Tribunal to provide explanations regarding the disqualification proposal, as envisaged in ICSID Arbitration Rule 9(3). By same letter, the Secretary of the Tribunal confirmed the suspension of the proceedings pursuant to ICSID Arbitration Rule 9(6).

59. Professor Francisco Orrego-Vicuña and Mr. Marc Lalonde furnished explanations by respective letters dated March 23, 2007. Dr. Sandra Morelli furnished explanations by letter dated March 26, 2007. Copies of these letters were circulated by the Secretary of the Tribunal to the parties on April 4, 2007.

60. By letter dated April 12, 2007, Argentina submitted observations to the communications of the Members of the Tribunal. Claimants submitted observations on April 19, 2007.

61. By letter of May 2, 2007 Argentina, forwarded to the Tribunal the agreement between UNIREN and Camuzzi titled "Acta Acuerdo de Adecuación del Contrato de Licencia de Distribución de Gas Natural."

62. By letter dated May 4, 2007, the Argentine Republic requested the Arbitral Tribunal to review the Claimants' witness testimony of Mrs. María de los Ángeles Alcolumbre which disputes the veracity of the testimony of Mr. George Michael Morgan.

63. On May 15, 2007, the Secretary-General of ICSID wrote to the Members of the Tribunal requesting them to confirm her understanding that the Tribunal, like other ICSID tribunals, gives due consideration to published decisions, in particular, the Decision of Liability issued in ICSID Case No. ARB/02/01 (LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic).

64. On May 16, 2007, the President of the Tribunal, on behalf of the Tribunal, confirmed that the Decision on Liability has been considered by the Tribunal in its deliberations.

65. By letter dated May 18, 2007, the Argentine Republic submitted observations to the Tribunal's letter of May 16, 2007.

66. By letter of June 5, 2007, the Secretary-General of ICSID informed the parties that the Chairman of ICSID Administrative Council had rejected the Respondent's proposal to disqualify the Members of the Tribunal. In accordance with ICSID Arbitration Rules 9(6) the proceedings were resumed on this date.

67. On June 21, 2007, the proceeding between Camuzzi International S.A. and the Argentine Republic was suspended until January 31, 2008, following an agreement of the parties.

68. By letter of June 22, 2007, Sempra Energy International clarifies its definition of "interest."

69. By letter dated June 25, 2007, Argentina submitted a copy of a letter addressed to Mr. Abraham D. Sofaer by the U.S. State Department dated September 15, 2006, regarding the U.S. position on the interpretation of certain provisions in the U.S. Bilateral Investment Treaties.

70. By letter of July 2, 2007, Claimant objected to the submission of the State Department letter. With a letter of the same day Argentina commented on Claimant's letter of June 22, 2007.

71. By letter dated July 6, 2007, Claimant asked the Tribunal to declare inadmissible Respondent's submission of Ms. Alcolumbre's labor lawsuit documents and the submission on the merits.

72. The Tribunal continuously deliberated by correspondence, meeting for this same purpose on a number of occasions. Throughout the proceedings, the parties' numerous procedural applications were promptly and unanimously decided by the Tribunal.

3. Declaration of Closure of the Proceeding

73. ICSID Arbitration Rule 38(1) requires that when the presentation of the case by the Parties is complete, the proceeding shall be declared closed.

74. Having reviewed all of the presentations by the parties, the Tribunal, came to the conclusion that there was no request by a Party or any reason to reopen the proceeding, as is possible under ICSID Arbitration Rule 38(2).

75. Accordingly, by letter dated July 19, 2007, the Tribunal declared the proceeding closed, in accordance with ICSID Arbitration Rule 38(1).

C. Considerations

76. A number of awards issued by ICSID tribunals have dealt with many issues concerning the measures adopted by the Respondent which have also been brought before this Tribunal. In some instances, counsel for each side has been the same as in previous cases and memorials have been written in similar or identical language. Members of this Tribunal have also sat in other such cases. On occasion, the wording used in the paragraphs that follow resembles that of prior awards, particularly insofar as it concerns the explanation of the positions of the parties and some of the considerations relating thereto. The Tribunal, however, has examined every single argument and petition on the basis of their merits in this proceeding.

The Stamp Tax Claim (Discontinuance)

77. Claimant included in paragraph VI of its memorial on the merits (labeled "The Investment Dispute") a section named "Imposition of Illegal Taxes," concerning claims related to stamp taxes, provincial gross sales taxes and municipal taxes for the occupation of public domain ("the Tax Claims").

78. During the hearing on the merits of February 6-14, 2006, the parties agreed to discontinue the proceedings concerning the Tax Claims.

79. On February 15, 2006, at the end of the hearing on the merits, after having heard the position of the parties, the Tribunal issued a Procedural Order on Discontinuance of the Stamp Tax Claims embodying the parties' agreement on the discontinuance, without prejudice to the merits of the proceeding of the stamp Tax Claims.

80. The Procedural Order decides as follows:

> *[…] the Tribunal has taken note of the parties'* Agreement on the Discontinuance of the Treatment of Certain Claims *of February 3, 2006, accompanied by the parties during the hearing. In light of this agreement, the Tax Claims described in Chapter VI, Section F of the Claimants' Consolidated Memorial on the Merits are discontinued in the terms described in the Agreement. The Award will also take note of this discontinuance in due course.*

81. The Tribunal confirms in this Award the discontinuance of such Stamp Tax Claim in the terms of the Agreement noted.

The regulatory framework of Argentina's Privatization Program

82. Argentina's privatization program began in 1989 and developed gradually through the adoption of its basic governing legal and regulatory framework. One such basic instrument, introduced in 1991, was the Convertibility Law[4] which provided for the convertibility of the Argentine currency and, by means of its implementing Decree

[4] Law 23.928 of 1991 also known as the Convertibility Law.

(Decree 2128/91), fixed the Argentine peso at par with the United States dollar. Various other measures were directed at opening the economy to foreign trade and investment.

83. A second set of rules that is relevant specifically to the privatization of the gas industry, with which the present dispute is concerned, was introduced in 1992 by the Gas Law (Law 24.076) and the implementing regulations embodied in the Gas Decree (Decree 1738/92). Under this regulatory framework, gas transportation was separated from distribution and eight companies were established to conduct distribution activities. This dispute concerns the investment of Sempra International ("Sempra") in two companies, Sodigas Pampeana S. A. ("Sodigas Pampeana") and Sodigas Sur S. A. ("Sodigas Sur"), which in turn are the owners of two such distribution companies, Camuzzi Gas Pampeana ("CGP") and Camuzzi Gas del Sur ("CGS"), which obtained licenses as a result of the privatization effort.

84. A third set of rules relevant to this dispute is the Standard Gas Transportation License or "Model Licence" approved by Decree 2255/92. This includes the applicable Basic Rules. An "Information Memorandum" concerning the privatization of Gas del Estado, the former State-owned transportation and distribution company, together with a "Pliego" explaining the bidding rules and the pertinent legal and contractual arrangements, were provided to prospective investors in order to organize the bidding process. The parties dispute the legal significance of these information materials.

85. The Claimant explains that in making the decision to invest in CGS and CGP, it relied specifically on the conditions offered by these various legislative and regulatory enactments. The Claimant asserts that these conditions included: (i) a license for a term of 35 years, with a possible 10-year extension; (ii) the calculation of tariffs in U.S. dollars and their semiannual adjustment according to changes in the U.S. Producer Price Index ("PPI"); (iii) a commitment that there would be no price freeze applicable to the tariff system and, if one was imposed, that the licensee had a right to compensation; (iv) the commitment that the license would not be amended by the Government, in full or in part, except with the prior consent of the licensee; (v) a commitment not to withdraw the license except in case of specific breaches listed; and (vi) the principle of indifference in respect of subsidies granted by the Government so that the distributor's income would not be altered.

86. The Claimant maintains that all of the above were in turn related to the setting of gas tariffs at a level that would ensure that operators received revenues sufficient to cover all reasonable costs, taxes and depreciation, as well as a reasonable profit. In this context, the Claimant asserts, the Government of Argentina made additional representations concerning the immediate and automatic adjustment of tariffs in case the parity between the dollar and the peso experienced a variation, the use of the New York exchange rate for adjustments, and the passing through to consumers of all cost variations resulting from changes in tax provisions. It is further argued that these rights resulted in an allocation of risk with respect to currency fluctuations or devaluation that protected the Licensees from such risks.

87. The Government has a different understanding of the meaning and extent of these various elements of the legal and regulatory framework, as will be discussed further below.

The Claimant's investment in CGP and CGS

88. The Claimant explains that it indirectly owns 43.09% of the shares of Sodigas Sur and Sodigas Pampeana, which in turn, respectively, own 90% and 86.09% of the distribution licensees CGS and CGP. The investment began in April 1996 when the Claimant acquired a 12.5% interest in Sodigas Pampeana and Sodigas Sur from Citicorp Equity Investment for the amount of U.S. $ 48.5 million.

89. This participation was increased in March 1998 when the Claimant acquired an additional 9% interest in the Licensees from the Argentine company Loma Negra for an amount of U.S. $ 42.4 million, thus totalling an interest of 21.545%.

90. Ownership was further increased in October 2000 when the Claimant acquired shares in the Licensees for U.S. $ 159.4 million from Consolidated Natural Gas, thus doubling its participation to a total of 43.09%. Also in October 2000 Sodigas Pampeana acquired in auction from the Government of Argentina an additional 6.35% interest in CGP, totalling a 77.21% interest. On October 11, 2000, Camuzzi Argentina transferred

to Sodigas Pampeana an 8.88% direct interest in CGP, which increased Sodigas Pampeana's interest in CGP to the current 86.09%.

91. The Claimant also made in July 1999 a pro-rata share equity contribution of U.S. $ 32.3 million which was used to pay existing Sodigas Mid-Term Notes.

92. The Claimant asserts that its total investment amounts to U.S. $ 350 million, corresponding to U.S.$114 million for Sodigas Sur, U.S.$180 million for Sodigas Pampeana and U.S.$56 million loaned by Sempra to CGP and CGS. The Government of Argentina questions the real amount involved in the investment and its actual dates, a matter that the Tribunal will consider to the extent relevant in the context of valuation.

The measures complained of

93. The Claimant argues that a number of measures adopted by the Government of Argentina in the period 2000-2002 and thereafter have resulted in the permanent abrogation and repudiation of most of the rights it had under the regulatory framework and the License, and that these rights will not be restored. The Claimant asserts that this is particularly so in the case of the measures prohibiting PPI adjustments of tariffs, the derogation of the calculation of tariffs in U.S. dollars, the unilateral modification of the License by the Government without payment of compensation, and the failure to reimburse subsidies owed.

The legal claims

94. The Claimant's main argument in this case is that the various measures complained of have been adopted and implemented in violation of specific commitments made to the investors, and of the contractual obligations which the Government undertook under the Licenses, all in a manner contrary to the applicable legal and regulatory framework and the specific guarantees provided under the Argentina-U.S. bilateral investment treaty. All such commitments and guarantees were determinative of the decision to invest in CGS and CGP, the Claimant further asserts.

95. In the Claimant's view, the wrongful expropriation of the investment has followed from the above abrogation in the forms of direct and indirect, or creeping, expropriation. It is also claimed that fair and equitable treatment and legitimate expectations have been violated, arbitrariness and discrimination have characterized the measures adopted, full protection and security have not been provided to the investor, and the Treaty "umbrella clause" has been breached. It follows, according to the Claimant, that all of the guarantees provided under Article IV of the Treaty have been breached.

The legal defenses

96. The legal defense of the Republic of Argentina is based principally on the arguments that the legal and regulatory framework governing the privatization provided only for the licensees' right to a fair and reasonable tariff, and that the right to the calculation of the tariffs in U.S. dollars was a feature that could last only so long as the Convertibility Law was in force, but not if this law was abandoned.

97. The Respondent also argues that if the investors relied on the information conveyed by private consulting firms, such as that contained in the Information Memorandum, this cannot be attributed to the Government, which has expressly disclaimed any responsibility for such information.

98. In the Government's view, the legal and regulatory framework of Argentina has been strictly enforced through the adoption of the measures in question, and none of it involves a breach of the Licenses or the Treaty. Moreover, the Government maintains that its responsibility is excluded both under its legislation and jurisprudence on emergency, and also by the rules of international law governing the state of necessity, whether customary or contained in the Treaty.

99. The legal claims put forth by the Claimant, and the defenses opposed by the Respondent, will be examined in the necessary detail further below in connection with each of the specific measures complained of, and in the context of the applicable law.

The first claim: PPI adjustment of tariffs

1. The facts of the claim

100. Throughout the 1990s, the tariff system established under the regulatory framework and the License operated relatively smoothly. By the end of that decade, however, the situation began to change as economic, social and political difficulties in the Republic of Argentina became gradually evident. It is in this last context that Government officials met with industry representatives in late 1999 and early 2000 to discuss the suspension of tariff increases. As a result, an agreement was signed on January 10, 2000, postponing for six months the PPI adjustment due on January 1, 2000 and providing for the recovery of the deferred increase with interest for the period from July 1, 2000 to April 30, 2001.[5]

101. This agreement, however, would not last long. Within a few months, the Government had insisted that tariffs be frozen altogether for a two-year period. As a result, a second suspension agreement intervened on July 17, 2000, suspending PPI adjustments from July 1, 2000 through June 30, 2002. It further provided that the differences would be placed in an interesting-bearing stabilization fund, and that tariff increases would resume at the end of the suspension period, including with respect to the recovery of the deficits originating in these arrangements (Decree 669/00). The Government expressly stated in this last decree that investments connected to the privatization process were protected by the legislation in force, and especially by the bilateral investment treaties signed by the Government. It should be noted that while the Government considers the above-mentioned agreements to be the outcome of genuine consent by the Parties, the Claimant asserts that they were pressured by the Government into giving consent, and that the motivation behind these measures was political.

102. Not long after the second agreement was reached, a judicial injunction was requested by the Argentine Ombudsman ("Defensor del Pueblo de la Nación") against

[5] Enargas Resolutions 1472/00 for CGS and 1473/00 for CGP.

Decree 669/00 on the ground that it was both unconstitutional and contrary to Argentine law. The injunction was granted on August 18, 2000, suspending this decree pending a ruling on the legality of the PPI adjustment mechanism. The injunction was appealed by both the Government regulatory agency for the gas sector (ENARGAS) and the Ministry of Economy, on the ground that it would upset the economic balance of the license and alter the system of tariffs established in U.S. dollars and their PPI adjustment. Both appellants described the injunction as "arbitrary" and a "true legal outrage." The appeal was, however, rejected on October 5, 2000.

103. On the basis of this injunction, ENARGAS directed the licensees to suspend all PPI adjustments. It has also rejected all requests for adjustment made since then. This includes the PPI adjustment under the first agreement noted. As a result, no such adjustments have been made since 1999.

2. The Claimant's arguments

104. The Claimant explains that the PPI adjustment was an essential guarantee under Article 41 of the Gas Law that was directed at preventing any erosion of tariffs in U.S. dollars, and at establishing an incentive for attracting long-term dollar financing.

105. In fact, the Claimant argues in this respect that Article 41 of the Gas Decree provided for the adjustment of tariffs "in accordance with a formula based on international market indicators," a guarantee that was confirmed by the Basic Rules which, as explained in the Information Memorandum also invoked by the Claimant, was specifically related to the PPI. The Claimant asserts that it is a vested right and was so recognized under Decree 669/00 noted above in describing this adjustment as a "legitimately acquired right."

3. The Respondent's arguments

106. The Government has a different view about the meaning of this measure. The Respondent explains that the PPI adjustment no longer made sense in 2000 when the Argentine economy entered into recession and deflation, with lower costs and prices, and U.S. inflation became considerably higher than that of Argentina, thus making the PPI an unreasonable mechanism that would only lead to tariff increases at a time when the economy was experiencing serious difficulties and, later, when it ended up in a major crisis. Indexation of tariffs was, the Respondent maintains, meant only to reflect the change in the value of goods and services, as had been expressly envisaged in Article 41 of the Gas Law. This is what in the Respondent's view justifies the need for the agreements made with the licensees, and together with the interests of consumers was also the issue considered by the judge granting the injunction. In any event, it is asserted, the Government in suspending this adjustment was only complying with a binding judicial decision, even if did not agree with its terms.

107. The Respondent also argues in this connection that as the purpose of the PPI adjustment was simply to reflect the evolution of cost changes, it cannot be understood as a guarantee to ensure a given value of tariffs in U.S. dollars. The Respondent takes the view, contrary to that of the Claimant, that the costs envisaged include operational costs which are a part of the concept of fair and reasonable tariffs according to the Gas Law.

108. In any event, it is also maintained by the Respondent that the suspension of the adjustment was first agreed with the licensees and next ordered by the judicial injunction of August 2000. It is also maintained that the fact that the Government appealed the injunction with arguments shared by the Claimant does not mean that the Government should at present ignore the decisions of the Argentine judiciary in dismissing the appeal, in contravention of its duty under the Argentine Constitution and administrative law.

4. Additional discussions about the ENARGAS resolutions

109. The parties have also contested the meaning of the ENARGAS Resolution that ordered the observance of the judicial injunction of August 2000 (Resolution 3480/00). In the Claimant's view, the Resolution went beyond the judicial suspension, which referred only to the adjustments embodied in the second agreement (i.e., those due as from July 1, 2000), and not also to what had been agreed for the first semester in the first agreement. On these bases, the Claimant requested the reconsideration of the ENARGAS Resolution, but this request was denied. The Respondent explains that the Resolution in question established only that the injunction should be observed and the tariffs managed accordingly.

5. The Tribunal's findings on the first claim

110. The Tribunal observes at the outset that it is correct to argue that Article 41 of the Gas Law, while providing for the adjustment of tariffs in accordance with a formula based on international market indicators, also related this formula to the change in value of goods and services. The formula was not defined under the Law, however. This task was left to the Basic Rules of the License, which provided in this respect that tariffs were to be adjusted semi-annually in accordance with the PPI. This was the information also conveyed to investors by the Information Memorandum.

111. The Tribunal is persuaded that the Government shared this understanding at the time and indeed for almost a whole decade. This explains Decree 669/00, which dealt specifically with this mechanism and referred to the adjustment under it as a "legitimately acquired right", thereby expressing an unequivocal recognition of the existence of such a right.

112. It may also be noted that when the Chilean gas carrier *Colbún* pretended to pay in pesos for billings under export contracts on the ground that the PPI had been eliminated, and the case was taken to court, the view taken by ENARGAS and adopted by the Court of Appeals in that case affirmed that U.S. dollar-denominated tariffs and the PPI adjustment remained unaffected in respect of export contracts, and thus that

such a right was quite independent of the question of costs and even of the Convertibility Law, which by that time had been derogated.[6]

113. Even if the Information Memorandum was in fact prepared by private consultants and the Government expressly disclaimed responsibility for it, and even if there had been some error in this respect, what is unlikely in the case of highly prestigious consulting firms engaged by the Government to explain the privatization plan to prospective foreign investors, such errors would have passed unnoticed by competent government officials. Moreover, the Government would in such a situation have been duty-bound to issue a clarification to avoid the engendering of a false legitimate expectation. No such clarification was ever issued. It is thus the Tribunal's conclusion that the licensees had a right to enjoy the PPI adjustment under both the regulatory framework and the License.

114. This is not to deny the Government's sovereign authority to change its mind, as in fact it later did. Its rationale might have been perfectly reasonable in the light of changing economic conditions in the country, a matter which is not for the Tribunal to judge. But even to achieve this end, the Government had other mechanisms available under the License and the regulatory framework, including the quinquennial tariff revision (Revisión Quinquenal de Tarifas or RQT). Mr. Patricio Carlos Perkins, a witness for the Claimant who had important responsibilities during the privatization process and in the preparation of the License, has explained that under "a price cap regime, between every periodic tariff review, tariffs are solely adjusted based on automatic indexes … to assure the regulated company that the value of tariffs remain constant in real terms."[7] One such revision had already taken place ("RQT I") and another was begun to govern the tariffs precisely as from 2002 ("RQT II"), but this latter procedure was never finalized. If the Government decided to take a different route, this cannot be to the detriment of investors' rights.

115. The Tribunal understands the meaning of the ENARGAS Resolution in the context of the related judicial injunction of PPI adjustments and this latter action's

---

[6] ENARGAS response and Court of Appeals decision of May 27, 2005 in *Colbún S. A. v. Ente Regulador del Gas*, both as introduced by the Claimant in cross-examination of the Respondent's expert Dr. Gabriel Bouzat.

[7] Additional Witness Statement of Mr. Patricio Carlos Perkins of May 2005, par 23.

object. While the Claimant is right to point out that the injunction did not refer to adjustments relating to the first agreement, it is clear that the injunction in question sought to suspend the increase of tariffs in general. ENARGAS cannot be faulted for having so understood it. It must be kept in mind that the first agreement's undertakings would have also begun to materialize during the second semester of 2000, the period with which the injunction was concerned.

The second claim: "Pesification of tariffs" under the Emergency Law

1. The facts of the claim

116. On January 6, 2002 the Government enacted Law No. 25.561, also known as the "Emergency Law." The essence of the Law's purpose was the elimination of the right to calculate tariffs in U.S. dollars, and the conversion of tariffs to pesos at the fixed rate of exchange of one dollar to one peso. The Law further authorized the Government to devalue the peso, which a few days later was fixed at a new exchange rate of 1.40 pesos per dollar. A month later, this rate was replaced by a floating exchange rate system.

2. The Claimant's arguments

117. The Claimant asserts that of the several tariff-related guarantees mentioned above, the one concerning the calculation of tariffs in U.S. dollars is paramount and was abrogated by the Emergency Law. The Claimant maintains that this guarantee against currency fluctuations was the central and essential protection offered to attract foreign investors to the privatization process. The Claimant further asserts that its claim is unrelated to the issue of devaluation, and is likewise unrelated to questions arising under the Convertibility Law, as the Respondent argues. The Claimant instead bases its claim on the alleged breach of guarantees made available to investors in order to keep them clear of the extreme fluctuations that had historically characterized the Argentine economy.

118. In support of this view, the Claimant invokes in particular Article 41 of the Gas Decree, which provides that "Transportation and Distribution Tariffs shall be calculated in Dollars." Similarly, Article 9.2 of the Basic Rules indicates that the "tariff has been calculated in US dollars." The tariff would then be expressed in pesos at the time of billing. The Claimant further contends that this understanding is confirmed by the minutes of a Privatization Committee meeting held on October 2, 1992, which state in connection with Article 9.2 of the Basic Rules that it "makes sufficiently clear that the tariffs are in dollars and that they are expressed in convertible pesos, and, therefore, in case of an eventual amendment to the Convertibility Law, they should be automatically re-expressed at the modified parity." In the view of the Privatization Committee, this understanding made it unnecessary to include additional rules in the License concerning this guarantee.

119. The Claimant further invokes a number of provisions in confirmation of this understanding, among which is the wording of Annex F of the Pliego, to the effect that tariffs "shall be adjusted immediately and automatically in the event that parity varies," and thus that the "quantity of Argentine currency necessary to acquire a US dollar in the New York market shall be applied."

120. The Claimant also invokes in support of its argument the opinion of several witnesses and legal experts. For example, Mr. Philip Dexter Peacock states in this context that the "assets simply could not be marketed unless tariffs were to be calculated in U. S. dollars," particularly because of the high risk of inflation in Argentina at the time of the privatization, and also due to the experience of the preceding years.[8] Although the Convertibility Law was in force at the time these arrangements were made, it was not in the view of Professor Hector Mairal relevant to the existence of the Licensees' rights to calculate tariffs in US dollars since that law concerned only the question of "peso holders to change their pesos into dollars, but not with the exchange rate between the peso and the dollar"[9] Mr. Perkins's witness statement in this respect will be considered further below.

[8] Witness Statement of Philip Dexter Peacock of June 21, 2003 Cl. Exh. 7B, paras.14-15.

[9] Second Expert Report of Professor Héctor A. Mairal of September 14, 2005, Cl. Exh 188, para. 34.

121. The Claimant also maintains that while the Government has recognized the difficulties many companies are going through, and on occasion has been willing to authorize small emergency adjustments, these have been systematically blocked by court injunctions. The Tribunal must note in connection with this argument that the licensees in this case have reached in 2007 an agreement with the Government as to certain tariff adjustments which the Tribunal will examine further below. The Bill on National Public Utilities, introduced by the Government in Congress in 2004, has in the Claimant's view also been a cause of concern because, if approved, it would result in the final and complete abandonment of the regulatory system and the conditions governing the licenses. The Claimant also argues that a trusteeship arrangement established for the expansion of the gas transportation network does not benefit the existing licensees despite the inclusion of a tariff adjustment. To the contrary, the Claimant asserts, the new scheme benefits only new investors.

3. The Respondent's arguments

122. The Government attaches an entirely different meaning to the developments outlined above. It first explains that the crisis that erupted in full force in late 2001 has been among the most severe in world economic history, with dramatic consequences in social well-being and increased poverty, deep recession, deflation and unemployment, all of it leading to catastrophic political events and institutional collapse. The Respondent further explains that in this context, the Government had no other option than to enact the Emergency Law and abandon the convertibility regime. The Respondent points out that the pesification of contracts and financial obligations that followed was applied to the Argentine economic system as a whole and did not particularly target foreign investors in utility companies.

123. The Respondent believes that the essential provision governing this issue is embodied in Article 2 of the Gas Law, which provides that tariffs shall be fair and reasonable. This concept is also included in Article 2(6) of the Gas Decree in terms of the obligations which ENARGAS must ensure. The concept of a fair and reasonable tariff is connected, in the view of the Government, to the objectives of covering operating costs, taxes and depreciation, and earning a reasonable income, all within the

framework of an efficient operation providing satisfactory service at the least possible cost and a return similar to other activities of comparable risk.

124. In this context, the Respondent contends that the reference made to the calculation of tariffs in U.S. dollars, and the related PPI adjustment, could only be understood as being inextricably related to the Convertibility Law in that they were established in the normative framework governing the privatization of the gas industry. This is confirmed, the argument follows, by the express reference of Article 41 of the Gas Decree to the fact that tariffs shall be expressed in pesos convertible under the Convertibility Law, and taking into account the parity established in Article 3 of the Regulatory Decree of the Convertibility Law (Decree No. 2.128/91), namely the one-to-one parity between the peso and the dollar. The Respondent finds further confirmation of this link to the Convertibility Law in Article 9.2 of the License, which also referred to Article 3 of the Regulatory Decree of the Convertibility Law and its eventual modifications.

125. The Respondent asserts, moreover, that the mechanism envisaged only the possibility of a modification of the peso-dollar relationship under the Convertibility Law, but not a situation in which the Convertibility Law was altogether abandoned. In the Respondent's view, the modification of the parity under the Convertibility Law is different from the abandonment of the Law. The Respondent believes that in the latter scenario, the calculation of tariffs in U.S. dollars no longer made any sense, and explains that this was also the understanding of the Privatization Committee, which recorded in its minutes of July 17, 1992 that the parity should be adjusted in accordance with the New York market and that "the proposed adjustment is not based on the present exchange rate, but on the convertibility exchange rate." The Committee concluded that "as long as Argentina does not abandon the convertibility regime no adjustment of tariffs shall take place under this concept."[10]

126. The Respondent also reads the above-referenced minutes of the Privatization Committee of October 2, 1992 as expressly conditioning upon the Convertibility Law the adjustment of tariffs in case of modification of the parity. The Respondent argues

[10] Minutes of the Privatization Committee, July 17, 1992, Exhibit 43 to Argentine's counter memorial.

that this is so particularly because the Committee, in concluding that the License offered a sufficient guarantee in this respect, rejected a proposal by Mr. Perkins that would have provided for adjustment in case convertibility was abandoned. The Respondent further maintains that the Gas Decree makes no mention at all of the possibility of the Convertibility Law's abandonment.

127. Although the above-noted Annex F of the Pliego seems to convey a broader conception of tariff adjustment in case of parity modification, the Respondent points out that this Annex was held to be merely descriptive. The Respondent ascribes this same quality to the Information Memorandum, on which the Claimant also relies. The Respondent explains that this latter document is non-binding and was not prepared by the Government, which expressly disclaimed any responsibility for it.[11] It is further observed that in any event the Memorandum was prepared before the regulatory framework was enacted.

4. Discussion of the historical experience

128. The parties' views of this specific claim have also differed significantly in respect of their arguments concerning the historical experience of the privatization of ENTEL, the national telecommunications company. The Respondent asserts that this privatization confirms that the calculation of tariffs in U.S. dollars was inextricably related to the Convertibility Law.

129. ENTEL was privatized under the Law on the Reform of the State, albeit before the Convertibility Law was enacted. Tariffs had originally been set in "Australes," the Argentine currency at the time, and adjusted in accordance with the Consumer Price Index of Argentina (IPC). The Respondent explains that because the Convertibility Law froze tariffs and adjustments in pesos, the parties agreed to express tariffs in U.S. dollars and to adjust them on the basis of PPI variations. This was, however, done without specific reference to the Convertibility Law, unlike in the cases of CGS and CGP. The Respondent finds this evolving framework to be evidence that no exchange rate

[11] Legal Opinion of Mr. Gabriel Bouzat and Mr. Carlos F. Rosenkrantz, Rebuttal Opinion, paras. 20-23 filed with Respondent's Rejoinder. See also Argentina's counter memorial at para. 172-173.

assurance was given. Consequently, in the Respondent's view, the devaluation risk was not eliminated or shifted to the Government, as argued by the Claimant, and the Respondent received no compensation for any such currency risk.[12]

130. The Claimant draws the opposite conclusion about this historical experience. It first explains that even before any changes were made, the ENTEL tariffs included a U.S. dollar component to temper devaluation effects that was automatically triggered if certain ratios were met. The Claimant next maintains that the changes introduced after the Convertibility Law was enacted, were made precisely to ensure that no adverse effects would ensue for the investors, and thus to provide incentives for new investments.

131. The Claimant finds additional confirmation of the lack of relation between the system and the Convertibility Law in the fact that the tariffs calculated in U.S. dollars were to be billed in pesos at the exchange rate applicable at the time of billing. The Claimant also explains that underwriting arrangements made with banks, and the placement of the remaining shares of the telecommunications company in the New York and Buenos Aires markets, resulted in additional benefits to the Government that would not have been possible had the risk of currency fluctuation not been eliminated under the tariff system.

[12] Argentina's counter memorial, p. 65.

5. The discussion about country risk

132. Another issue dividing the parties is whether tariffs were higher because they included a premium for the risk that convertibility might be abandoned at some point in the future. The Respondent equates this "convertibility risk" with country risk or default risk, and argues that if the licensees were guaranteed that U.S. dollar tariffs would be converted to pesos at the prevailing exchange rate, they would be obtaining a double benefit since the tariffs were already set higher to offset this risk.[13]

133. In the Respondent's view, the establishment of the original tariffs took into consideration the debt bonds of the Argentine Republic (Bonex 1989), and resulted in a higher debt cost of 9.50%. RQT I also considered a 6.47% country risk, while RQT II envisaged a figure of 7.40% on this basis, with all of it leading to additional return over the invested capital. The Tribunal is mindful of the fact that RQT I was finalized and implemented while RQT II was in an advanced stage of preparation but did not materialize as a result of the emergency measures. The Respondent concludes from this that the Claimant cannot pretend at one time to charge higher tariffs for a risk, and later, if the risk actually materializes, argue that it should not bear such a risk.

134. The Claimant maintains that such an argument is wrong because country risk relates only to a default on sovereign debt, which is conceptually different from the risk concerning "pesification" and the freezing of tariffs. The latter was, in the Claimant's view, allocated to the Government through the License and the envisaged tariff system, for which the investors, not the Government, paid more for shares benefiting from this guarantee.

6. The Constitutional debate

135. The Respondent asserts on this distinct issue that gas distribution licenses entail a relationship governed by public law, which must take into account not only the interest of the parties concerned but also the public interest. To calculate tariffs in U.S.

[13] Legal Opinion by Experts Mr. Gabriel Bouzat and Mr. Carlos F. Rosenkrantz, Second Legal Opinion, paras. 32-35.

dollars independently of the Convertibility Law would in the Respondent's view be unconstitutional since it would be contrary to reasonableness, the Constitution and the Gas Law. In the view of a witness for the Respondent, were rates to have been denominated in U.S. dollars at a parity different from that of the Convertibility Law, "the exchange risk would have eventually passed on to the users, who are the least prepared to face the financial issues of the utility providers."[14] In any event, the Respondent maintains that it would be contrary to the Argentine legal system to keep tariffs in U.S. dollars in the context of a floating rate system.

136. In the Claimant's opposing view, the basic constitutional principle relevant to the situation is instead the respect of private property. The Claimant contends that this cannot be ignored by the Government after it enacted the rights and guarantees offered to investors pursuant to its own regulatory powers. It is additionally argued that a fundamental principle of the legal system is that if the economic equation of a contract is not respected, the resulting losses must be compensated.

7. Discussion about an incomplete regulatory framework

137. Still one other issue divides the opinion of the parties in connection with the meaning of the tariff system. In the Respondent's view, because the regulatory framework was incomplete and did not foresee what should be done in case the Convertibility Law was abandoned, it falls upon the Government to adapt the licenses to the new situation. The Respondent explains that this was done by means of the pesification of the whole economy, the dollarization of export-related tariffs, and the renegotiation of contracts and licenses.[15]

138. The Respondent maintains that this adaptation is the duty of the Government in respect of a public utility service, and that such regulatory powers are exercised in a discretionary manner, as is accepted practice in economic theory and judicial decisions in both Argentina and other countries, particularly in respect of adaptation necessitated by a major economic crisis. The Respondent also invokes Supreme Court decisions in

[14] Witness Statement of Mr. Cristian Folgar of July 2005, para. 48.
[15] Witness Statement of Mr. Cristian Folgar of July 2005, para. 40 *et seq.*

Argentina to the effect that there is no right to normative stability since no one is entitled to the maintenance of any law or regulation, and that the amendment of norms by other norms cannot be considered as being contrary to a right under the Constitution.

139. The Claimant contends in opposition that the regulatory framework cannot be considered incomplete because all of the assurances given were specifically related to the possibility that the Convertibility Law might be abandoned in the future. The only purpose of the Emergency Law in this context, it is maintained, was to unilaterally change the tariff system and its related aspects. Moreover, the Claimant argues, none of the mechanisms provided under the License to undertake a tariff revision were employed.

140. The Claimant also points out that the Argentine legislation itself provides all necessary guarantees in terms of fundamental safeguards of acquired rights and legitimate expectations, as has been repeatedly held by the Argentine Supreme Court. It is further argued that even the regulatory powers of governments which are recognized in cases of changed circumstances are limited and subject to specific conditions, and do not reach into questions of compensation and financial advantages. Least of all, the argument goes, do they alter the economic balance of the contract. The Claimant further asserts that it was precisely in order to provide for a clear limit to these powers that the Government included in the License the guarantee that it could only be amended with the consent of the parties, and that it could not be terminated except in very specific situations.

8. The Tribunal's findings on the US dollar calculation of tariffs

141. The Tribunal finds that the Claimant's arguments about the existence of a right to the calculation of tariffs in U.S. dollars are persuasive. This conclusion is based first on the examination of the legal and regulatory framework. If the Gas Law, Gas Decree and Basic Rules of the License all unequivocally refer to the calculation of tariffs in U.S. dollars, and if such feature was also explained in the same terms by the Information Memorandum, there cannot be any doubt that this is the central feature governing the tariff regime.

142. Given the emphasis that this regulatory framework placed on the stability of the tariff structure, it is not surprising that the calculation of tariffs in U.S. dollars, as well as the PPI adjustment, were assigned a significant role therein. While the possibility of devaluation intervening at some time was not ignored, it was hardly addressed from the viewpoint of stability being the principal aim or, as will be explained, from that of the problem being corrected by means of the automatic adjustment of tariffs to the new exchange rate level.

143. The Respondent has devoted particular attention to the link which it alleges exists between these clauses and the Convertibility Law. As previously noted, the Respondent believes that if tariffs were set in U.S. dollars independently of the terms of the Convertibility Law, this would result in a situation contrary to the Constitution. Sophisticated investors and their lawyers, it is further asserted, could not have relied solely on the information conveyed by unofficial documents, such as the Information Memorandum or Annex F of the Pliego, which were issued with an express disclaimer of Government responsibility for their content. A legal expert for the Respondent, asked at the hearing whether the Convertibility Law implied assurances in terms of the exchange rate, answered: "No, there were no assurances in terms of the exchange rate."[16] This expert and another also stated in their written opinion that the reply to the question of an exchange rate guarantee must be "firmly negative."[17]

144. The Respondent is correct in pointing out that the Gas Law provides that tariffs calculated in U.S. dollars shall be expressed in pesos convertible under the Convertibility Law, and that reference is made to the need to take into account the parity established under Decree 2128/91, which regulated the convertibility regime.

145. These provisions are not, however, inconsistent with a guarantee as to the calculation of tariffs in U.S. dollars. Convertibility, as the Claimant has argued in reliance upon the above-noted opinion of Professor Mairal, is of a different nature than the matter of a given parity or exchange rate. This is because convertibility relates simply to the right to buy a certain foreign currency with local currency. This view is

---

[16] Expert Statement of Mr. Gabriel Bouzat, Hearing Transcript, Vol. 4, February 9, 2006, pp. 707-708.

[17] Legal Opinion of Mr. Gabriel Bouzat and Mr. Carlos F. Rosenkrantz, Second Legal Opinion, para. 16.

shared by legal experts for the Respondent.[18] It is the exchange rate that will determine how much local currency you will need to buy a unit of the foreign one. Because the Convertibility regime was aiming at the stabilization of the Argentine economy following a period of galloping inflation and continued devaluation of the currency, it chose to do the two things at the same time. It first confirmed the right to convertibility of the currency, which has remained unaffected. It simultaneously pegged the peso to the U.S. dollar at the one-to-one parity, while also prohibiting indexation in pesos. This fixed parity is the one no longer available following the peso's devaluation and the adoption of a floating rate system.

146. This difference is reflected in the regulatory framework with which the Tribunal is concerned. The Gas Law indeed made a link to the first aspect by referring to pesos convertible under the Convertibility Law. The reference of the License to a given parity established under the convertibility decree was more qualified, however. In fact, Clause 9.2 of the License takes into account the fact that the parity and the ratio could be amended in the future, as it expressly refers to the eventual modifications of convertibility through Decree 2128/91. Further references of the Pliego to the New York market exchange rate must be understood in the same context.

147. The Tribunal must also note that the standing of the Pliego is not extraneous to the investors' understanding. While not an official document, it was reviewed by government agencies, and there appears to have been a shared understanding about its meaning at the time. The witness statement of Mr. Peacock explains that the Pliegos were certainly carefully reviewed by Sindicatura General de Empresas Públicas (SIGEP), the government agency responsible for the surveillance and auditing of State-owned enterprises. He further explains the process of their preparation:

> "Those of us who produced them were schooled in the U.S. system mandated by the Securities Act of 1933, and we undertook the drafting of the representations contained in the Pliegos with the same seriousness as we would have if we had been drafting a '33 Act prospectus. I myself considered that the Argentine Government was bound by the representations it made to prospective purchasers in the Pliegos, and I believe every person involved in the process, including especially the Argentines, believed so too."[19]

---

[18] Legal Opinion by Mr. Gabriel Bouzat and Mr. Carlos F. Rosenkrantz, Rebuttal Opinion, para. 54.

[19] Witness Statement of Mr. Philip Dexter Peacock of June 21, 2003, para. 32.

148. In reaching this conclusion, the Tribunal is mindful of the economic context in which convertibility and the ensuing privatization were introduced. Precisely because these measures were preceded by a long period of economic turmoil, investors would not be attracted to participate in the privatization process unless specific assurances were given in respect of the stability of their arrangements. These were the specific guarantees envisaged in the calculation of tariffs in U.S. dollars, their conversion at the time of billing into pesos at the prevailing exchange rate and its PPI adjustment, and other stabilization mechanisms found in the contractual arrangements. Mr. George Michael Morgan, a witness for the Claimant explained that the "assurances that we were given were in the absence of a specific convertibility scheme."[20]

149. The Respondent requested the Tribunal on June 29, 2007 to exclude the witness testimony of Mr. George Michael Morgan on the ground that another prospective witness for the Claimant, Ms. María de los Ángeles Alcolumbre, had brought to the Respondent's attention a complaint that she had been pressured by officials of the Claimant company to provide a witness statement not in accordance with the truth, concerning in particular financial matters relating to this case, and having refused to do so her testimony was replaced by that of Mr. Morgan as her employment was terminated. Ms. Alcolumbre also began judicial proceedings against the Claimant in Argentina on such employment matters. The Claimant explained that Ms. Alcolumbre had been withdrawn as a witness on January 17, 2006, before the hearing, and that her complaints were directed to obtain better compensation after her dismissal. The Claimant also provided explanations on the substance of the financial questions complained of.

150. While the jurisdiction to hear the complaints by Ms. Alcolumbre is with the Argentine courts, this Tribunal has considered the request for excluding the witness statement of Mr. Morgan. The Tribunal does not believe that there is ground to exclude such testimony, first because the allegations against the witness need to be proven, and this again will be done before the courts to the extent related to her dismissal, and next because the issues on which Mr. Morgan has testified are also addressed by other

[20] Testimony of Mr. George Michael Morgan, Hearing Transcript, Vol. 1, February 6, 2006, para. 184.

witness statements and material in the record. Such testimony, while illustrative of the Claimant's view, is thus not determinative of the conclusions of the Tribunal.

151. The distinction drawn by the Respondent between the modification of the convertibility regime and its abandonment is unpersuasive. Guarantees and stabilization are meant to operate specifically when problems arise, not when business continues as usual. The tariff regime approved was devised as a permanent feature of the privatization, not a transitory one. If a temporary duration was actually intended, it should have been clearly indicated to prospective investors. Again, however, nothing of the sort was done. The regulatory and contractual arrangements were thus not incomplete, as has been argued. If such were the case, it would certainly not have passed unnoticed by competent officials, businessmen and lawyers.

152. The Tribunal must observe that the Privatization Committee's discussion of the matter was at times confusing. The Respondent has, as noted above, invoked in its favor the minutes of the Privatization Committee of July 17, 1992, which a few weeks after the enactment of the Gas Law made reference to the adjustment of tariffs, not at the actual exchange rate, but at the convertibility rate. They further stated that unless convertibility was abandoned there should be no adjustments on this basis. The minutes made additional references to the adjustment of parity in the New York market and to an understanding of the Committee to the effect that licensees should be assured of adjustment according to a realistic exchange rate if convertibility was abandoned.

153. While these minutes could be read as allowing for adjustment under the convertibility regime rather than upon its abandonment, a different reading is also possible. In fact, the Committee was discussing two different kinds of adjustment. It first discussed the notion of an automatic adjustment undertaken in accordance with the variation of cost structure expressed in pesos, but this was ruled out since it meant an indexation forbidden under the Convertibility Law. It is in relation to this cost adjustment that reference was made to the convertibility exchange rate. Reference was also made to the view that no adjustments should take place on this basis unless convertibility was abandoned, and if such were the case, a realistic exchange rate should then be found for the adjustment.

154. At the same time, the Committee discussed an adjustment related to the parity and its eventual modifications. This was the one that the regulatory framework and the License eventually included in their terms. This is the kind of adjustment that would follow the New York market exchange rate, and was expressly referred to as the "adjustment for parity." This was what the Committee later addressed in the minutes of October 2, 1992, which were invoked by the Claimant in support of its own view. The Committee was recorded in the minutes as deciding to reject a proposal referring expressly to the abandonment of the convertibility regime, on the ground that Clause 9.2 of the License embodied a sufficient guarantee in connection with the adjustment at the modified exchange rate.

155. The Tribunal also wishes to consider on this point the witness statement of Mr. Perkins who, as previously noted, was a key official in the privatization process and the author of the initiative that the Committee addressed on October 2, 1992. In referring to the approach followed by the Government officials at the time, Mr. Perkins explains that since indexation in pesos was prohibited under the Convertibility Law, assurances of U.S. dollar-denominated tariffs had become crucial to attract potential bidders, but that there were different views as to how to express this criterion. Some officials, like the witness himself, pressed for a clear reference to U.S. dollar tariff rates, while others considered that the reference to the Convertibility Law and its Decrees was sufficiently clear to this effect.[21] In the end, there was a compromise decision reached in the Privatization Committee to denominate tariffs in dollars and express them in local currency at the rate prevailing on the billing date. Mr. Perkins explains this decision as follows:

> "The guarantee that tariffs would be calculated in US Dollars was a matter of significant discussion within the Privatization Committee …. After significant discussion, it was eventually decided that including an express provision for a tariff adjustment in the event of a modification of the dollar-peso parity was redundant in view of the provisions of Section 9.2 of the draft License."[22]

156. The Tribunal would have wished that Mr. Perkins had been examined and cross-examined on this and other aspects of his testimony, and also that questions had been put to him. His participation in the hearing on the merits was, however, regrettably

[21] Witness Statement of Mr. Patricio Carlos Perkins of June 2, 2003, paras. 288-290.
[22] Additional Witness statement of Mr. Patricio Carlos Perkins of May 2005, para. 16.

prevented by an injunction issued by an Argentine judge on November 24, 2005 at the request of the Government. In the Respondent's view, there had been contractual relations between the Government and Mr. Perkins that made his statement in this and other arbitrations inadmissible. The Tribunal draws no inference from this situation, but did decide that the witness's written statement was admissible and that Mr. Perkins enjoyed and continues to enjoy the immunities provided under Articles 21 and 22 of the ICSID Convention.[23]

157. The Respondent also objected on similar grounds to the statements of Mr. Peacock and the opinions of Professor Mairal, but these challenges did not ultimately prevent their admissibility or presentation before the Tribunal.

158. In the light of the above discussion, the Tribunal cannot conclude that there was an incomplete regulatory framework in respect of this matter, as the Respondent has argued. The Tribunal would reach the same conclusion independently of Mr. Perkins' witness statement. In fact, the dollar-denominated tariff was expressly included in the regulatory regime and the Licenses as an additional safeguard, as described by Mr. Perkins: "In agreeing to the language of Section 9.2 of the License, all involved recognized that the express provision for U.S. Dollar-denominated tariffs was an additional guarantee that would protect the Licensees in the face of an eventual modification of the Convertibility Law and devaluation in the local currency, such as the one that occurred following the Emergency Law in January 2002."[24] This guarantee, in the view of Professor Mairal, is "unconditional and has no limitations to it."[25] Such an allocation of risk is also quite evidently different from the operation of the country risk premium, as will be discussed further below.

159. It has also been explained by another witness that if anyone at the time had expressed the thought that the tariff system was dependent on the continuing existence of the Convertibility Law and the fixed exchange rate,

---

[23] Letter from the Centre to the parties dated January 16, 2006.

[24] Additional Witness statement of Mr. Patricio Carlos Perkins of May 2005, par. 17

[25] Expert Statement of Professor Héctor A. Mairal, Hearing Transcript, Vol. 4, February 9, 2006, p. 640; Claimant's Post Hearing brief of April 3, 2006, para. 5.

> "we would have advised that such a contorted construction renders the guarantee useless. The idea that a future Argentine legislature could rescind the guarantee simply by repealing the Convertibility Law makes the guaranty illusory, and the privatization would not have proceeded as it did. Every description of the dollarized tariffs in the privatization documents points to an entirely contrary interpretation."[26]

160. The Tribunal is likewise persuaded by the argument that if the tariff system had not intended to provide for a right to calculate tariffs in U.S. dollars in case of devaluation or currency fluctuation, or ultimately of the abandonment of the Convertibility Law, it would have been futile to resort to such a denomination because a peso-denominated tariff would have accomplished exactly the same result. A further confirmation of this view is found in Article 8 of the Emergency Law, which put an end to the right to U.S. dollar-denominated tariffs. Professor Mairal has explained in this connection that if:

> "Also if the end of convertibility brought about by Law 25.561 would have been enough to end the Licensee rights to dollar-based tariffs, section 8 of Law 25.561 would have been unnecessary. As enacted, said section 8 clearly terminates -as from the date of enactment of the law- a pre-existing right that -had section 8 not been included- would have remained unaffected by the end of the convertibility."[27]

161. In support of its view that the calculation of tariffs in U.S. dollars is inextricably linked to the Convertibility Law, the Respondent, as already noted, has invoked *inter alia* arguments concerning the historical experience surrounding the privatization of ENTEL. The conclusions which the Tribunal draws from that experience are not quite the same as those of the Respondent.

162. To begin with, it is an undisputed fact that because the Convertibility Law froze indexation in pesos and adopted other currency stabilization measures, the terms of the original ENTEL privatization were no longer viable and had to be adapted to the new economic policy. All the changes introduced were done in agreement with the licensee, which makes for an entirely different situation from the present one with the exception of the changes introduced by the 2007 Memoranda of Understanding. The ultimate meaning of a consented agreement was, as argued by the Claimant, to avoid adverse economic consequences for the licensees arising from the changed regulatory measures.

---

[26] Additional Witness statement of Mr. Philip Dexter Peacock of September 16, 2005, para.6.

[27] Second Expert Report of Professor Héctor A. Mairal of September 14, 2005, Cl. Exh 188, paras. 37-38.

This is also a proposition that is different from the present one, with the exception indicated.

163. Without prejudice to the Claimant's argument that the original tariff structure included a U.S. dollar component and other stable value references, the fact that the new ENTEL agreement provided for U.S. dollar-calculated tariffs without reference to the Convertibility Law, far from proving that those tariffs were later inseparable from that law, as the Respondent alleges was also the case with the gas tariffs, rather proves the contrary. If tariffs were calculated in U.S. dollars and converted into pesos without reference to the Convertibility Law in the case of ENTEL, this can well be read as a confirmation of the conclusion that the reference to the Convertibility Law in later arrangements was not a guarantee conditioned to a given parity. On the other hand, the fact that ENTEL's tariff was unrelated to the Convertibility Law did not spare this company from the consequences of the Emergency Law and related measures.

164. The Tribunal is no more persuaded by the argument concerning the country risk premium. That such a premium was considered in the tariff structure and RQT I is undisputed. The issue is whether this premium and the guarantee of tariff adjustment in the case of a tariff freeze and pesification are compatible, or whether they should instead be considered as a kind of "double dipping" by the Claimant.

165. The Tribunal concludes in this respect that country risk or default risk is related exclusively to the risk of a given country's default on its foreign debt and, as such, relates to the question of the investment's financial structure. This makes borrowing more costly and is compensated by means of an additional premium. The guarantee concerning the calculation of tariffs in U.S. dollars addresses a different kind of risk and responds to a different rationale since it concerns the level of income and revenues of a company as reflected in the tariff system and its eventual adjustments. While these risks can be to some degree interlinked, for example by country risk increasing if the guarantees concerning the tariff system are altered, they operate independently from each other and are subject to different safeguards.

166. The Tribunal is also mindful of the arguments advanced by the parties in connection with the role of the Constitution in this dispute. The Tribunal will consider

issues arising under the Constitution and the law in connection with this dispute further below. It must at this point be noted, however, that besides the invocation of different Argentine Supreme Court decisions by both parties in support of their respective views, particular attention has been devoted to the *Maruba* case, which was concerned with the issue of a reduction in tariffs for port-towing services.[28] The Respondent invokes this decision to show that there was no entitlement to the original tariff, but only to a reasonable rate of return. The Claimant, meanwhile, distinguishes *Maruba* on the basis that the tariff system was different, was not established by contract, and contained no provisions for its amendment. The Claimant further points out that the Supreme Court held that while the tariff could vary during the concession period, the concessionaire had a right to receive compensation if the new prices altered the economic equation of the concession.

167. The observance of contracts, and the guarantees they embody, cannot be considered inconsistent with a long-standing Constitution such as that of the Argentine Republic. Quite to the contrary, the Argentine Constitution has enshrined the rule of law and guaranteed both the rights enjoyed by citizens and those of others who develop their business in that country. Prominent among these aspects are the right to property and limits placed upon the regulatory powers of the State. The Respondent has rightly noted that licenses and concessions do not depend exclusively on the rules governing private contracts because they have an important administrative component that reflects the nature of a public service. However, neither is this administrative law dimension in any way incompatible with the observance of contracts in the Argentine legal framework. This will be discussed further below.

168. The Tribunal's conclusion in respect of this claim does not mean that it ignores economic reality or the crisis that has recently affected Argentina. It is perfectly possible that economic conditions can change, as they in fact dramatically did. These changes can have a profound effect on the economic balance of contracts and licenses. In this context, the Respondent's argument that the Gas Law was concerned principally with a fair and reasonable tariff is not wrong. The regulatory framework provided for specific adjustment mechanisms, particularly if tariffs ceased to be fair and reasonable.

---

[28] *Maruba Empresa de Navegación Marítima c. Ministerio de Obras y Servicios Públicos,* Fallos 321:1784, issued on June 30th, 1998, Argentina's Legal Auth. 17.

These included tariff reviews on a periodic basis and even the possibility of an extraordinary review. The issue then is not whether contracts should remain frozen forever, but whether they can be adjusted to such changing realities in an orderly manner, as is provided under the regulatory framework and the contract itself. Such methods include the negotiated modification of the license, the alternative being that such change will be accomplished by unilateral action of the Government.

169. The real problem underlying the claims is that the latter option was taken unreservedly. Broad as the regulatory authority of States and governments might be at present, it can only be exercised within the confines of the law and when duly taking into account the rights of individuals. It will be seen further below that the Argentine legislation and the decisions of that country's courts have carefully set out the limits of government regulatory power in the light of a long experience of economic crisis and emergency intervention.

The third claim: The breach of the License's stability clauses

170. The Claimant has also argued that the measures adopted by the Respondent resulted in other breaches of the License which concerned some basic guarantees about the stability of this instrument. This claim refers in particular to Clause 9.8, which prohibits the freezing, administration or control of prices, and provides that if prices are lower than the level resulting from the tariff because of controls, the Licensee shall be entitled to compensation for the difference. The claim further refers to Clause 18.2 of the License, under the terms of which the Licensor shall not amend the Basic Rules of the License, in whole or in part, without the written consent of the Licensee.

171. This claim relates to the discussion about the question of contractual rights and the meaning of the umbrella clause under the Treaty, which will be examined further below.

172. There is, however, an argument of the Respondent that the Tribunal must address at this point. The Respondent asserts that the prohibition of Clause 18.2 refers to the License not being modifiable by the Licensor. Since the Licensor is the

Executive Branch of the Government, the Respondent contends that any measures or effects arising from congressional action, such as the Emergency Law, or from judicial decisions, such as the PPI injunction, are not adopted by the Licensor and hence not envisaged in the prohibition on unilateral modification.[29] In support of this view, the Respondent relies on Clause 18.3 of the License, which refers to the event in which a given clause of the license is declared invalid or unenforceable by judicial decision. The Respondent further relies on this clause as establishing that every license clause is valid and enforceable to the fullest extent permitted by the applicable law.

173. There can be no doubt that a judicial decision can declare a given provision invalid, just as a law can alter the operation of a contract. The issue here is different, however. First, the provisions of Clause 18.3 relate to situations in which given individual clauses of a license are affected, and in addressing this question ensure that other provisions of the license will remain unaffected through the principle of "divisibility." It does not, however, envisage derogation from the contract or its abandonment. Second, and more important, the issue here does not concern the powers of the State to adjudicate or legislate. It only concerns the question of whether, if contracts to which the State is a party are affected due to executive, judicial or legislative action, any damage to the other party will have to be compensated under the very provisions of the contract or, in this case, under the Treaty. If contract rights were held at the mercy of the Executive or other branches of the State, the rule of law would be seriously in jeopardy. This view is not quite likely to be accepted in an arbitration that is governed at least in part by international law.

174. The Tribunal must also observe that Clause 18.2 of the License, in prohibiting the License's unilateral modification, makes special reference to the fact that even if an authorized modification under the Service and Tariff Regulations results in a favorable or unfavorable alteration of the existing economic and financial balance, the Licensee will have the right to request a pertinent adjustment of the tariff. It is that economic balance which the whole tariff regime purported to ensure.

[29] Respondent's Rejoinder, paras. 409-415; Respondent's Post Hearing, paras. 36-40.

The fourth claim: Failure to reimburse subsidies

1. The Claimant's arguments

175. The fourth claim before this Tribunal concerns the alleged failure of the Government to reimburse the subsidies set for residential customers in Patagonia. The Claimant explains that these subsidies ranged from 34% to 87% according to the area, and amounted to 54% of the annual income of CGS. The Claimant further explains that subsidies accounted for 38% of the annual revenues of CGS.

176. The Claimant asserts that these subsidies are governed by the "Principle of Indifference" described by Article 48 of Decree 1738/92 as one whereby the distributors' "income is not altered, nor must they bear financial costs, or have their regular flow of money collections … modified for such cause." The Decree also allows for compensation of the reduced income, or increase in financial costs, caused by subsidies during the fiscal year in which they arise.[30] The principle of neutrality has also been explained in the terms that "the Licensee cannot win as a result of the subsidies, nor can he lose money as a result of the subsidies."[31] The Claimant argues in this respect that while the Government has recognized its obligations to reimburse subsidies, it has consistently failed to pay Licensees in a timely manner. Various court injunctions were also issued so as to prevent the companies from charging the full tariff in cases of failure to reimburse the subsidies, as was allowed under Section 20.1 of the License.

177. The Claimant explains that an Agreement reached on December 12, 2001 ("Subsidies Agreement") to regularize the payment of AR$108,151,227.73 (including principal of AR$75,172,807.88 and interest of AR$32,978,419.85) was never approved, and that the schedule of payments was not observed. The Claimant further asserts that a Trust Fund established to compensate the Licensees as from May 2002 (Decree No. 786/02) was not properly implemented since its assets would not be recognized as

---

[30] Decreto 1738/92 –Apruébase la Reglamentación de la Ley N. 24.076 que regula la actividad de transporte y distribución de gas natural como servicio público nacional, September 18, 1992.

[31] Testimony of Mr. Walter Kunz, Hearing Transcript, Vol. 3, February 8, 2006, pp. 530-531.

separate and intangible, and could accordingly be diverted to other budgetary allocations. The Claimant contends that the Respondent owes subsidies accrued before October 2001, other subsidies accrued in the period October-December 2001, yet other subsidies corresponding to the period January-April 2002, and other payments due under the Trust Fund. Moreover, the Claimant puts forward its view that as subsidies were an integral part of the tariff, and because the tariff was calculated in U.S. dollars, the subsidies owed should be calculated in this last currency before devaluation of the AR peso took place, that is on a one-to-one basis.

2. The Respondent's arguments

178. The Respondent has a different understanding about the role of subsidies in this dispute. It explains that while subsidies were at first paid directly by the Government to the Licensees, since 1994 yearly budget credits have been transferred to the provinces for the payment of such subsidies, and the Trust Fund was established to regularize their payment as from March 2002. Budget transfers to the provinces were temporarily suspended during 2001 when Argentina's budgetary problems became acute, but the Government attempted to regularize even this by means of the Subsidies Agreement already noted. This Agreement was in the Respondent's view never formally approved by the required administrative acts, and hence does not entail any binding obligation.

179. The Respondent further asserts that with the approval of the 2002 budget law (Law 25.565), not only was the Trust Fund established to handle future payments, but specific schedules for the payment in installments of past subsidies owed were also approved to begin in 2003. The 2005 budget included other measures for the regularization of payments for the period October-December 2001. It is also explained that the amendments introduced through the Trust Fund's implementation were aimed at strengthening rather than weakening the availability of funds. The Respondent explains that the end result is that CGS and CGP have received more than AR$330 million in subsidies since December 2001, and that the situation is now entirely normal, to the point that there is at present a claim by CGS before the Ministry of Economy for only

3% in unpaid subsidies.[32] In the Respondent's view, subsidies have been always established in pesos, and so any payment due is to be calculated in that currency and not in U.S. dollars, as is argued by the Claimant.

3. The Tribunal's findings about the subsidies claim

180. The claim about subsidies has two aspects, and the Tribunal will consider each separately. There is first the question of a right to the subsidies, and particularly whether they are established in AR pesos, as argued by the Respondent, or in U.S. dollars, as argued by the Claimant. This question will be examined now. Thereafter, the Tribunal will examine the second question, which concerns the amounts owed, if any, and whether they are being paid or not. This shall be discussed in the context of valuation issues and related matters.

181. There is no doubt that the Claimant is entitled to the payment of subsidies accorded by the Government to residents of some defined provinces. This issue is not questioned by the Respondent. This was the policy followed by ENARGAS from the outset.[33] The regulatory framework allows for the granting of subsidies, and the License guaranteed in Clause 20.2 that if the Licensees were not reimbursed within 15 days, they would be authorized to apply full tariff rates. As noted above, the subsidies are governed by the "principle of indifference" in the light of Article 48 of Decree No. 1738/92. The neutrality of subsidies is explained by Mr. Perkins as meaning that the "financial burden of any subsidies was to be borne solely by the Government."[34]

182. The question left for the Tribunal to decide at this point is whether such subsidies were owed in AR pesos or U.S. dollars. The Claimant has argued that subsidies were an integral part of the tariff, and that as such they are due in U.S. dollars like the tariff itself. The Claimant's witness Mr. Albarracín has explained that the "nature of the subsidy and the tariff are the same … The amounts are calculated in

---

[32] Witness Statement of Messrs. Nachon, Vera, Labadie, Kunz, filed with Respondent's Rejoinder, paras. 25-30.

[33] Witness Statement of Mr. Philip Dexter Peacock of June 21, 2003, Cl. Exhibit 7B, para. 28.

[34] Witness Statement of Mr. Patricio Carlos Perkins of June 2, 2003, Exhibit 7A, para. 251.

dollars expressed in pesos."[35] Financial experts for the Claimant have also made the same point in respect of valuation because what matters in their view is the "true value of the money at the moment the obligation was due."[36]

183. The Respondent argues to the contrary that subsidies have always been established, billed and collected in pesos. Asked by the Tribunal how subsidies were in practice collected, witness for the Claimant Mr. Martin Juan Blaquier explained that "the system produces a bill for the customer in pesos, and a sworn statement in pesos that is the first process that goes to ENARGAS."[37] Another witness for the Claimant likewise expressed the view that at the time the Agreement was entered into, "it was in pesos."[38] This view was followed by various demands for clarification at the hearing, the answers to which were none too clear.[39] More explicit yet was a witness for the Respondent, who explained that the subsidy is a result of a budget allocation which by law is set up in pesos, as the "nature of the subsidy is to discount the amount to be paid by the end user … is already set up in pesos."[40]

184. The Tribunal is persuaded by the Respondent's argument that the subsidies were payable in Argentine pesos. To begin with, there is a question concerning the practical operation of the subsidy. Once the tariff was calculated in U.S. dollars at any given point in time, it was expressly provided that it would be converted into pesos for billing purposes. At that time, the tariff departed from its U.S. dollar denomination and became due in pesos. Billing was made in pesos, and sums owed were collected in pesos. The role of the subsidy is that the Government picks up a part of the bill and reimburses the distributor for that part, the other part being paid by the customer. It was never envisaged that the customer should pay the equivalent in U.S. dollars. Neither was it ever envisaged that the Government should do so for its part of the bill. If it were

---

[35] Testimony of Mr. Santiago Albarracín, Hearing Transcript, Vol. 2, February 7, 2006, pp. 267-268; Claimant's Post Hearing brief of April 3, 2006, para. 19.

[36] Expert Statement of Mr. Manuel Abdala, Hearing Transcript, Vol. 5, February 10, 2006, p. 918; Claimant's Post Hearing brief of April 3, 2006, para. 85; LECG Supplemental Report of September 20, 2005, para. 102.

[37] Testimony of Mr. Martin Juan Blaquier, Hearing Transcript, Vol. 7, February 13, 2006, pp. 1375-1376.

[38] Testimony of Mr. Santiago Albarracín, Hearing Transcript, Vol. 2, February 7, 2006, p. 250.

[39] Testimony of Mr. Santiago Albarracín, Hearing Transcript, Vol. 2, February 7, 2006, pp. 250-251, 253-256.

[40] Testimony of Mr. Walter Kunz, Hearing Transcript, Vol. 3, February 8, 2006, pp. 507-508.

intended to be otherwise, it would have had to be expressly provided, which was certainly not the case.

185. Even with the subsidies being payable in pesos, there was a clear obligation on the part of the Government to pay them on time. If this was not done within a period of fifteen days, as noted, the License allowed the Claimant to charge the customer the full tariff. This was the natural consequence of the principle of indifference noted above. The Subsidies Agreement made on December 12, 2001 was made in pesos,[41] but it included payment of part of the subsidies owed in U.S. dollars and the option to accept U.S. dollar denominated government bonds since pegging was still in force at the time. Had the Government paid the subsidies when they were due, the value of such payment, even counted in pesos, would have been quite different from the value after devaluation. The Tribunal believes in the light of the License provisions that the Claimant cannot be made to bear the consequences of the Government's fall into arrears. The conclusion that follows is that the value of the pesos owed is necessarily to be established as that at December 2001.

186. The amount owed through October 31, 2001 was established in the Subsidies Agreement of December 12, 2001 (AR$108,151,277.73). Additional amounts for the months of November and December 2001 accrued later, which the Claimant puts at AR$17.3 million, a figure that the Tribunal will correct in view that it also covered the month of September 2001.

187. While both parties have argued, for different purposes, that the Agreement was not ratified by the pertinent administrative act, the Tribunal can only conclude that such an agreement genuinely embodied a firm commitment of both parties. If no necessary follow-up was undertaken, this was most likely the result of the administrative nightmare into which the Government was plunged when the crisis erupted in full strength a few days later. In fact, a witness for the Claimant confirmed in answer to a question from the Tribunal that the Agreement had been signed by company representatives as well as by Ministers Cavallo and Bastos, who "were Ministers at the time in Argentina."[42] In answer to another question from the Tribunal, Counsel for the

---

[41] Testimony of Mr. Walter Kunz, Hearing Transcript, Vol. 3, February 8, 2006, p. 521.
[42] Testimony of Mr. Martin Juan Blaquier, Hearing Transcript, Vol. 7, February 13, 2006, p. 1360.

Respondent explained that the pertinent Executive Order of the President, which in the Respondent's view was the necessary administrative act of approval, was apparently not issued because "we are talking about … 10 days before the President was overthrown, so …"[43]

188. In the light of the principle of indifference explained above and the fact that Argentina recognized the amount of subsidies as owing before December 31, 2001, the Tribunal concludes that any amount owed for the period terminating on December 31, 2001, in spite that it might have been expressed in pesos, must be compensated at the parity exchange value which the peso had in December 2001 as otherwise the Claimant would be put at great disadvantage.

The fifth claim: Interference with the collection of bills and related matters

1. The Claimant's arguments

189. On actions taken by the National Ombudsman, federal courts in Argentina issued preliminary measures directing the gas companies and other utilities to reschedule the date for payment of all bills due after December 31, 2001. This is a matter which the Claimant brings to this Tribunal. The Claimant similarly argues that other injunctions prevented the Licensees from interrupting service in case of non-payment of bills, and that these decisions, while later reversed, resulted nonetheless in the prevention of the companies' exercise of a right and led to what the Claimant believes was a judicial encouragement of default.

190. Other complaints brought by the Claimant concern the ENARGAS policy of rejecting requests for suspension of service to sub-distributors in arrears, the imposition by law of employee severance restrictions that resulted in added costs, and the regulatory agency's refusal to allow the passing-through to tariffs of most or any costs associated with the purchase and transportation of natural gas or the payment of easements to surface owners.

---

[43] Remarks of Mr. Gabriel Bottini, Hearing Transcript, Vol. 7, February 13, 2006, pp. 1366-1367.

2. The Respondent's arguments

191. The Respondent contends that none of these claims has any merit, as court measures rescheduling the due dates of bills were only one-time decisions, limited to a duration of 20 days that caused no damage and led the Supreme Court to reject the Licensees' complaints. Other court injunctions were equally exceptional, the Respondent maintains, as they were later reversed and in any event had arisen in the context of specific lawsuits concerning work stoppage that were soon settled.

192. The Respondent also asserts that the provisions of the Emergency Law prohibiting the lay-off of workers responded to the social and employment conditions produced by the crisis, and were upheld by the Supreme Court. While these measures are still in force, they have not impeded the severance of employees. They have only required the payment of additional compensation, which has been gradually reduced as employment conditions have improved.[44] In the Respondent's view, pass-through costs can only be adjusted under the regulatory framework on the occasion of the periodic five-year tariff review, or else in the light of an extraordinary review, neither of which was the case with the Claimant's applications to ENARGAS. In any event, it is also explained that the economic balance of the licenses has not been altered by these costs. The Respondent additionally argues that the license clauses allowing for the pass-through of costs associated with the use of the public domain are not applicable to easements.

3. The Tribunal's findings

193. Apart from factually explaining the measures taken concerning these matters and their circumstances, the parties have only briefly elaborated on the legal arguments and defenses supporting their respective positions. The Tribunal is nevertheless satisfied that some of the measures taken, such as the extension of the payment deadline or suspensions ordered in connection with a work stoppage, were applied for very limited

---

[44] Dr. Graciela Vilas' First Legal Opinion, filed with Respondent's Rejoinder, paras. 31-34.

periods of time, related to the circumstances of the moment, and do not entail demonstrable damages beyond or additional to the effects that the crisis had on the Licensees, which will be considered as a whole.

194. The Tribunal is also satisfied that the restrictions concerning the severance of employees apply to the economy as a whole and were not aimed at the Licensees in particular. As the Respondent has explained, these measures did not involve a prohibition on labor lay-offs, but only increased the pertinent compensation to be paid. This obligation has, moreover, been eased as conditions have improved. Here again, whatever the effects these measures had, they are part of the overall impact of the crisis on the business, which will also fall to be considered as a whole.

195. In accordance with the above, the Tribunal does not find merit in such peripheral claims, and will not consider these aspects separately from the Claimant's overall claim for compensation.

196. Questions concerning the passing through to tariffs of certain costs have also been raised in connection with easements. To the extent that there might be damages in connection with this claim, they are equally to be considered in the context of the overall claim for compensation and not as a separate item.

Damages claimed

197. As a consequence of the measures described above, the Claimant alleges that damage was caused to two major areas of its business. It first argues that the Licensees were unable to secure international credit, and that in order to avoid default, the Claimant loaned the Licensees U.S.$56,017,000 by the end of 2001. The Claimant next argues that the Licensees were rendered unable to pay gas producers, and thus made vulnerable to numerous lawsuits for unpaid debt.

198. In its closing statement, the Claimant explains that, including damage to equity value and debt, unpaid subsidies and historical PPI damage, its share of the damages suffered amounts to U.S.$209.3 million. The precise amounts will be considered in the section on Remedies.

199. The Respondent objects to the Claimant's estimates, arguing first that the price originally paid for CGS and CGP was lower than that claimed in the present case, particularly because part of this price was paid in government debt instruments that were valued higher than the market price. The Respondent further contends that the loans made to the Licensees in late 2001 responded to their financial policies, and that the risks which they took cannot be attributed to the Government. Neither, in the Respondent's view, can the decision of the Licensees to take debt abroad in dollars or other currencies be so attributed, given that the Government is not a financial insurer. The Tribunal accepted the Respondent's request for the Claimant to produce a number of financial statements and documents on which its claim is based.

200. The Respondent additionally objected to the expert valuation of the Licensees produced by the Claimant, and requested further information on cash flows. The Respondent also for its part produced expert reports concluding that the Licensees had obtained a reasonable return on their capital, which under one "project finance" methodology is estimated at US$120,000,000 as of 2005. The Respondent particularly objects to the Claimant's argument that there is a principle of international law requiring full compensation to be paid. In the Respondent's view, if any valuation is to be required, this must be done in terms of the stock's value. The Claimant considers this method inappropriate, however, since CGS is not traded on any stock market, and since CGP's very limited stock trading is extremely illiquid and any large sale of its shares would substantially affect the market price.

201. The parties' discussion of the relevant aspects of the technical reports and conclusions will be considered further below in the context of valuation.

Regulatory and financial issues and defenses

202. In addition to the parties' specific arguments in respect of each of the claims explained above, they have also discussed a number of important questions touching on economic and financial matters that are closely related to the regulatory framework governing the investment. These issues and defenses will be examined next, without

prejudice to the pertinent items that will be discussed in connection with valuation issues further below.

1. The valuation date

203. In view of the fact that the Claimant had significantly increased its investment in CGS and CGP in October 2000, after the PPI adjustment injunction had been issued, the Tribunal raised at the hearing on the merits the question of the date which the Claimant was asserting as the relevant one in respect of the alleged expropriation acts. If this date was the day prior to the PPI injunction in August 2000, *i.e.*, August 17, 2000, it raised questions about why the company had decided to increase its investment shortly afterwards, and how this increase should be treated for the purpose of valuation. If, on the other hand, the date was one prior to the enactment of the Emergency Law in January 2002, it raised a different question, namely about whether the injunction was in fact considered an act of expropriation.

204. The Claimant has clarified that it is requesting that the expropriation date be set at December 31, 2001, a few days before the enactment of the Emergency Law. This is because that measure was the one which gave rise to the central claim in this arbitration.[45] In Professor Reisman's view, this choice by the Claimant is entitled to some deference,[46] and the Claimant further argues that such deference was paid by the Tribunal in *CMS*.

205. A witness for the Claimant also stated at the hearing on the merits that the decision to increase the investment in October 2000 was explained by the view at the time that there was no indication on the part of the Government that the investor's rights could be affected, and also by the fact that both the Government and ENARGAS had appealed the injunction.[47] Professor Reisman has likewise explained that the injunction

---

[45] Claimant's Post-hearing Brief, para. 90.

[46] Expert Statement of Professor W. Michael Reisman, Hearing Transcript, Vol. 6, February 11, 2006, p.1055; see also Opinion of Professor W. Michael Reisman of July 25, 2003, paras 146-157.

[47] Testimony of Mr. George Michael Morgan, Hearing Transcript, Vol. 1, February 6, 2006, pp. 203-205.

could be regarded as a first small step that only with the benefit of hindsight could be seen as an indirect expropriation ultimately leading to the Emergency Law.[48]

206. The Claimant concludes on this basis that the injunction was at first considered a temporary deferral that would be fully compensated in the short-term. The Claimant also contends that even if the Tribunal were to choose August 17, 2000 as the valuation date, this should not affect the treatment of the investment done in October 2000 because, for the reasons already explained, there was no expectation at the time that the suspension would lead to a deprivation of rights and failure of compensation.

207. The Respondent has noted the Claimant's apparent contradiction in alleging expropriation with respect to the injunction of August 2000 and yet increasing the investment a few weeks later. The Respondent has, however, quite naturally not offered a valuation date in this context because in its view there has been no expropriation and no compensation is due.

208. One can be puzzled by the fact that an experienced investor would have taken a decision to increase its equity participation at a time when trouble was around the corner. This decision in fact prompted questions and explanations before the investor's governing board.[49] Yet, considering the fact that both the Government and ENARGAS were fully supporting the rights of the Licensees, as became apparent in the appeals brief when it explained in detail the rights the Licensees had under the regulatory framework and the License, the explanation given by the Claimant is plausible. While the events at the time could give rise to concern, the real warning signals had not yet appeared, and both the Government and the Licensees were confident that the situation could be managed.

209. The Tribunal will accordingly use December 31, 2001 as the proper valuation date. This is not because it believes that the Claimant's argument should be given any deference, but simply because the explanation given shows that there was an investment decision made in good faith. Neither does the Tribunal share the interpretation which

[48] Expert Statement of Professor W. Michael Reisman, Hearing Transcript, Vol. 6, February 11, 2006, pp.1054-1055.

[49] Testimony of Mr. George Michael Morgan, Hearing Transcript, Vol. 1, February 6, 2006, pp. 204-205.

the Claimant has given to *CMS* with regard to the payment of certain deference in the choice of a valuation date. It is apparent that in *CMS* no acts or decisions taken by the claimant after the injunction raised any doubt about the date which triggered the events complained of.

210. The determination of the Tribunal as to the valuation date has two implications for the Claimant's pleas, one being positive and the other negative. The positive implication is that the investment made in October 2000 must be treated as part of the protected equity affected by the complained-of measures as from the valuation date. The negative implication for such pleas is that it raises questions about the situation of the inter-company loans made in December 2001. This last matter will be discussed next.

2. The inter-company loans

211. It has been noted above that the Claimant is arguing that the investment includes a loan for US$56 million that it made to CGS and CGP in December 2001, for which the Claimant should also be compensated. The Respondent believes that this loan responded to financial decisions made by the Claimant that are not to be attributed to anyone else, and for which the Government is not responsible.

212. The Tribunal must first take into consideration the context in which this loan was made. The Licensees had first obtained international financing by issuing Commercial Paper for six months. This was followed by a Floating Rate Note due in December 1996. When the Note became due, CGS and CGP issued negotiable instruments ("Obligaciones Negociables") under a Medium-Term Note Program that came due in December 2001. The Claimant explains that these instruments were not convertible into shares.

213. When the Licensees attempted to secure financing in order to cancel the notes due in December 2001, they found that it was no longer possible to do so because, as witness Mr. Blaquier explains, "[a]t that time, financial markets were for all purposes

closed to Argentine companies."[50] In order to avoid default, the Claimant made the presently discussed loan as it was felt that, from the investor's point of view, "a default from the Licensees on their bonds would have resulted in a severe negative impact on shareholders' values and, therefore, the decision to lend was a reasonable financial decision."[51]

214. Under the broad definition of investment contained in the Treaty, loans are generally to be considered as a protected investment. The Tribunal has carefully considered whether in the light of the *Joy Mining* case,[52] in which a distinction was drawn between a purely commercial operation and an investment, there could here be a situation in which the loans might, as argued by the Respondent, be considered a commercial operation not different from those normally made by financial institutions, and which would result in the loans not qualifying as a part of the investment. Despite the fact that the commercial papers, notes, bonds and negotiable instruments, as the instruments have been variously described, are not different from any other issuance of obligations, they were still made by a qualifying investor as a substitute for financial obligations previously undertaken in the context of the financing of the same investment. Such loans were in fact part of the investment's continuing financing arrangements, and were interposed at a moment when only the investor was available to make them.

215. While a witness for the Claimant described this operation as one in which "[t]he only contribution that the partners made was an amount to pay the bond that was to mature,"[53] it was a normal business move by the investor in a situation where additional financing was necessary to keep a company out of default. To the extent that the loans were made in connection with a legitimate business purpose, as they in fact were, there is no reason to exclude them from the protected investment.

---

[50] Supplemental Witness Statement of Mr. Martin Juan Blaquier, filed with Claimant's Reply Memorial, para. 7.

[51] Supplemental Witness Statement of Mr. George Michael Morgan, filed with Claimants' Reply Memorial, para. 14.

[52] *Joy Mining Machinery Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/03/11), Award of August 6, 2004.

[53] Testimony of Mr. Martin Juan Blaquier, Hearing Transcript, Vol. 7, February 13, 2006, p. 1362.

216. While the question of the reasonableness of leverage has been discussed at various points in the pleadings, including with respect to the loans made to the Licensees, the issue does not appear to be any different in the presently discussed context. As noted above, the loans were made in substitution for an investment financing scheme that had been ongoing from the beginning, and which had not met with any objection from the regulatory authority. The Tribunal sees no reason why they should not now be considered equally reasonable.

3. Regulated and non-regulated business

217. The parties have also discussed whether the existence of a non-regulated sector of the Licensees' business that was particularly involved in the production and marketing of LPG, ethane and raw gasoline should have any influence on the valuation of the companies, and also on the discussion about whether they benefited from devaluation in view of the improved results of this side of the business.

218. The Tribunal is persuaded that the two sides of the business are entirely separate both legally and financially. This has been the consistent understanding of the Respondent and its regulatory bodies from the outset. The bad results in one area of the business cannot be set off against the good results in the other. Avoidance of cross-subsidization is the right economic principle applied by many companies that have various sectors of activity within their overall business. The success of the non-regulated business should not subsidize the losses of the regulated business, and this is to be the criterion that shall guide the eventual determination of compensation. Furthermore, any such determination shall relate only to the measures adopted in respect of the regulated sector of the business.

219. The Tribunal therefore concludes that the regulated and non-regulated sectors of CGS and CGP are to be kept separate and independent for the purposes of this claim.

4. The issue of renegotiations

220. The Emergency Law directed the Government to begin a renegotiation process for public utility contracts affected by the measures indicated. While the rights of

licensees were expressly safeguarded under the arrangements originally set up for the process, the Government gradually conditioned the right to participate on the abandonment of all claims before local courts or arbitral tribunals. Various bodies in charge of renegotiation have been set up over time, and the deadlines have been regularly extended, with the last extension bringing the deadline to the end of 2007.

221. The renegotiation process has not made much progress in the gas transportation and distribution industry as a whole, but it has advanced in respect of some contracts. One such contract was entered into with a gas provider and was finalized in July 2005 but is still pending legislative and executive approval (i.e., GASBAN).[54] As noted above, two other agreements signed in 2007 involve the Licensees in this claim, although as it will be explained the investor concerned in this claim has challenged the process followed.[55] The process of renegotiation has also been successfully completed in connection with the contracts of gas producers and in some other sectors of the economy.

222. The Claimant explains in this respect that the failure of the renegotiation process as far as its interests are concerned is due partly to the fact that the tariff adjustment proposed by the Government has been well below the minimum required by the industry, and partly to the fact that none of the rights existing under the License would be reestablished and no compensation would be paid for the losses incurred thus far. The Claimant further asserts that it is required to withdraw its legal actions and make the Government whole for any adverse decision.

223. The Government for its part maintains that the renegotiation process is gradually advancing, and that out of 64 contracts subject to renegotiation, 37 agreements have been successfully completed, including those noted in the gas transportation sector.[56] It is further asserted that international claims have been an obstacle to the more expedient

[54] Witness Statement of Mr. Jorge Gustavo Simeonoff, filed with Respondent's Rejoinder, para.64.

[55] Acta Acuerdo Adecuación del Contrato de Licencia de Distribución de Gas Natural between the Argentine Republic and CGS and CGP, respectively, of April 26, 2007 (Cited as Agreements, Memorandums of Understanding or MOU).

[56] Testimony of Mr. Jorge Gustavo Simeonoff, Hearing Transcript, Vol. 2, February 7, 2006, pp. 279-282, and Witness Statement of Mr. Jorge Gustavo Simeonoff, filed with Respondent's Rejoinder, paras. 64 and 127.

progress of negotiation. According to the Respondent, CGS also participates in various expansion projects, all of which result in benefits to the company.

224. As indicated above, the Respondent signed Memoranda of Understanding on April 26, 2007 with both Licensees concerned in this case, CGS and CGP. Under these agreements a 25% tariff adjustment will take place as from January 1, 2008 for one company and from July 1, 2007 for the other. Neither shall exceed an average tariff increase of 15%. In addition, a 2% increase shall be allocated to infrastructure improvement. The agreements also envisage the suspension and discontinuance of judicial or arbitral claims.

225. On the basis of this development, the Respondent wrote to the Tribunal on June 29, 2007 putting forth the view that the agreements made the claim in this case inadmissible as the Licensees had accepted a new tariff regime and the investor did not have any separate claim of its own. This view was opposed by the Claimant on the argument that it had not accepted the agreements in question and that these bound only Camuzzi, the claimant in a separate proceeding which was also an indirect investor in CGS and CGP. The Claimant also explained that it had initiated legal proceedings against Camuzzi in Argentina for breach of a shareholders agreement.

226. The Tribunal shall not pass judgment on the features of a renegotiation between the Licensees and the Government of Argentina, least between the shareholders, but it is bound to take note that the Licensees agreed to new contractual terms with the Government and that these cover the period running from January 6, 2002 until the end of the License. The Tribunal must also take note of the fact that the Claimant in this case has expressly disavowed its acceptance of the agreements. The issue for the Tribunal is then to decide whether the Claimant is bound by the agreements to which a separate investor has consented. Whether this consent was given in accordance with corporate arrangements and required majorities is something to be decided by the Argentine courts. Yet, the Tribunal must take into consideration the effect of such agreements on the Claimant's interests in the Licensees.

227. After considering this matter and the arguments of the parties, the Tribunal has reached two conclusions. The first is that as the Claimant is still an investor whose

interests are protected by the Treaty, it cannot be bound by an agreement between different entities to the extent that those interests have not been adequately satisfied. The agreements are to this effect *res inter alios acta*. The agreements envisage that corporate majorities involving both majority and minority shareholders are necessary to express the required consent. The interests of the Claimant in its investment in the Licensees are still affected by the measures complained of and it is to be regarded as entitled to pursue his grievances in this arbitration. Consequently, there is no ground to justify a decision of inadmissibility of the claim in this context.

228. The second conclusion is that, in spite of the above holding, the agreements do have consequences for the Claimant in view of the fact that there are objective outcomes that benefit the Licensees to an extent. The first concerns the question of double dipping, in that the agreements envisage an obligation for the parties to them to keep the Respondent free from any adverse implications of compensation that could be obtained by the Claimant in an arbitral or other forum. The second consequence is that objectively the agreements will improve the business of the Licensees and to that extent the Claimant will also benefit as a shareholder. Both consequences will be examined separately, one in the context of the argument of double dipping and the other in the context of valuation.

5. The Trust Fund

229. The Respondent has argued that both the Claimant's participation in the "Agreement for the Expansion of the Andean Line,"[57] to which CGS is a party, and the related establishment of a Trust Fund to expand the gas transportation and distribution system, are further evidence that tariffs are being adjusted to the benefit of the Licensees' operations and business. A separate Trust Fund Agreement concerning the expansion of distribution systems and carriage capacity in Tierra del Fuego has also

[57] Convenio entre la Unidad de renegociación y análisis de contratos de servicios públicos, la Empresa Transportadora de Gas del Sur S.A. y la empresa Camuzzi Gas del Sur S.A., para la ampliación del sistema del gasoducto cordillerano of February 27, 2004, Annex RA 169.

been described as particularly benefiting CGS.[58] The Claimant opposes these assertions.

230. Again, this is not a matter for the Tribunal to consider. Agreements between the parties about matters not involving the Licenses cannot be interpreted as changing any rights or obligations established under the Licenses. At most, such agreements offer insights into the organization of certain aspects of the business after the emergency.

The law applicable to a finding of liability

231. The parties have disagreed about the law applicable to this dispute under Article 42(1) of the Convention. This article provides that the Tribunal "*shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable.*"

232. The Claimant argues that the parties have chosen the Treaty as the *lex specialis* applicable in this case under the first sentence of this Article. Other rules of international law not inconsistent with the Treaty are, according to the Claimant, likewise applicable in the light of the second sentence of the same Article. These include rules on the interpretation of treaties and customary rules that provide for a minimum standard of treatment for covered investments. The Claimant asserts, moreover, that domestic law is relevant only in the context of factual matters, such as the nature of the assurances made to the investor. In the opinion of a legal expert introduced by the Claimant, such assurances acquired international legal force by virtue of the Treaty, and therefore to "regard Argentine law rather than the *lex specialis* of the BITs … would be to eviscerate the fundamental objectives of the States parties to the BITs."[59]

233. The Respondent for its part believes that Article 42 has an entirely different meaning. In the Respondent's view, domestic law is not confined in scope of

[58] Testimony of Mr. Cristian Folgar, Hearing Transcript, Vol. 3, February 8, 2006, pp. 581-582.

[59] Expert Opinion of Professor W. Michael Reisman of July 25, 2003, pars 59, 60.

application to factual matters, but also has a substantive role in defining the rights of the investor, particularly where property rights are involved in the dispute. These rights are allegedly not defined by international law, but by the local law to which the investor has voluntarily submitted. In support of this view, the Respondent invokes in particular Clause 18.3 of Annex 1 of the Licenses, which provides that "[e]ach and every provision of this License shall be valid and enforceable to the fullest extent permitted by the applicable law."[60] It is maintained that this law is contained in the Constitution, the Gas Law, the Gas Decree and the License itself. The Respondent also argues that when parties have agreed on a forum-selection clause giving jurisdiction to a domestic court, this choice cannot later be ignored by an international tribunal.

234. The Respondent further explains that this approach does not exclude the application of either the Treaty, for example in defining which investors are covered under its provisions, or general international law, which provides for rules on the treatment of investments. In any event, the Respondent asserts that any finding of international responsibility would require the Claimant to prove that a specific breach of the Treaty has taken place, and that this has not been done in the present case.

235. The parties' discussion concerning Article 42(1) of the Convention appears to be theoretical to some extent since this Article provides for a variety of sources to play simultaneous roles. Indeed, the Respondent is right to argue that domestic law is not confined in scope of application to the determination of factual questions. It indeed has a broader role, as is evident from the pleadings and arguments of the parties to this very case. The License is itself governed by the legal order of the Argentine Republic, and it must be interpreted in its light.[61]

236. So too, the Claimant is right in arguing for the prominent role of international law. In fact, the Treaty, international conventions and customary law have been invoked by the parties in respect of a number of matters. While writers and decisions have on occasion tended to consider domestic law and international law as mutually

---

60 Executive Order 2255/92, Exhibit "B", Distribution License, Subexhibit I, Basic Rules.

61 License, Clause 16.1 on governing law.

incompatible in their application, this is far from actually being the case. Both have a role to perform in the resolution of the dispute, as has been recognized.[62]

237. The legal order of the Argentine Republic, in keeping with those of many other modern States, provides for a prominent role to be played by international law under both Articles 27 and 31 of the Constitution. Treaties are recognized as “the supreme law of the Nation.” It follows that in case of a conflict between a rule of domestic law and a rule embodied in a treaty, it is international law that will prevail. This is also the solution provided by Article 27 of the Vienna Convention on the Law of Treaties, which establishes that a State “may not invoke the provisions of its internal law as justification for its failure to perform a treaty.”

238. In examining the Claimant’s allegation that Argentina has incurred a liability in consequence of its adopted measures, and the Respondent’s defense that no such consequence arises under the law, the Tribunal finds that there is generally no inconsistency between the Argentine law and international law insofar as the basic principles governing the matter are concerned. Problems arise only in respect of some specific issues that will be noted in due course. To the extent that there is any inconsistency between Argentine law and the treaties in force, however, international law will prevail, as is established under both the Argentine Constitution and Article 27 of the Vienna Convention on the Law of Treaties.

239. The parties have given particular attention in their arguments to the meaning in this context of the *Tecmed* decision.[63] The Claimant believes that this award reached the right conclusion, namely that an “Act of State must be characterized as internationally wrongful if it constitutes a breach of an international obligation, even if the act does not contravene the State’s internal law …” The Respondent, however, distinguishes that case because under the relevant investment promotion treaty, unlike the Treaty applicable to this case, domestic law has a different role, and also because the *Tecmed*. tribunal considered the relevant Mexican law to determine whether the

---

[62] *Wena Hotels Limited v. Arab Republic of Egypt*, *Ad Hoc* Committee Decision on Application for Annulment of February 5, 2002, 41 *ILM* 933 (2002), at 941; *CMS Gas Transmission Company v. the Argentine Republic,*(ICSID Case No. ARB/01/8), Award of May 12, 2005.

[63] *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States,* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003.

treatment required had actually been afforded. The Tribunal concludes that the Respondent is right in asserting that the *Tecmed* award relates to an entirely different legal context, and that it does not provide helpful guidance in respect of the present dispute.

240. In accordance with the above considerations, the Tribunal will consider both Argentine law and international law to the extent each is relevant to a determination on liability.

The stability of the License under the Argentine Constitution and contract law

241. The Tribunal concluded above that various rights which the Claimant held under the License have ceased to be observed as a result of the measures complained of. It is now necessary to examine the Argentine law governing contracts in order to determine whether liability exists under the domestic legal order. The Respondent has in this context again raised the objection that to the extent they exist, such rights belong to CGS and CGP as the Licensees, and not to the Claimant. The Tribunal has already decided this question in the Decision on Jurisdiction, however, and shall not discuss it again here.

242. The Tribunal has examined above the aspects of the parties' discussion dealing with the constitutional implications of a right to calculate tariffs in U.S. dollars, and has concluded that there is no inconsistency between such a right and the provisions of the Constitution. The basic principles enshrined by the Argentine Constitution are also pertinent to the discussion on liability. Indeed, Article 17 of the Constitution establishes the basic principle that the "right to property is inviolable and that no inhabitant of the Nation can be deprived of it except by a judicial decision founded in the law." The Constitution further provides at Article 28 that "the principles, guarantees, and rights recognized in the preceding articles shall not be altered by the laws regulating their exercise." Consistent with these provisions, Article 1197 of the Civil Code mandates that contractual rules must be observed as the law between the parties. The stability of rights and contracts is thus clearly a central feature of the applicable domestic law.

243. This is not to say that contractual obligations must never be changed, irrespective of the circumstances. Article 1198 of the Civil Code addresses cases in which extraordinary and unforeseeable events can allow a party to a contract to request its termination for having become excessively onerous. It thereby recognizes the theory of "imprévision" and the seeking of a rebalancing of contractual benefits. *Force majeure* and unjust enrichment are additional mechanisms that allow for the renegotiation and rebalancing of contractual obligations.

244. The Tribunal observes in this context that the award of the Tribunal in *CMS* identified the *Gaz de Bordeaux* decision as the source of the theory of "imprévision" in administrative law,[64] as an expression of the common understanding about general principles of law that are found in most legal systems, particularly those of the civil law tradition.

245. The Respondent's legal experts have concluded in this case that, as a result of the aforementioned jurisprudential developments, the theory of "imprévision" has been incorporated into Argentine law.[65] A legal expert for the Claimant reaches the same conclusion, with the understanding that the theory was accepted in Argentine jurisprudence even before *Gaz de Bordeaux.*[66]

246. It must further be kept in mind that, insofar as the theory of "imprévision" is expressed in the concept of *force majeure*, this other concept requires, under Article 23 of the Articles on State Responsibility, that the situation involve the occurrence of an irresistible force, beyond the control of the State, making it materially impossible under the circumstances to perform the obligation. In the commentary to this article, it is stated that "[*f*]*orce majeure* does not include circumstances in which performance of an obligation has become more difficult, for example due to some political or economic crisis."[67]

---

[64] *CMS Gas Transmission Company v. the Argentine Republic,* ICSID Case N. ARB/01/8, Award of May 12, 2005, para. 224.

[65] Legal Opinion of Mr. Gabriel Bouzat and Mr. Carlos F. Rosenkrantz, Second Legal Opinion filed with Respondent's Counter Memorial, paras. 131-132.

[66] Expert Statement of Professor Héctor A. Mairal, Hearing Transcript, Vol. 4, February 9, 2006, p. 699.

[67] James Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, (ed., Cambridge University Press) (2002), p. 171.

Emergency as a defense under Argentine jurisprudence

247. The Respondent has relied significantly on the argument that, under Argentine law, a state of emergency justifies the legal standing of the measures adopted. The Respondent's view allegedly finds support in the various aforementioned legal concepts allowing for the rebalancing of contracts. The courts of Argentina have on various occasions addressed recurring emergency situations, declared by Congress, by conditioning their legal recognition on very precise terms.[68] This jurisprudential definition acquires particular significance in the light of the fact that, as explained by the legal expert Professor Mairal, the Argentine Constitution does not "expand the powers of Congress in the case of emergencies."[69] The Argentine Supreme Court has for its part held in connection with the Emergency Law presently in force that

> "it is not useless to remind, as the Tribunal has done for long, that restrictions imposed by the State on the normal exercise of patrimonial rights must be reasonable, limited in time, and constitute a remedy and not a mutation in the substance or essence of the right acquired by judicial decision or contract …"[70]

248. It is against this background that the Tribunal must examine the effects of the emergency measures enacted in 2002 on the obligations and commitments defined in the License. The License is of course not an ordinary contract since it involves the operation of a public service under the regulatory authority of the State. Even in this context, however, the licensees enjoy specific rights which are subject to protection under the Constitution, relevant law and the provisions of the contract. As noted above, however strong the regulatory powers of the State might be, they are yet governed by the law and the State's obligation to protect the rights acquired by individuals.

1. First requirement: Temporality

249. The Tribunal can well understand the need to adopt emergency measures in the midst of the major crisis that has been noted. Yet, invocation of an "emergency" is not

---

[68] See the jurisprudence cited in *CMS Gas Transmission Company v. the Argentine Republic* (ICSID Case No. ARB/01/8), Award of May 12, 2005, footnote 91.

[69] Second Expert Report of Professor Héctor Héctor A. Mairal of September 14, 2005, Cl. Exh 188, para. 63.

[70] Argentine Supreme Court, Judgment in the case "*Provincia de San Luis c. P. E. N. –Ley 25561, Dto. 1570/01 y 214/02 s/ amparo)"*, March 5, 2003.

enough *per se* to exempt these measures from liability in the light of the applicable law. A first question that must be examined in this respect is whether the measures adopted are temporal or permanent in nature. This is a matter on which the parties' views differ. The Respondent has repeatedly emphasized both the temporal nature of the emergency measures and the fact that the Emergency Law expires on a precise date. This ending date has been extended, it is argued, so as to ensure the orderly settlement of complex, outstanding problems. The fact is, however, that the expiry date has been extended year after year, so that the Emergency Law is presently scheduled to end on December 31, 2007. This is the situation that has given rise to the Claimant's argument that the Emergency Law has in reality been turned into a permanent feature of the Argentine economy.

250. The Tribunal finds this to be a rather disquieting situation because in actual fact the crisis is largely over, even if aftershocks might quite naturally still be felt for some time. Experts and tribunals have considered different dates as the ending point of the crisis, ranging from mid-2003[71] to the end of 2004 or even early 2005.[72] A witness for the Respondent states that while the economy started to recover in 2003, "it is only in 2004 when we see a very important recovery,"[73] including an increasing flow of foreign direct investment comparable in level to that of the 1990's.[74]

251. In any event, it is not presently disputed that the crisis is over, and the strong performance of the Argentine economy evidences this conclusion unequivocally. In point of fact, the Argentine Gross Domestic Product grew 35.5% in the period 2003-2006, with an average growth of 8.8%.[75] The continued extension of the emergency legislation would thus not seem to be quite justified by the facts.

252. The requirement of temporality is also not met by the Respondent's policy not to allow for PPI adjustments or the calculation of tariffs in U.S. dollars, on the ground that

---

[71] Expert Statement of Professor Sebastian Edwards, Hearing Transcript, Vol. 6, February 11, 2006, p.1160.

[72] *CMS Gas Transmission Company v. the Argentine Republic* (ICSID Case No. ARB/01/8), award of May 12, 2005.

[73] Expert Statement of Mr. Daniel Chudnovsky, Hearing Transcript, Vol. 4, February 9, 2006, p. 771.

[74] Expert Report of Mr. Daniel Chudnovsky, filed with Respondent Rejoinder, para. 34.

[75] Economic Commission for Latin America and the Caribbean, *Statistics Yearbook of Latin America and the Caribbean 2006*, Economic Statistics, Table 2.1.1.1; see also Claimant's Exhibit 338.

there is still an ongoing crisis. When questioned about these issues at the hearing, a witness for the Respondent replied that the answer to PPI adjustment was "no," and that the one to the calculation of tariffs in U.S. dollars was likewise "[n]o. The tariffs resulting from the renegotiation process are in pesos."[76]

2. Second requirement: No essential mutation of rights

253. A second requirement which the courts have imposed for the establishment of the emergency measures' legal validity is that the restrictions imposed must provide a remedy while not also resulting in the mutation of the substance or essence of the rights acquired under a contract. Counsel for the Respondent, however, has advanced an interpretation that appears to be inconsistent with this requirement, namely that the Emergency Law meant "basically the granting of a death certificate" for the calculation of tariffs in U.S. dollars, as the Argentine currency had already been devalued in international markets.[77] So too, a witness for the Respondent stated at the hearing that the Government made the "great mistake … to keep the Convertibility Law in effect as a long-term plan since it should have been a short-term resource to solve a specific problem; namely, serious hyperinflation, serious problems in the eighties and nineties."[78]

254. The decision to do away with this policy, while within the prerogative of the Government, means in reality that the rights granted under the License shall be permanently eliminated, at least insofar as the calculation of tariffs in U.S. dollars and their PPI adjustment are concerned. Licensees might of course accept the terms of a new tariff regime in the context of a renegotiated contract. In such a case, the mutation would be validated by the agreement of the parties. The natural outcome of the operation of "emergency" is not, however, a legal exemption from liability.

---

[76] Testimony of Mr. Jorge Gustavo Simeonoff, Hearing Transcript, Vol. 2, February 7, 2006, p. 335.

[77] Respondent's Closing Statement, Hearing Transcript, Vol. 8, February 14, 2006, p. 1497; see also Testimony of Mr. Jorge Gustavo Simeonoff, Hearing Transcript, Vol. 2, February 7, 2006, pp. 335-336; Claimant's Post Hearing brief of April 3, 2006, para. 14.

[78] Testimony of Mr. Eduardo Ratti, Hearing Transcript, Vol. 3, February 8, 2006, pp. 490-491.

3. Third requirement: Reasonableness

255. A third requirement the courts have indicated is that restrictions imposed under the emergency must be reasonable. The discussion concerning the tariff regime which the Tribunal has outlined above reveals profound disagreement between the parties as to what is to be regarded as a just and reasonable tariff. While the Claimant believes that a tariff frozen for nearly seven years and kept unadjusted for nine years cannot in any way be considered reasonable, the Respondent contends that this was the only measure possible in the context of crisis and deflation, and that it is thus eminently reasonable.

256. The Tribunal can only note in this respect that both the Government and the licensees of public services have repeatedly indicated that there is an inescapable need to attend to tariff adjustments and thereby ensure both the continued operation of the companies and the necessary supply of energy and other services. The very emphasis which the Respondent has placed on the question of renegotiation and the Agreements reached with the Licensees as to certain tariff adjustments are further evidence of this recognition. It follows that the prolongation of emergency measures for such a long period without the reestablishment or rebalancing of the License's benefits cannot be regarded as satisfying the legal requirement of reasonableness.

4. Unilateral determinations and adjustment by consent

257. There is still one other aspect of the matter that does not help the Respondent's argument about the consistency of the emergency measures with the domestic legal order. If changes indeed become necessary, they cannot be unilaterally adopted by the Government or its regulators, however competent they may be. This conclusion is supported by the view of a witness for the Respondent, who testified that because the crisis did not entail a merely circumstantial alteration of costs, but rather profound implications for contracts and licenses, "a negotiation between the State and the

concessionaires, not just the mere intervention of regulatory entities, was justified by the crisis."[79]

258. The decision to adjust contracts has either to be taken jointly by the parties, as in a successful renegotiation, or requested from a judge, as is provided for in Article 1198 of the Civil Code. In any event, this decision is subject to judicial control even when the relevant regulatory authority is entailed in a license. It so happens, however, that the domestic judicial control of the emergency decisions has been mostly adverse to the Respondent's claimed justification, as in the *Provincia de San Luis* case noted above.

259. It must also be noted that the licenses have carefully provided for a detailed adjustment mechanism so that tariffs are revised periodically in order to take into account the true conditions of the industry. This shows that the question of an eventual rebalancing of benefits was not ignored. The semi-annual PPI adjustment, an efficiency-related adjustment following the first quinquennial review, and an investment-related adjustment likewise applicable after this review were some of the mechanisms envisaged to reflect the changes in the value of goods and services for the operator. The five-year review was another such mechanism, as was the possibility, provided for by the License, of an extraordinary review to correct tariffs considered to be inadequate, discriminatory or preferential. This review could be initiated either by ENARGAS or the licensees.

260. All such mechanisms could equally have resulted in either an increase or reduction in tariffs. The interests of consumers could also have been addressed and protected by these mechanisms, particularly if the tariffs became unrealistic and excessive in the context of a changed economic environment. Such changes would also have met the Government's obligation under the License not to amend the License without the agreement of the licensees. Yet, the Government chose not to use the alternatives provided under the License, and resorted instead to the unilateral determination reached under the emergency measures. The 2007 Agreements reached by the Government with the Licensees in part seeks to correct this imbalance.

---

[79] Witness Statement of Mr. Eduardo Ratti, filed with Respondent's Counter Memorial, Spanish version, para. 31.

261. Even assuming that the implementation of any such mechanism would have taken some time, and that the Government needed to react quickly in confronting an emergency situation, which is a perfectly understandable concern, such measures could have been undertaken pursuant to a limited time schedule while reviews were carried out. It is the Government's unilateral determination, taken outside the appropriate regulatory system, and not the License corrections required, which resulted ultimately in the inconsistency of the measures taken with the domestic legal order.

The stability of licenses under Argentine administrative law

262. The Respondent has correctly argued that a situation involving the regulatory powers of the State and licenses concerning public services cannot be examined only from the point of view of private contracts, but also requires that principles arising from Argentine administrative law and jurisprudence be taken into consideration. This the Tribunal will examine next.

263. On the basis of Articles 14 and 17 of the Constitution, the Argentine Supreme Court has broadly interpreted the meaning of the right to property, so that "every right that has a value recognized as such under the law, whether it originates in private law relations or is born from administrative acts (subjective rights of public or private nature), is comprised within the constitutional concept of property, on the condition that the holder of this right to property has a right of action against anyone attempting to interfere with its use, even if it is the State itself."[80]

264. While it is true that such rights are not absolute, and that in certain circumstances they must yield to the public interest, it is nevertheless true that in such a case the State is obliged to compensate the owner affected or limited in the exercise of its right. This is the very principle embodied in Article 2511 of the Civil Code in respect of expropriation.

[80] *Bustos, Alberto Roque y otros c/ Estado Nacional y otros s/ amparo*, Corte Suprema de Justicia de la Nación, October 26, 2004.

265. The opinions of learned authors equally impose very specific conditions on the operation of the doctrine of the "fait du prince" that is applicable to administrative acts which would alter the contractual relationship to the detriment of the other party. Among such conditions is the requirement that an administrative act be of a general nature and attributable to the public authority, that it would alter the economic balance of the contract, and that it was unforeseeable at the time of the contract's execution. All of these lead to a right to compensation for the affected party.

266. As the expert report of Professor Mairal concludes in this matter, the measures presently in question were adopted by the Respondent's Government, while the Respondent was also a party to the contract with the licensees, and were unforeseeable at the time the Licenses were approved. There is also a direct causal relationship between the act and the damage suffered by the other party, all of it fundamentally altering the economic equation of the contract and thereby leading to the inescapable conclusion that compensation must be paid.[81]

267. The same conclusion is reached by Professor Mairal when examining the attribution of liability in the light of acts that breach the principle of equality in public obligations established under Article 16 of the Argentine Constitution, which would not permit a situation in which the licensees bore the entire cost of measures directed at preventing the sudden increase in gas tariffs.[82]

Liability under Argentine law

268. The Tribunal's inescapable conclusion is that in considering the claims solely from the point of view of the Argentine legislation as the law applicable to the dispute, the obligations and commitments which the Argentine Republic owed in relation to the License were not observed. Whether the question is examined from the point of view of the Constitution, the Civil Code or Argentine administrative law, the conclusion is no different. Liability is the consequence of such a breach, and there is no legal excuse

[81] Expert Statement of Professor Héctor A. Mairal, filed with Claimant's Memorial on the merit, p. 46.

[82] Expert Statement of Professor Héctor A. Mairal, filed with Claimant's Memorial on the merit, p. 47.

under the legislation that could justify the Government's non-compliance since the very conditions set out by the legislation and the decisions of courts have not been met. As will be examined further below, these conclusions are no different from those that could be reached under the Treaty and international law.

269. All the same, the Tribunal bears in mind that there was indeed a major crisis. While these unfortunate events do not in themselves amount to a legal excuse, neither would it be reasonable for the Claimant to believe it remains wholly unaffected by them. The economic balance of the License was clearly affected by the crisis, and just as it is unreasonable for the licensees to bear the entire burden of such a changed reality, neither would it be reasonable for them to believe that nothing has happened in Argentina since the License was approved. This is a point which the Tribunal will duly take into account when considering the compensation that follows upon this finding of liability and how the crisis period shall influence its determination.

The discussion of liability under the Treaty

270. The Tribunal must now examine the question of whether the breach of the License and its regulatory regime, in addition to its meaning under Argentine legislation, also results in a breach of the Treaty guarantees.

1. The claim of expropriation

271. The principal claim made in this arbitration is that the measures adopted since early 2000, and particularly those taken in 2002 pursuant to the Emergency Law, have both directly and indirectly expropriated the Claimant's investment in a manner contrary to the protection granted under Article IV of the Treaty. The Claimant argues that its investment comprises the equity in CGS and CGP, and also the specific contractual rights arising from the License regime. The Claimant maintains that its deprivation is permanent rather than merely ephemeral, and that no prompt, adequate

and effective compensation has been paid. In the Claimant's view, compensation must be paid irrespective of the purpose of the measures taken.[83]

272. The Claimant contends that the effects of the measures taken by the Government have been to significantly reduce the licensees' revenues, withhold owed subsidies, restrict the severance of employees to control costs, permanently repudiate vested legal rights, require the continuing provision of service regardless of unilateral changes made to the regime, subject the licensees to a coerced renegotiation process, and exclude the licensees from tariff adjustments if they seek to enforce their legal rights.

273. The Claimant asserts that the Respondent's measures resulted in the direct expropriation of the rights conferred on it by law and contract, in that all of these rights have been repudiated by the Emergency Law. The Claimant argues that since a claim for direct expropriation was not pleaded or addressed in *CMS*, the fact that in that case it was held that no expropriation had taken place is irrelevant to the resolution of the instant dispute, in which direct expropriation has allegedly occurred. The Claimant further argues that in *CMS* no question of expropriation of vested contractual and legal rights was pleaded. The Claimant invokes in support of its argument an OPIC "Memorandum of Determinations" of August 2, 2005 concerning an insurance claim brought by Enron in a similar dispute with Argentina, and concluding that "[i]nternational arbitral tribunals have recognized that rights under contracts are property subject to expropriation."[84]

274. The Claimant also argues that the measures in question are "tantamount to expropriation," and thus constitute an indirect or creeping expropriation unfolding over time and resulting in a cumulative substantial destruction of the investment's value. This kind of measure, the Claimant asserts, not only pertains to the day-to-day management and control of the investment, as was discussed in *CMS*, but also includes various forms of regulatory action resulting in the abrogation and repudiation of stabilization rights granted in the Licenses, just as the measures resulted in an

---

[83] *Compañía del Desarrollo de Santa Elena S. A. v. Republic of Costa Rica,* (ICSID Case No. ARB/96/1), Final Award of February 17, 2000, 15 ICSID Review—FILJ 169 (2000), paras. 71, 72.

[84] OPIC Memorandum of Determinations; Expropriation Claim of Ponderosa Assets, L.P.; Argentina, Contract of Insurance No. D733, August 5, 2005; *Enron Corp. and Ponderosa Assets, L. P. v. Argentine Republic,* (ICSID Case No. ARB/01/3), Award of May 22, 2007, para. 235.

interference with legitimate expectation, the assurances offered to induce the investment, and the capacity for rational decision-making on behalf of the business.

275. The Respondent argues as a preliminary point that the only rights which the Claimant could invoke in the context of expropriation are those relating to its condition as shareholder. The Respondent contends that the Claimant cannot lay claim to contractual or other rights since these pertain exclusively to the licensees.

276. The Respondent opposes the claims of direct and indirect expropriation on the basis of several tests that, in its view, are accepted in arbitral and judicial decisions as well as in the literature on expropriation. It first invokes the test of redistribution, arguing that there has been no transfer of property rights to the benefit of the Government or consumers. The Respondent asserts that there is no expropriation without redistribution.[85] The Respondent further argues that temporary measures, particularly emergency measures, do not qualify as expropriation as they do not entail a permanent deprivation of earnings or corporate rights, and as no such effects can be shown in the present dispute. The Respondent further contends that: (i) a substantial deprivation of fundamental property rights must be established, and that no such deprivation has taken place or been proven in this case; (ii) losses must be significant, and that the Claimant instead continues to benefit from earnings; (iii) the value of the investment would have been further reduced had the measures not been adopted; and (iv) a mere contract violation cannot be turned into a Treaty claim.

277. On the other hand, the Respondent argues that the purpose of the measures is relevant to the determination of an expropriation claim, particularly if such measures are adopted under the police power of the State and are proportional to the requirements of public interest. Moreover, the Respondent maintains, the Treaty does not protect legitimate expectations, but rather only specific rights. The Respondent argues that in this case none of the measures questioned can be assimilated to those deemed in other cases to be inconsistent with the guarantees offered to induce investment, or amounts to a destruction of the capacity for rational decision-making. It is also asserted that a

---

[85] *Ronald S. Lauder v. The Czech Republic*, UNCITRAL Arbitration Proceeding, Final Award of September 3, 2001, available at <http://ita.law.uvic.ca/documents/LauderAward.pdf>, cited in Respondent's Counter Memorial, para. 330.

legitimate expectation cannot in any event arise from mere road shows or information materials not attributable to the Government.

278. The Tribunal is again grateful to the parties' counsel for having undertaken a detailed explanation of their respective views on the issue of expropriation, and for invoking in support of their arguments a wealth of decisions, scholarly opinions and other authorities that allow the Tribunal to understand the parties' arguments in all their aspects and differences.

279. The first question which the Tribunal must consider is that concerning the protected investment. The parties do not dispute that equity is a protected investment under the Treaty, but they differ on whether the Claimant has other rights, particularly those of a legal or contractual nature. As the Tribunal explained in the Decision on Jurisdiction, the Treaty definition of investment is quite broad, with the equity investment being in this context the vehicle through which a complex business relationship is developed. The investment can also be affected in other ways by the measures in question. This is the case, for example, with the measures affecting the tariff regime envisaged in the License, which is the key factor determining the success or failure of the equity investment in CGS and CGP. The expropriation claim can therefore refer to those elements of the investment that are inextricably linked to the legal and contractual framework that governs the operation of the business.

280. This discussion turns out in any event to be rather academic in view of the Tribunal having been persuaded by the merits of the Respondent's argument on expropriation. The Tribunal does not in fact believe that there can be a direct form of expropriation if at least some essential component of the property right has not been transferred to a different beneficiary, in particular the State. In this case, it can be argued that economic benefits may have to some extent been transferred from the industry to consumers, or from the industry to another industrial sector, and that this will ultimately benefit society and the State as a whole. This does not, however, amount to an effect upon a legal element of the property held, such as title to property.

281. It is quite true, as argued by the Claimant, that interference with contractual rights can in certain circumstances amount to an expropriation. Yet, in the instant case

the Tribunal is not persuaded that such has been the result of the measures taken. In spite of all the difficulties which the Licensees and the investors have experienced, and which have doubtlessly affected rational management,[86] they are still the rightful owners of the companies and their business. No one else has or could lawfully claim any such right. While the noted adverse effects can give rise to compensation, they cannot do so in connection with direct expropriation. The same is true with respect to the breach of stability clauses under the contract which, while potentially resulting in damage, is to be protected against and eventually compensated under a separate Treaty guarantee rather than under the heading of expropriation.

282. It is at this point that the intention to expropriate becomes relevant, and the parties have discussed this matter with clear attention. The Tribunal is persuaded that while many damages can be inflicted unintentionally, and as such will be entitled to compensation if liability is found to exist, a transfer of property and ownership requires positive intent. This is not a question of formality, but rather one of establishing a causal link between the measure in question and the title to property.

283. The question of indirect or creeping expropriation requires a more complex assessment. The Tribunal has no doubt about the fact that such expropriation can arise from many kinds of measures, and that these have to be assessed by their cumulative effects. Yet, in this case, the Tribunal is not convinced that such has happened either.

284. The Respondent has invoked, among other authorities, the list of measures considered in the *Pope & Talbot* case as being tantamount to expropriation. These are, in the Tribunal's view, representative of the legal standard required to make a determination on alleged indirect expropriation. Substantial deprivation results under this list from depriving the investor of control over the investment, managing the day-to-day operations of the company, arresting and detaining company officials or employees, supervising the work of officials, interfering in administration, impeding the distribution of dividends, interfering in the appointment of officials or managers, or depriving the company of its property or control in whole or in part.[87] The list of

---

[86] Witness Statement of Mr. Martin Juan Blaquier of June 30, 2003, Claimant's Exhibit 7E, para. 40.

[87] *Pope & Talbot Inc. v. Government of Canada*, Interim Award of June 26, 2000, para. 100.

measures could be expanded significantly in the light of the findings of many other tribunals, [88] but would still have to meet the standard of having as a result a substantial deprivation of rights.

285. Many of the measures discussed in the instant case have had a very adverse effect on the conduct of the business concerned. This is, however, again a question that the Treaty addresses in the context of other safeguards for protecting the investor. A finding of indirect expropriation would require more than adverse effects. It would require that the investor no longer be in control of its business operation, or that the value of the business have been virtually annihilated. This is not the case in the present dispute.

286. The Tribunal must accordingly conclude that the Government did not breach the standard of protection established in Article IV(1) of the Treaty by adopting the measures complained of. This holding is without prejudice to the other findings which the Tribunal will make below in connection with these measures.

287. The question of devaluation has also been discussed by the parties in the context of its influence on a determination of expropriation. Each party has done so particularly in the light of the meaning it respectively attaches to the *Himpurna* case.[89] As the Tribunal has explained above, however, this is not a dispute about devaluation, nor has such been claimed. The dispute is instead about an alleged breach of rights under the regulatory framework and the License. The devaluation discussion thus does not alter the Tribunal's determination about expropriation.

288. Legitimate expectation is also an issue which the parties have discussed, and is subject to protection under broadly conceived treaty standards and international law. This does not mean, however, that this right will operate to make the test for indirect expropriation less stringent.

---

[88] Campbell McLachlan, L. Shore and M. Weiniger: International Investment Arbitration. Substantive Principles, 2007, 298-309.

[89] *Himpurna California Energy Ltd. v. Republic of Indonesia*, May 4, 1999.

289. The Respondent has argued that the Government also had many expectations in respect of the investment that were not met or were otherwise frustrated. Apart from the question of investment risk, it is alleged that there was, *inter alia*, the expectation that the investor would bear any losses resulting from its activity, work diligently and in good faith, not claim extraordinary earnings exceeding by far fair and reasonable tariffs, resort to local courts for dispute settlement, dutifully observe contract commitments, and respect the regulatory framework. The Tribunal notes that to the extent that any such issues would be within the Tribunal's jurisdiction to decide, and could have resulted in breaches of the Treaty, the Respondent would be entitled to raise a counterclaim. While this right has been resorted to by Respondent States only to a limited extent in cases submitted to ICSID tribunals, nothing prevents its exercise in the light of Article 46 of the Convention and Rule 40 of the Arbitration Rules. This right was not exercised in the present case.

2. The claim concerning the standard of fair and equitable treatment

290. The Claimant has argued that, in addition to effecting an expropriation, the Respondent has in various ways breached the standard of fair and equitable treatment established under Article II(2)(a) of the Treaty, including by failing to act in good faith, frustrating the Claimant's legitimate expectations, unreasonably interfering with the investor's property rights, violating and repudiating assurances and representations offered to attract foreign investment, altering the legal and business environment upon which the Claimant had relied in making the investment, failing to provide a stable and predictable legal environment, and abusing its rights.

291. The Claimant explains that while this particular standard originates in the obligation of good faith under international law, it has gradually acquired a specific meaning in the light of decisions and treaties, and requires, *inter alia*, a treatment compatible with the expectations of foreign investors,[90] the observance of arrangements

[90] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* , (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, 43 *ILM* 133 (2004), para. 115.

on which the investor has relied in making the investment,[91] and the maintenance of a stable legal and business framework.[92]

292. The Respondent's argument on this point is based on the premise that fair and equitable treatment is a standard indistinguishable from the customary international minimum standard, and that it is not for tribunals to set out its meaning and even less to legislate on the matter. The Respondent asserts that this view is confirmed by the practice of a number of governments, NAFTA and ICSID decisions, and opinions of learned writers.

293. In the Respondent's view, what has been criticized by recent decisions is a kind of conduct that evidences either inconsistency in State action,[93] radical and arbitrary modification of the regulatory framework,[94] or endless normative changes to the detriment of the investor's business as decided in the *OEPC* case cited. None of these, the Respondent's argument follows, is present in the instant case since the measures adopted were eminently reasonable in the light of the economic crisis described above, and of the changes in the economic conditions of the country.

294. The Respondent maintains in particular that devaluation was the result of market decisions, and that the consistent decisions of courts in other crises have reaffirmed the constitutionality of such a measure, most notably in the context of the Great Depression in the U.S. The *Thunderbird v. Mexico* decision[95] has also been invoked by the Respondent in support of its view that the standard of fair and equitable treatment does not include the protection of legitimate expectations, and it is no different from the international minimum standard.[96]

---

[91] *CME Czech Republic B.V. v. Czech Republic*, Partial Award of September 13, 2001, as published in http://www.investmentclaims.com/decisions/CME-Czech-PartialAward-13Sept2001.pdf, para. 611.

[92] *Occidental Exploration and Production Company (OEPC) v. The Republic of Ecuador*, LCIA Case No. UN3467, Final Award of July 1, 2004, <http://www.asil.org/ilib/OEPC-Ecuador.pdf >, para. 183.

[93] *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile*, (ICSID Case No. ARB/01/7), Award of May 25, 2004, <http://www.asil.org/ilib/MTDvChile.pdf>para. 164.

[94] *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States,* (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, 43 *ILM* 133 (2004), para. 154

[95] *International Thunderbird Gaming Corporation v. The United Mexican States*, Award of January 26, 2006, http://www.iisd.org/pdf/2006/itn_award.pdf, para. 147.

[96] Respondent's Post Hearing Brief, para. 100.

295. Again, counsel for the parties have competently discussed their respective views and arguments in great detail, with particular reference made to the many past and contemporary decisions that have purported to clarify the standard of treatment required under international law generally and bilateral investment treaties in particular.

296. The Tribunal finds the Respondent to be right in arguing that fair and equitable treatment is a standard that is none too clear and precise. This is because international law is itself not too clear or precise as concerns the treatment due to foreign citizens, traders and investors. This is the case because the pertinent standards have gradually evolved over the centuries. Customary international law, treaties of friendship, commerce and navigation, and more recently bilateral investment treaties, have all contributed to this development.[97] Not even in the case of rules which appear to have coalesced, such as denial of justice, is there today much certainty.

297. The evolution that has taken place is for the most part the outcome of a case-by-case determination by courts and tribunals, as is evidenced by many investment treaty and NAFTA decisions, including the *Tecmed*, *OEPC* and *Pope & Talbot* cases cited. This shows that, as with the international minimum standard, there has been a fragmentary and gradual development. However, it has been rightly commented that essentially "the purpose of the clause as used in BIT practice is to fill gaps which may be left by the more specific standards, in order to obtain the level of investor protection intended by the treaties."[98] The principle of good faith is thus relied on as the common guiding beacon that will orient the understanding and interpretation of obligations, just as happens under civil codes.[99]

298. The essence of the protection sought was well explained in *Tecmed*, where the tribunal held in the light of the good faith requirement that under international law, the foreign investment must be treated in a manner such that it "will not affect the basic expectations that were taken into account by foreign investor to make the

---

[97] Stephen Vasciannie: "The Fair and Equitable Treatment Standard in International Investment Law and Practice," British Yearbook of International Law, (1999), vol. 70, p. 100.

[98] Rudolf Dolzer: "Fair and Equitable Treatment: a Key Standard in Investment Treaties", The International Lawyer, 2005, Vol. 39, No. 1, 87-106, at p. 90

[99] *Ibid*. at 91.

investment."[100] This requirement becomes particularly meaningful when the investment has been attracted and induced by means of assurances and representations, as has been established in the jurisprudence that the Claimant has invoked.[101] The recent *Thunderbird* case does not alter at all the meaning of this protection in the context of fair and equitable treatment. This is so first because it reaffirms the relevance of the standard in question, and next, most importantly, because it finally decided the issue with respect to a question arising from a misrepresentation made by the Claimant to the Mexican Government that precisely violated the principle of good faith which is at the heart of the concept of fair and equitable treatment.[102]

299. The Respondent has distinguished a number of recent cases in which the principle of fair and equitable treatment has been upheld, particularly the *Tecmed*, *MTD* and *OEPC* cases. This is correct given that the circumstances of individual cases are almost invariably different. There remains, however, a requirement of good faith that permeates the whole approach to the protection granted under treaties and contracts. Even if the standard were restricted to a question of reasonableness and proportionality not entailing objective liability, as the Respondent argues in the light of *Tecmed*, there are nevertheless expectations arising from promises that must be respected when relied upon by the beneficiary.

300. It follows that it would be wrong to believe that fair and equitable treatment is a kind of peripheral requirement. To the contrary, it ensures that even where there is no clear justification for making a finding of expropriation, as in the present case, there is still a standard which serves the purpose of justice and can of itself redress damage that is unlawful and that would otherwise pass unattended. Whether this result is achieved by the application of one or several standards is a determination to be made in the light of the facts of each dispute. What counts is that in the end the stability of the law and the observance of legal obligations are assured, thereby safeguarding the very object and purpose of the protection sought by the treaty.

---

[100] *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, (ICSID Case No. ARB(AF)/00/2), Award of May 29, 2003, para. 154.

[101] *Embassy Limousines & Services v. European Parliament,* [1998] ECR II-4239, para. 8, cited in Claimant's Memorial footnote 708.

[102] Claimant's Post Hearing brief of April 3, 2006, para. 47.

301. It must also be kept in mind that on occasion the line separating the breach of the fair and equitable treatment standard from an indirect expropriation can be very thin, particularly if the breach of the former standard is massive and long-lasting. In case of doubt, however, judicial prudence and deference to State functions are better served by opting for a determination in the light of the fair and equitable treatment standard. This also explains why the compensation granted to redress the wrong done might not be too different on either side of the line.

302. It might well be that in some circumstances in which the international minimum standard is sufficiently elaborate and clear, the standard of fair and equitable treatment might be equated with it. But in other cases, it might as well be the opposite, so that the fair and equitable treatment standard will be more precise than its customary international law forefathers. On many occasions, the issue will not even be whether the fair and equitable treatment standard is different or more demanding than the customary standard, but only whether it is more specific, less generic and spelled out in a contemporary fashion so that its application is more appropriate to the case under consideration. This does not exclude the possibility that the fair and equitable treatment standard imposed under a treaty can also eventually require a treatment additional to or beyond that of customary law. Such does not appear to be the case with the present dispute, however. The very fact that recent interpretations of investment treaties have purported to change the meaning or extent of the standard only confirms that, those specific instruments aside, the standard is or might be a broader one.

303. The measures in question in this case have beyond any doubt substantially changed the legal and business framework under which the investment was decided and implemented. Where there was business certainty and stability, there is now the opposite.[103] The tariff regime speaks for itself in this respect. A long-term business outlook has been transformed into a day-to-day discussion about what is next to come. The guarantees given are no longer available. The Respondent might be right in distinguishing this case from the situations that recent decisions had in view, but this

---

[103] *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability of October 3, 2006, available at <http://www.worldbank.org/icsid/cases/pdf/ARB021_LGE-Decision-on-Liability-en.pdf>, paras. 124, 125.

does not mean that the present conditions are consistent with the meaning of the protection granted under the Treaty.

304. Even assuming that the Respondent was guided by the best of intentions, what the Tribunal has no reason to doubt, there has here been an objective breach of the fair and equitable treatment due under the Treaty. The Tribunal thus holds that the standard established by Article II(2)(a) of the Treaty has not been observed, to the detriment of the Claimant's rights.

3. The claim concerning the alleged breach of the umbrella clause

305. The Claimant has also brought to this Tribunal a claim about an alleged breach of the observance of the obligations into which the Respondent entered with regard to the investment in the light of the "umbrella clause" of Article II(2)(c) of the Treaty. This aspect of the claim is built on the premise that the envisaged protection is an expression of the obligation to observe the principle *pacta sunt servanda*. The Claimant cites in this context the view of Judge Higgins to the effect that this principle and its related acquired rights "emphasize the protection that the private party has been given against either a later change of mind by the State or against the exercise of the State's regulatory powers."[104]

306. The Claimant argues that the umbrella clause applies to obligations arising from a contract or from broader undertakings contained in the State's own law, and that the Respondent's measures breached every commitment made in the Gas Law, the Gas Decree and the License. The Claimant makes particular reference to the tariff regime and the Government's commitment not to amend the License without the consent of CGS or CGP, respectively.

307. The Respondent opposes this claim, arguing that under customary law violations of contracts cannot be equated with a treaty breach and consequently do not engage the

[104] R. Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 Recueil des Cours 267, 347 (1982), as cited in Claimants' Consolidated Memorial on the merits, para. 444, footnote. 721.

international responsibility of the State.[105] The Respondent further contends that, as held in *SGS v. Pakistan*, contract claims do not qualify as BIT claims.[106] The Respondent also maintains that the tribunal in *SGS v. Philippines*, while disagreeing with some aspects of the *Pakistan* decision, still held that the umbrella clause comprises only obligations undertaken with respect to a specific investment, and thus that the clause does not extend to ordinary contractual breaches, which must instead be taken to the contract forum.

308. In any event, according to the Respondent, since the commitments were made in respect of the Licensees they cannot be invoked by the Claimant, and the License does not qualify as an investment agreement. The Respondent invokes the *Noble Ventures v. Romania* decision insofar as it would limit the application of the umbrella clause to investment contracts which do not include a license.[107] The Claimant opposes such an interpretation, finding instead that *Noble Ventures* referred to contracts made with regard to an investment.[108] The Award in the *Encana* case[109] has also been invoked by the Respondent as rejecting the view that a Claimant can rely on a contract to which the State and a local corporation in which the Claimant has invested are parties.[110]

309. Various recent decisions have dealt with the meaning and extent of the "umbrella clause", and the mystery surrounding the matter seems to be gradually lessening.[111] The parties are in agreement that a contractual breach does not necessarily

---

[105] *Noble Ventures, Inc. v. Romania*, (ICSID Case No. ARB/01/11), Award of October 12, 2005, <http://www.investmentclaims.com/decisions/Noble-Ventures-Final-Award.pdf>, para. 53.

[106] *Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (ICSID Case No. ARB/01/13), Decision of the Tribunal on Objections to Jurisdiction of August 6, 2003, available at http://www.investmentclaims.com/decisions/SGS-Pakistan-Jurisdiction-6Aug2003.pdf.; see also *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic* (ICSID Case No. ARB/97/3), Decision on Annulment of July 3, 2002, para. 96.

[107] Respondent's Opening Statement, Hearing Transcript, Vol. 1, February 6, 2006, para. 160.

[108] Claimant's Post Hearing brief of April 3, 2006, para. 50.

[109] *EnCana Corporation v. Republic of Ecuador*, LCIA Case No. UN3481, UNCITRAL, Award, of February 3, 2006.

[110] Respondent's Post Hearing brief, para. 112.

[111] *Fedax N.V. v. Venezuela,* (ICSID Case No. ARB/96/3), final award of March 9, 1998, *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan,* (ICSID Case No. ARB/01/13), Decision on Jurisdiction of August 6, 2003; *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines,* (ICSID Case No. ARB/02/6), Decision on Jurisdiction of January 29, 2004; *Joy Mining Machinery Limited v. Arab Republic of Egypt* (ICSID Case No. ARB/03/11), Award of August 6, 2004; *Noble Ventures, Inc. v. Romania*, (ICSID Case No. ARB/01/11), Award of October 12, 2005; *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Jordan*, (ICSID Case No. ARB/02/13), Award of January 31, 2006; *Impregilo S.p.A. v. Islamic Republic of Pakistan*, (ICSID Case No. ARB/03/3), Decision on Jurisdiction of April 22, 2005; *El Paso Energy International Company v. The Argentine Republic*, (ICSID

result in a Treaty breach unless it simultaneously violates a right or obligation protected under the Treaty. The difference between the parties arises rather from the view of one party that no breach of the License has occurred, or that, if the contrary is the case, the License is not an investment agreement made with the Claimant. The other party's view is that the violations of the License are manifest and not ordinary contractual breaches. Instead, they allegedly entail the violation of Treaty rights and obligations, and consequently trigger the operation of the umbrella clause.

310. The Tribunal fully shares the view that ordinary commercial breaches of a contract are not the same as Treaty breaches, as was well explained by the tribunal in *SGS v. Philippines* when distinguishing a contractual dispute over payment from a Treaty dispute. So too, the Tribunal can only agree with the view adopted in *SGS v. Pakistan* that such a distinction is necessary so as to avoid an indefinite and unjustified extension of the umbrella clause. The decisions dealing with the issue of the umbrella clause and the role of contracts in a Treaty context have all distinguished breaches of contract from Treaty breaches on the basis of whether the breach has arisen from the conduct of an ordinary contract party, or rather involves a kind of conduct that only a sovereign State function or power could effect.[112]

311. In many cases, it might be difficult to draw this distinction, as not every kind of conduct can be clearly ascribed to one or the other type. The measures discussed before this Tribunal are not, however, mere ordinary contractual breaches of a commercial nature. They are instead the outcome of major legal and regulatory changes introduced by the State, and give expression to a change of policy that is evidently not what was envisaged in the License and legal framework governing the privatization and the investments made in its context. Only the State, and not an ordinary contract party, can decide that such sweeping changes will operate as part of the public function. Contractual breaches made in this context are far from ordinary, and may in themselves be a source of Treaty violations if they affect a right protected under the Treaty.

Case No. ARB/03/15), Decision on Jurisdiction of April 27, 2006; *Enron Corp. and Ponderosa Assets, L. P.v. Argentine Republic,* (ICSID Case ARB/01/3), Award of May 22, 2007, paras. 275-276.

[112] *Impregilo S.p.A. v. Islamic Republic of Pakistan,* (ICSID Case No. ARB/03/3), Decision on Jurisdiction of April 22, 2005, para. 260.

312. Even if the umbrella clause is considered in the light of the limited understanding provided for it by the *SGS v. Philippines* tribunal, to wit that it extends only to obligations undertaken with respect to a specific investment agreement and its related aspects, the clause applies in this case. Jurisdictional aspects aside, the License is the ultimate expression of a series of complex investment arrangements made with the specific intention of channeling the influx of capital into newly privatized companies. Such a network was required under the law and the regulations, and it is therefore impossible to argue now the separation of the License from the investments made in the resulting process.

313. Specific obligations undertaken not to freeze the tariffs or subject them to price controls, to compensate for any resulting differences if such actions were in fact taken, and not to amend the License without the licensee's consent are among the obligations that typically come under the protection of the umbrella clause. There are other obligations contained in the License and the law that could also eventually fall under the protection of the umbrella clause, such as those concerning detailed aspects of the tariff regime. As some of these relate more closely to the breach of fair and equitable treatment, they have been considered above.

314. The Tribunal accordingly concludes that the breach of the aforementioned obligations undertaken in respect of the investment have resulted in a breach of the protection provided by the umbrella clause of Article II(2)(c).

4. The claim about arbitrariness and discrimination

315. The Claimant asserts that there has also been a breach of Article II(2)(b) of the Treaty because the measures adopted are both arbitrary and discriminatory. The claim of arbitrariness is based on the argument that such measures destroyed the Claimant's rights and reasonable expectations, lacked proportionality, and were in violation of the law. The claim of discrimination for its part relies on the Claimant's view that the measures fell disproportionately on the largely foreign-owned gas sector.

316. The Respondent opposes this claim, asserting that the measures were consistent with the law and aimed at the continuing operation of the companies and the maintenance of their income and earnings, while at the same time being reasonable and proportionate to the purpose sought. In any event, the Respondent maintains, there was no intention to breach the rule of law or affect judicial propriety, with such intent being an element required by numerous judicial and arbitral decisions.

317. Neither has there been any discrimination, the Respondent contends, because the regulated gas sector is very different from other sectors operating in a competitive market, such as banking, and because the entities involved are far from being in a similar or even comparable situation. In the Respondent's view, there cannot be discrimination if actors are treated differently in the light of each individual's or sector's requirements. Least of all has there been any capricious, irrational or absurdly differential treatment of the Claimant, who is not even among those who have suffered the most severe consequences of the measures adopted.

318. After examining the detailed arguments of the parties and their supporting authorities and decisions, the Tribunal remains unpersuaded by the Claimant's view that there is here arbitrariness or discrimination. The measures adopted might have been good or bad, but this is not a matter which is for the Tribunal's to judge. As the Tribunal has already concluded, they were inconsistent with the domestic and Treaty frameworks. They were not, however, arbitrary in that they responded to what the Government believed and understood to be the best response to the unfolding crisis. Irrespective of the question of intent, a finding of arbitrariness requires that some important measure of impropriety be manifest. This is not found in a process which, although far from desirable, is nonetheless not entirely surprising in the context in which it took place.

319. The Tribunal reaches a similar conclusion in respect of the alleged discrimination. There are quite naturally important differences between the various affected sectors, so it is not surprising that different solutions might have been or are being sought for each. It could not be said, however, that any such sector has been particularly singled out either to have applied to it measures harsher than in respect of others, or conversely to be provided with a more beneficial remedy to the detriment of

another. The Tribunal does not find that there has been any capricious, irrational or absurd differentiation in the treatment accorded to the Claimant as compared to other entities or sectors.

320. The Tribunal accordingly concludes that the Respondent has not breached the duty of protection established under Article II(2)(b) of the Treaty.

5. The claim concerning the alleged failure to give full protection and security

321. Lastly, the Claimant argues that there has been a failure to give full protection and security to its investment, as is required under Article II(2)(a) of the Treaty. The Claimant relies in this regard on the broader interpretation of this requirement made particularly in *CME*, in which the standard was deemed applicable not just to physical security but also to the legal protection of the investment.

322. The Respondent believes differently, arguing first that the standard relates only to physical protection and security, as is evidenced in *AAPL* and *AMT*, in which installations were destroyed. The Respondent next asserts that the support of *CME* does not mean that the Claimant's interpretation of the standard is the one accepted under international law, particularly as it was contemporaneously contradicted by the opposite conclusion in *Lauder*.

323. There is no doubt that historically this particular standard has been developed in the context of physical protection and the security of a company's officials, employees and facilities. The Tribunal cannot exclude as a matter of principle the possibility that there might be cases in which a broader interpretation could be justified. Such situations would, however, no doubt constitute specific exceptions to the operation of the traditional understanding of the principle. If such an exception were justified, then the situation would become difficult to distinguish from that resulting in a breach of fair and equitable treatment, and even from some form of expropriation.

324. In this case, there has been no allegation of a failure to give full protection and security to officials, employees or installations. The general argument made about a possible lack of protection and security in the broader ambit of the legal and political

system has in no way been proven or even adequately developed. The Tribunal accordingly rejects this claim and finds that no breach of Article II(2)(a) of the Treaty has taken place.

The alternative plea of emergency

325. In case the Tribunal found that a breach of the Treaty had taken place, the Government has pleaded in the alternative an exemption from liability in the light of a national emergency or state of necessity under domestic law, general international law and the Treaty, all based on the severity of the crisis that has affected the country since 2000.

326. The Respondent has explained in detail the severity that characterized the crisis affecting the country, which in its view threatened the very existence of the State and its independence. The Respondent asserts in particular that the significant decreases in the Argentine Gross Domestic Product, consumption and investment during the crisis period, together with deflation and the reduction in value of Argentine corporations, resulted in widespread unemployment and poverty, with dramatic consequences for health, nutrition and social policy. Public institutions were also no longer functioning. A witness for the Respondent describes the crisis as "a combination of political, economic, financial, institutional, fiscal circumstances that coalesced."[113]

327. With a view to overcoming such difficulties, there was an urgent need to resort to emergency, described by the Respondent as a severe form of necessity, and which materialized in the 2002 Emergency Law. The Respondent explains in this respect that the Emergency Law was not the cause of the unfolding economic emergency, but rather the normative consequence of a situation that had become manifest in world financial markets. The Respondent maintains that the measures adopted were the remedy recommended by distinguished economists and led to the gradual recovery that is noticeable at present.

---

[113] Testimony of Mr. Eduardo Ratti, Hearing Transcript, Vol. 3, February 8, 2006, pp. 442-445.

1. Necessity and emergency under the Argentine Constitution

328. The Respondent explains that the Argentine Constitution provides for various kinds of emergency measures, including most prominently those for dealing with economic emergencies such as the one declared by Congress in this case. The Respondent contends that as a public act, such a declaration benefits from a presumption of legality, albeit subject to constitutional control by the judiciary. According to the Respondent, the emergency legislation meets the requirements laid down by judicial decisions to the extent that there exists a state of necessity, the rules are aimed at attending to a public interest, the remedy introduced is proportional to the emergency, and its time frame is reasonable and related to the causes of the emergency. So too, in the view of the Respondent, the measures enacted by the Government when acting on powers delegated by Congress observe the legal requirements of emergency as provided under the Constitution.

329. In the Claimant's view, the Respondent has not demonstrated that the degree of threat required to invoke the defense of necessity has been met, particularly since the existence of the State has not been imperiled as if it faced a military threat. Nor, according to the Claimant, has it been demonstrated that the derogation from the specific guarantees and disputed obligations was justified.

330. The Tribunal has examined above the circumstances of the measures complained of in the context of the Argentine legislation. While there can be no doubt that "emergency" has been continuously invoked and recognized in Argentina, it is precisely for this reason that the courts have been careful in stating the conditions under which emergency may be exercised and legally validated. The case of *Peralta* is well known for having set out the limits of emergency legislation with regard to both the temporal effects of the measures taken and the obligation not to alter the substance of contracts.[114] During the hearing, the *Bourdieu* case was discussed in the context of the recognition that concessions and other contracts with the State entail "ownership rights"

---

[114] *Peralta v. Estado Nacional*, CSJN 313 Fallos 1513 (1990), cited in the Second Expert Report of Professor Héctor A. Mairal of September 14, 2005, Cl. Exh 188, paras. 91-96.

protected under the Constitution.[115] In the context of the present emergency, the Tribunal is mindful of the specific requirements laid down in *Provincia de San Luis*, and these, as has been concluded above, have not been met by the emergency legislation. It follows that the very constitutional provisions which were subject to judicial control and which led to the definition of those conditions cannot be invoked to preclude a finding of wrongfulness as to the measures adopted if they do not comply with the conditions indicated.

331. The discussion about institutional survival and preservation of the constitutional order has also been related to the provisions of the Inter-American Convention on Human Rights, to which Argentina is a party. At the hearing, Counsel for the Respondent put the following question to a legal expert: "[W]ould Argentina have been compelled because of the Inter-American Convention to maintain its constitutional order towards the end of 2001, 2002, and afterwards?"[116] The answer from Professor Reisman was "[y]es."[117]

332. This debate raises the complex relationship between investment treaties, emergency and the human rights of both citizens and property owners. Yet, the real issue in the instant case is whether the constitutional order and the survival of the State were imperiled by the crisis, or instead whether the Government still had many tools at its disposal to cope with the situation. The Tribunal believes that the constitutional order was not on the verge of collapse, as evidenced by, among many examples, the orderly constitutional transition that carried the country through five different Presidencies in a few days' time, followed by elections and the reestablishment of public order. Even if emergency legislation became necessary in this context, legitimately acquired rights could still have been accommodated by means of temporary measures and renegotiation.

---

[115] Examination by Mr. Roberto Aguirre Luzi, Hearing Transcript, Vol. 3, February 8, 2006, pp. 465-466; see also Supreme Court in *Bourdieu v. Municipalidad de la Capital*, 145 Fallos 307, 327(1925), cited in the Second Expert Report of Professor Héctor A. Mairal of September 14, 2005, Cl. Exh 188, para. 62, footnote 38.

[116] Remarks of Mr. Gabriel Bottini, Hearing Transcript, Vol. 6, February 11, 2006, pp. 1021-1022.

[117] Expert Statement of Professor W. Michael Reisman, Hearing Transcript, Vol. 6, February 11, 2006, p. 1022.

2. *The plea of state of necessity under customary international law*

333. The Respondent maintains in this respect that the concept of "state of necessity" has consolidated itself under international law so as to foreclose any wrongfulness on the part of measures adopted in its context and to exempt the State from international responsibility. The *Neptunus* case and the *Gabcíkovo-Nagymaros* judgment, as well as Article 25 of the International Law Commission's Articles on State Responsibility, are invoked in support of this conclusion.

334. The Respondent argues in particular that it has not contributed to the state of necessity since most of the relevant factors were exogenous, the measures adopted were the only means to safeguard an essential interest against a grave and imminent peril because otherwise the situation would have gone out of control, no essential interest of other States benefiting from the obligation or of the international community as a whole have been seriously impaired, and the Claimant, CGS and CGP have not been treated differently from other investors in this sector.

335. In answering the Claimant's arguments, the Respondent distinguishes the *Himpurna* case from its own situation on the ground that in that case the State company PLN had expressly waived in the contract the possibility of invoking *force majeure* in justification of non–performance, and that the alleged events were not proven. This, in the Respondent's view, explains the tribunal's decision not to admit economic emergency. So too, the Respondent distinguishes *Socobelge*, in which the financial situation of Greece never came to be considered by the Permanent Court of International Justice.

336. The Respondent emphasizes in particular the view of experts that Argentina had no other option than to undertake the pesification of its contractual relations since every other remedy was unviable.[118] Furthermore, as already noted, it is argued that Argentina did not contribute to the situation of necessity because the main difficulties originated in external shocks, including the Asian and Russian crises, devaluation in

[118] First Expert Report of Professor Nouriel Roubini of July 13, 2005, para. 37 *et seq*.

Brazil, and the strengthening of the U.S. dollar. An expert for Argentina concludes that the option of dollarization at the old parity in order to avoid depreciation "was altogether undesirable and most likely unfeasible."[119]

337. Following the *Gould* case, the Respondent concludes that in view of the existence of a state of necessity, any damage caused is not attributable to the State as it originates in "social and economic forces beyond the power of the state to control through the exercise of due diligence."[120] Compensation is thus not due, in the Respondent's view.

338. While the Claimant shares the Respondent's view that Article 25 of the Articles on State Responsibility reflects customary international law in this matter, it believes that the Respondent has not met the requirements for the preclusion of a wrongfulness finding under that Article. Specifically, the Claimant maintains that Argentina has not demonstrated that it was threatened by a grave and imminent peril, that the measures adopted were the only way to safeguard against that peril, that the obligation in question does not exclude the defense of necessity, and that the Government did not contribute to the state of necessity. The Claimant relies upon *Himpurna* and *Socobelge* in support of these assertions.

339. The Claimant emphasizes that, contrary to the Respondent's assertion, the crisis finds its origins in endogenous factors which, in the view of another expert, are almost entirely the result of Argentina's own policy failures,[121] particularly the failure to implement structural reforms in the 1990's to ensure fiscal discipline, labor market flexibility, open foreign trade and the maintenance of the currency board's credibility. The Claimant further argues that options other than pesification were available, and thus that pesification was not the only way to address the crisis. The Claimant also points out that among the options discussed were the structural reforms earlier noted, the agreed restructuring of Argentina's debt, dollarization, and devaluation without pesification.

---

[119] Second Expert Report of Professor Nouriel Roubini of November 28, 2005, par 58.

[120] *Gould. Marketing Inc., as succesor to Hoffman Export Corporation v. Ministry of National Defense of Iran*, 3 IRAN-US C.T.R. 147 (AL RA 202), cited in Respondent's Rejoinder, footnote 213.

[121] Expert Report of Professor Sebastian Edwards of September 13, 2005, Claimant's Reply memorial, Exhibit 183, paras. 33-59

The expert explained that such alternative plans have worked in other countries, such as Uruguay.

340. Asked by the Tribunal about the various alternatives available to Argentina in the crisis, the Claimant's expert stated that, in his view, there was still time in 2000 and 2001 to implement the appropriate policies to sustain the currency board, and that this was the first best option. Because this was not done, dollarization was preferable to devaluation in the expert's view, and even in the case of devaluation there was no need to undertake a costly pesification of contracts.[122]

341. The expert opinion of Professor Sebastián Edwards can be summarized as reaching the following main conclusions: (i) Argentina itself primarily caused its economic crisis by making policy mistakes prior to 2001, and also through a series of additional mistakes in 2001; (ii) external shocks played a limited role in the Argentine economic crisis; (iii) the country had a number of options available to it throughout the 1990's, and also during 2000 and 2001; and (iv) even after devaluation, Argentina did not have to pesify.[123]

342. A rebuttal opinion by Professor Nouriel Roubini was introduced by the Respondent in opposition to the Claimant's views and its expert's analysis.[124] Professor Roubini has also explained in other reports that at least some domestic factors contributed to the collapse of the currency board, most notably structural rigidities in the economy, fiscal deficits and debt accumulation. In Professor Roubini's view, however, the crisis was triggered mostly by external shocks.[125]

343. The conclusion which the Claimant reaches is that even in the case of a state of necessity, the preclusion of wrongfulness is established without prejudice to: (i) the requirement of compliance with the obligation concerned if and to the extent that the circumstance precluding wrongfulness no longer exists; and (ii) the question of compensation for any material loss caused by the measures adopted. This is allegedly in

---

[122] Expert Statement of Professor Sebastian Edwards, Hearing Transcript, Vol. 6, February 11, 2006, pp.1211-1215.

[123] Expert Report of Professor Sebastian Edwards of September 13, 2005, Claimant's Reply memorial, Exhibit 183, paras. 129-139.

[124] Second Expert Report of Professor Nouriel Roubini of November 28, 2005, para. 11 *et seq*.

[125] First Expert Report of Professor Nouriel Roubini of July 13, 2005, paras.16-20.

accordance with Article 27 of the Articles on State Responsibility, as it does not allow for the permanent repudiation of rights or necessary compensation.

344. The Tribunal shares the parties' understanding of Article 25 of the Articles on State Responsibility as reflecting the state of customary international law on the matter. This is not to say that the Articles are a treaty or even themselves a part of customary law. They are simply the learned and systematic expression of the law on state of necessity developed by courts, tribunals and other sources over a long period of time. Article 25 states:

> *1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:*
>
> > *(a) Is the only way for the State to safeguard an essential interest against a grave and imminent peril; and*
> >
> > *(b) Does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.*
>
> *2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:*
>
> > *(a) The international obligation in question excludes the possibility of invoking necessity; or*
> >
> > *(b) The State has contributed to the situation of necessity.*

345. There is no disagreement either about the fact that a state of necessity is a most exceptional remedy that is subject to very strict conditions because otherwise it would open the door to States to elude compliance with any international obligation. Article 25 accordingly begins by cautioning that the state of necessity "may not be invoked" unless such conditions are met. Whether in fact the Respondent's invocation of a state of necessity meets those conditions is the difficult task that the Tribunal must now undertake.

346. The Tribunal has examined with particular attention the recent decision on liability[126] and subsequent award on damages[127] in the *LG&E* case as they have dealt with mostly identical questions concerning emergency and state of necessity. The

[126] *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability of October 3, 2006.

[127] *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Award, July 25, 2007.

decision on liability has been contrasted with the finding of the Tribunal in *CMS*.[128] While two arbitrators sitting in the present case were also members of the tribunal in the *CMS* case the matter has been examined anew. This Tribunal must note, first, that in addition to differences in the legal interpretation of the Treaty in this context, an important question that distinguishes the *LG&E* decision on liability from *CMS*, and for that matter also from the recent award in *Enron*,[129] lies in the assessment of the facts. While the *CMS* and *Enron* tribunals have not been persuaded by the severity of the Argentine crisis as a factor capable of triggering the state of necessity, *LG&E* has considered the situation in a different light and justified the invocation of emergency and necessity, albeit for a limited period of time. This Tribunal, however, is not any more persuaded than the *CMS* and *Enron* tribunals about the crisis justifying the operation of emergency and necessity, although it also readily accepts that the changed economic conditions have an influence on the questions of valuation and compensation, as will be examined further below.

347. The first condition which Article 25 sets out is that the act in question must be the only way for the State to safeguard an essential interest against a grave and imminent peril. The Tribunal must accordingly establish whether the Argentine crisis qualified as one affecting an essential interest of the State. The opinions of experts are sharply divided on this issue. They range from those that consider the crisis as having had gargantuan and catastrophic proportions, to those that believe that it was no different from many other contemporary crisis situations around the world.

348. The Tribunal has no doubt that there was a severe crisis, and that in such a context it was unlikely that business could have continued as usual. Yet, the argument that such a situation compromised the very existence of the State and its independence, and thereby qualified as one involving an essential State interest, is not convincing. Questions of public order and social unrest could have been handled, as in fact they were, just as questions of political stabilization were handled under the constitutional arrangements in force.

---

[128] Mathieu Raux: "La reconnaissance de l'état de nécessité dans la dernière sentence relative au contentieux argentin: LG&E c/Argentine", *Gazette du Palais,* 13-14 Décembre 2006, 56-60.

[129] *Enron Corp. and Ponderosa Assets, L. P. v. Argentine Republic,* (ICSID Case ARB/01/3), Award of May 22, 2007.

349. This issue is in turn connected with the alleged existence of a grave and imminent peril that could threaten the essential interest. While the Government had a duty to prevent a worsening of the situation, and could not simply leave events to follow their own course, there is no convincing evidence that events were actually out of control or had become unmanageable.

350. It is thus quite evident that measures had to be adopted to offset the unfolding crisis, but whether the measures taken under the Emergency Law were the "only way" to achieve this result, and whether no other alternative was available, are questions on which the parties and their experts are profoundly divided, as noted above. A rather sad global comparison of experiences in the handling of economic crises shows that there are always many approaches to addressing and resolving such critical events. It is therefore difficult to justify the position that only one of them was available in the Argentine case.

351. While one or the other party would like the Tribunal to point out which alternative was recommendable, it is not the task of the Tribunal to substitute its view for the Government's choice between economic options. It is instead the Tribunal's duty only to determine whether the choice made was the only one available, and this does not appear to have been the case.

352. Article 25 next requires that the measures in question do not seriously impair the interests of a State or States toward which the obligations exist, or of the international community as a whole. The interest of the international community does not appear to be in any way impaired in this context, as it is an interest of a general kind. That of other States will be discussed below in connection with the Treaty obligations. At that point, it will also be discussed whether the Treaty excludes necessity, this being another condition peremptorily laid down by the Article.

353. A further condition that Article 25 imposes is that the State cannot invoke necessity if it has contributed to the situation giving rise to a state of necessity. This is of course the expression of a general principle of law devised to prevent a party from taking legal advantage of its own fault. In spite of the parties' respective claims that the factors precipitating the crisis were either endogenous or exogenous, the truth seems to

be somewhere in the middle, with both kinds of factors having intervened. This mix has in fact come to be generally recognized by experts, officials and international agencies.

354. This means that there has to some extent been a substantial contribution of the State to the situation giving rise to the state of necessity, and that it therefore cannot be claimed that the burden falls entirely on exogenous factors. This state of affairs has not been the making of a particular administration, given that it was a problem which had been compounding its effects for a decade. Still, the State must answer for it as a whole.

355. The Tribunal must note in addition that, as held in the *Gabcíkovo-Nagymaros* decision with reference to the work of the International Law Commission, the various conditions discussed above must be cumulatively met. This brings the standard governing the invocation of necessity to a still higher echelon. In the light of the various elements examined above, the Tribunal concludes that the requirements for a state of necessity under customary international law have not been fully met in this case.

3. The plea of necessity under Article IV (3) of the Treaty

356. The Respondent also justifies the invocation of necessity under the terms of Article IV(3) of the Treaty. This Article provides:

> *3. Nationals or companies of either Party whose investments suffer losses in the territory of the other Party owing to war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events shall he accorded treatment by such other Party no less favorable than that accorded to its own nationals or companies or to nationals or companies of any third country, whichever is the more favorable treatment, as regards any measures it adopts in relation to such losses.*

357. The Respondent, following the holding in *Gabcíkovo-Nagymaros* that the essential interest of the State cannot be reduced to questions of the State's existence, but rather extends to other matters such as a grave danger to ecological preservation,[130] asserts that the fact that human life was endangered in the crisis under discussion justifies *a fortiori* the inclusion of this type of event under the terms of Article IV (3). The Respondent accordingly concludes that the invocation of necessity is not excluded

[130] *Gabcíkovo-Nagymaros Project* (Hungary/Slovakia), International Court of Justice, Judgment of September 25, 1997, para. 53.

by Article IV(3), so that the similar requirement envisaged by Article 25 of the Articles on State Responsibility is also met.

358. The Respondent additionally relies in this regard on the expert report of Dean Anne-Marie Slaughter and Professor William Burke-White, who conclude that the measures adopted by Argentina are fully consistent with the terms of Article IV(3).[131]

359. The Claimant opposes this asserted justification on the ground that Article IV(3), far from reducing Argentina's obligations, adds to them by requiring national treatment and most favored nation treatment of the investors, as compared to the treatment given other companies in the light of the measures adopted to offset any losses. It is also argued that the decisions in *AMT* and *AAPL* upheld the liability of the host State despite situations of war and civil disturbance that were invoked under the provisions of the respectively applicable treaties.

360. In the Claimant's view, Article IV(3) applies only to measures adopted in response to a loss, such as those respecting compensation, and not to the measures that caused the loss. Moreover, the covered measures allegedly cannot apply to economic emergencies, but instead only to "war or other armed conflict, revolution, state of national emergency, insurrection, civil disturbance or other similar events." In any event, the Claimant concludes, this Article does not exempt Argentina from liability and the duty to pay compensation.

361. The Claimant relies upon the expert opinion of Professor José Alvarez in support of its arguments. Professor Alvarez has concluded that the Article in question provides additional assurances to foreign investors and is not "a further exception permitting derogations from the treaty."[132]

362. The Tribunal must note that the only purpose of Article IV (3) is to provide for a minimum level of treatment for foreign investments that suffer losses in the host country by the simultaneous interplay of national and most favored nation treatments,

---

[131] First Expert Opinion of Dean Slaughter and Professor Burke-White of July 19, 2005, paras. 85-86. See also Respondent's Counter-memorial, paras. 652-653.

[132] Expert Opinion of Professor José E. Álvarez, September 12, 2005, para. 75.

and then only in respect of measures which the State "adopts in relation to such losses," *i.e.*, corrective or compensatory measures.

363. While there is no reason to exclude from this Article's scope economic emergency measures taken in circumstances of particular gravity, allowing for such inclusion would still not allow derogation from Treaty rights since the Article refers to a different matter. Even less so can the Article be read as a general escape clause from treaty obligations. It consequently does not result in the exclusion of wrongfulness, liability and eventual compensation. Accordingly, the Tribunal concludes that a state of necessity cannot be justified under this Article pursuant to the terms in which the Respondent has invoked it.

4. The plea of necessity under Article XI of the Treaty

364. The discussion of Article XI of the Treaty has been particularly complex in this proceeding given the richness of the parties' arguments and the wealth of authorities and materials brought to the attention of the Tribunal. The Tribunal is once again grateful to the parties' counsel and to the experts who have written learned opinions. In particular, the Tribunal would like to recognize the contributions of Dean Anne-Marie Slaughter, Professor William Burke-White and Professor José Alvarez in this regard.

365. Article XI of the Treaty reads as follows:

> *This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.*

366. The Respondent, relying on the opinion of Dean Slaughter and Professor Burke-White, asserts that public order and national security exceptions have to be interpreted broadly in the context of this Article so as to include considerations of economic security and political stability. Moreover, the Respondent's experts understand this Article to be self-judging insofar as each party will be the sole judge of when the situation requires measures of the kind envisaged by the Article, subject only to a determination of good faith by tribunals that might be called upon to settle a dispute on

this point.[133] In the Respondent's view, the gravity of the crisis that it faced amply justified resorting to such measures, which can only be considered as having been adopted in good faith.

367. The Respondent also explains that in applying this Article, Argentina has been able to maintain public order, protect its essential security interests and recompose with great difficulty its relations with the international economic system, all the while treating foreign investors like any other investor. The expert opinion of Dean Slaughter and Professor Burke-White emphasizes the view that measures can be adopted under Article XI to protect economic security and political stability, as well as classical military security.[134]

368. The Respondent assigns particular significance to the self-judging character of this Article, which the Respondent maintains has been reaffirmed by the interpretation given to the Article by the U.S. in a number of bilateral investment treaties and statements before Congress. The experts for the Respondent assert that "[t]he U.S.-Argentina Bilateral Investment Treaty specifically allows the two states Parties to take measures that would otherwise be inconsistent with their treaty obligations when public order or national security is threatened."[135]

369. The Claimant does not share this understanding, and neither does Professor José Alvarez. It is first argued that Article XI is not self-judging, and that judicial review is not limited to a good-faith determination, but instead has to examine the facts and whether they qualify under the requirements of a state of necessity. It is also maintained that a self-judging clause is an extraordinary exception that has to be clearly stated, as has been done in Article XXI of the GATT and confirmed by the International Court of Justice in the *Nicaragua* case in rejecting an argument of the U.S. similar to the one advanced here by Argentina. The Claimant notes that while such a clause has been expressly included in some bilateral investment treaties, most notably the U.S.-Russia BIT Protocol, nothing of the sort was done in the Treaty applicable here.

---

[133] Expert Opinion of Dean Anne-Marie Slaughter and Professor William Burke-White of July 19, 2005, paras. 43-46.
[134] Expert Opinion of Dean Anne-Marie Slaughter and Professor William Burke-White of July 19, 2005, paras. 47-55.
[135] Expert Opinion of Dean Anne-Marie Slaughter and Professor William Burke-White of July 19, 2005, para. 14.

370. Professor Alvarez has summarized the conclusions of his expert opinion on the meaning of Article XI as being that this essential security and public order clause: "(1) is not self-judging; (2) does not apply to 'economic emergencies', except in the most extraordinary and so far unprecedented circumstances; and (3) even when it does apply (for example, in the event of war or insurrection), is not the equivalent of a 'denial of benefits' or termination clause in a treaty, and so does not negate state responsibility to pay compensation for actions that harm investors."[136]

371. The Claimant does not believe that exchanges undertaken between the U.S. Government and Congress in different contexts and to a very limited extent could be taken to mean that a self-judging interpretation was intended for the Treaty here applied.[137] In fact, it is asserted that the opposite is true because the U.S. Government explained at the time that the Treaty "contains an absolute right to international arbitration of investment disputes."[138]

372. The Claimant further argues that Article XI does not in any event apply to economic emergencies, but rather only to internal security, just as international peace and security have been interpreted to mean the obligations under the Charter of the United Nations. Nor does the Claimant believe that Article XI relieves Argentina from the duty to pay compensation. A self-judging interpretation, the Claimant concludes, would result in the creation of a broad and sweeping exception to the obligations established under the Treaty, and would eviscerate the very object and purpose of this kind of treaty.[139]

373. In weighing this discussion, the Tribunal must first note that the object and purpose of the Treaty is, as a general proposition, for it to be applicable in situations of economic difficulty and hardship that require the protection of the internationally guaranteed rights of its beneficiaries. To this extent, any interpretation resulting in an escape route from the defined obligations cannot be easily reconciled with that object

---

[136] Expert Opinion of Professor José E. Álvarez September 12, 2005, para. 8.
[137] Expert Opinion of Professor José E. Álvarez, September 12, 2005, para. 41.
[138] Letter of Submittal of the U.S. BIT, January13, 1993, Claimants' Exhibit 274
[139] Expert Opinion of Professor José E. Álvarez, September 12, 2005, para. 64.

and purpose. Accordingly, a restrictive interpretation of any such alternative is mandatory.

374. The Tribunal considers that there is nothing that would prevent an interpretation allowing for the inclusion of economic emergency in the context of Article XI. Essential security interests can eventually encompass situations other than the traditional military threats for which the institution found its origins in customary law. However, to conclude that such a determination is self-judging would definitely be inconsistent with the object and purpose noted. In fact, the Treaty would be deprived of any substantive meaning.

375. In addition, in view of the fact that the Treaty does not define what is to be understood by an "essential security interest," the requirements for a state of necessity under customary international law, as outlined above in connection with their expression in Article 25 of the Articles on State Responsibility, become relevant to the matter of establishing whether the necessary conditions have been met for its invocation under the Treaty. Different might have been the case if the Treaty had defined this concept and the conditions for its exercise, but this was not the case.

376. The Tribunal notes that in the view of Dean Slaughter and Professor Burke-White, which the Respondent shares, the *CMS* award was mistaken in that it discussed Article XI in connection with necessity under customary law.[140] This Tribunal believes, however, that the Treaty provision is inseparable from the customary law standard insofar as the definition of necessity and the conditions for its operation are concerned, given that it is under customary law that such elements have been defined. Similarly, the Treaty does not contain a definition concerning either the maintenance of international peace and security, or the conditions for its operation. Reference is instead made to the Charter of the United Nations in Article 6 of the Protocol to the Treaty.

377. The expert opinion of Dean Slaughter and Professor Burke-White expresses the view that the treaty regime is different and separate from customary law as it is *lex*

[140] Expert Opinion of Dean Anne-Marie Slaughter and Professor William Burke-White of July 19, 2005, paras. 65-66, 68-72.

specialis.[141] As Professor Burke-White explained at the hearing, the consequence of this approach is that while Article XI requires only a good faith determination, under customary law the whole panoply of requirements laid down in Article 25 of the Articles comes into play.[142] Moreover, Professor Burke-White stated that the U.S. and Argentina had "decided to accord investors greater protection than they would receive under customary international law, but simultaneously to guarantee to states, the States Parties greater protection to deal with threats to their national security."[143]

378. It is no doubt correct to conclude that a treaty regime specifically dealing with a given matter will prevail over more general rules of customary law. The problem here, however, is that the Treaty itself did not deal with the legal elements necessary for the legitimate invocation of a state of necessity. The rule governing such questions will thus be found under customary law. As concluded above, such requirements and conditions have not been fully met in this case. Moreover, the view of the Respondent's legal expert, as expressed at the hearing, contradicts the Respondent's argument that the Treaty standards are not more favorable than those of customary law, and at the most should be equated with the international minimum standard. The Tribunal does not believe that the intention of the parties can be described in the terms which the expert has used, as there is no indication that such was the case. Nor does the Tribunal believe that because Article XI did not make an express reference to customary law, this source of rights and obligations becomes inapplicable. International law is not a fragmented body of law as far as basic principles are concerned and necessity is no doubt one such basic principle.

379. As explained by Dean Slaughter, the U.S. position has been gradually evolving towards support for self-judging clauses in respect of national security interests, and some bilateral investment treaties reflect this change, albeit not all of them. Yet, this does not necessarily result in the conclusion that such was the intention of the parties in respect of the Treaty under consideration. Truly exceptional and extraordinary clauses, such as a self-judging provision, must be expressly drafted to reflect that intent, as

---

[141] Expert Opinion of Dean Anne-Marie Slaughter and Professor William Burke-White of July 19, 2005, para. 6.

[142] Expert Statement of Professor William Burke-White, Hearing Transcript, Vol. 6, February 11, 2006, pp.1072-1073.

[143] Expert Statement of Professor William Burke-White, Hearing Transcript, Vol. 6, February 11, 2006, p.1068.

otherwise there can well be a presumption that they do not have such meaning in view of their exceptional nature.

380. In the case of the Treaty, nothing was said in respect of a self-judging character, and the elements invoked in support of this view originate for the most part in U.S. Congressional discussions concerning broader issues, or in indirect interpretations arising mainly with respect to the eventual application of model investment treaties used by the U.S.[144] The Respondent's post-hearing brief has listed a number of discussions and statements which relate to the issue of a self-judging interpretation,[145] but these items are contextual and do not specifically address the case of the Treaty in question.

381. Professor Burke-White also stated at the hearing that, in his understanding, the letter submitting the Treaty to the Argentine Congress did not say "anything about it being self-judging, nor anything about it being non self-judging … this document does not speak to that issue."[146] This expert also explained that while he had no evidence about the internal discussions within the Argentine Government as to the intent of the Treaty, there was such evidence in respect of the intent of the U.S. Government, and that given the "reciprocal nature of the Treaty … the intent … would be for a self-judging interpretation of Article XI."[147] This is, however, again a contextual interpretation that does not appear to meet the stricter requirements of Articles 31 and 32 of the Vienna Convention on the Law of Treaties in respect of treaty interpretation in the light of its context, or the resort to supplementary means of interpretation.

382. More to the point is a letter sent by an official of the United States Department of State on September 15, 2006 to a former official asked to testify in the context of a different arbitration, which the Respondent brought to the attention of the Tribunal on June 25, 2007. In this letter, it is stated that "notwithstanding the decision of the ICJ in the Nicaragua case, the position of the U. S. Government is that the essential security language in our FCN treaties and Bilateral Investment Treaties is self-judging, *i.e.*, only

---

[144] Expert Statement of Professor William Burke-White, Hearing Transcript, Vol. 6, February 11, 2006, pp. 1058-1062.

[145] Respondent's Post Hearing Brief, para. 124.

[146] Expert Statement of Professor William Burke-White, Hearing Transcript, Vol. 6, February 11, 2006, p. 1100.

[147] Expert Statement of Professor William Burke-White, Hearing Transcript, Vol. 6, February 11, 2006, at pp. 1101-1102.

the party itself is competent to determine what is in its own essential security interests." The Respondent is of the view that this confirms the interpretation given by it of the Treaty in this case. The Claimant, however, has opposed this understanding on the argument that the letter refers to an interpretation supposedly adopted as from 2006 and that in any event it does not refer to the Treaty with Argentina nor does it preclude liability or compensation.

383. The discussion noted above concerning the GATT and the *Nicaragua* decision, just like the *Oil Platforms* case, confirms that the language of a provision has to be very precise for it to lead to a conclusion about its self-judging nature. In those decisions, the fact that the language was not express turned out to be crucial to the rejection of arguments favoring a self-judging interpretation. So too, the International Court of Justice held in the *Gabcíkovo-Nagymaros* case, when referring to the conditions defined by the International Law Commission, that "the State concerned is not the sole judge of whether those conditions have been met."[148]

384. The Tribunal must also note that not even in the context of GATT Article XXI is the issue considered to be settled in favor of a self-judging interpretation, and the very fact that such article has not been excluded from dispute settlement is indicative of its non-self-judging nature.[149]

385. The same holds true of the U. S. Department of State letter referred to above in that it does not address any specific treaty, least that with Argentina. Furthermore, the fact that arbitration is the compulsory dispute settlement mechanism established in the Treaty in question, like with GATT/WTO, could be rather indicative of the non self-judging nature of the essential security interest clause. Not even if this is the interpretation given to the clause today by the United States would this necessarily mean that such an interpretation governs the Treaty. The view of one State does not make international law, even less so when such a view is ascertained only by indirect means of interpretation or in a rather remote or general way as far as the very Treaty at

---

[148] *Case Concerning the Gabcíkovo-Nagymaros Project* (Hungary/ Slovakia),Judgment of 25 September 1997, ICJ Reports(1997), paras. 51-52.

[149] M. Matsushita, T. J. Schoenbaum and P. Mavroidis: *The World Trade Organization*, 2006, at 594-598.

issue is concerned. What is relevant is the intention which both parties had in signing the Treaty, and this does not confirm the self-judging interpretation.

386. Moreover, even if this interpretation were shared today by both parties to the Treaty, it still would not result in a change of its terms. States are of course free to amend the Treaty by consenting to another text, but this would not affect rights acquired under the Treaty by investors or other beneficiaries. In fact, Article XIV of the Treaty provides that in case of termination, the investment will continue to be protected under its provisions "for a further period of ten years." So too, with reference to rights protected under the Energy Charter Treaty, the tribunal in *Plama* has held that any denial of advantages to which an investor might have rights "should not have retrospective effect," as such a situation would result in making legitimate expectations false at a much later date.[150]

387. As an English court has recently held in respect of a claim of non-justiciability relating to a State challenge to the *OEPC* award, the fact that a treaty is concluded between States cannot allow the derogation of rights that belong to private parties. In that case, the issue concerned dispute settlement, and as a consequence the doctrine of non-justiciability was held not to apply.[151]

388. In the light of this discussion, the Tribunal concludes that Article XI is not self-judging and that judicial review is not limited in its respect to an examination of whether its invocation, or the measures adopted, were taken in good faith. The judicial control must be a substantive one, and concerned with whether the requirements under customary law or the Treaty have been met and can thereby preclude wrongfulness. Since the Tribunal has found above that the crisis invoked does not meet the customary law requirements of Article 25 of the Articles on State Responsibility, it concludes that necessity or emergency is not conducive in this case to the preclusion of wrongfulness, and that there is no need to undertake a further judicial review under Article XI given that this Article does not set out conditions different from customary law in such regard.

---

[150] *Plama Consortium Limited v. Bulgaria*, (ICSID Case No. ARB/03/24), Decision on Jurisdiction of February 8, 2005 para. 162.

[151] *Republic of Ecuador v. Occidental Exploration and Production Corporation,* English Commercial Court, Case No: 2004 FOLIO 656, judgment given on April 29, 2005, para. 85.

389. A judicial determination as to compliance with the requirements of international law in this matter should not be understood as suggesting that arbitral tribunals wish to substitute their views for the functions of sovereign States. Such a ruling instead simply responds to the Tribunal's duty that, in applying international law, it cannot fail to give effect to legal commitments that are binding on the parties, and must interpret the rules accordingly unless a derogation of those commitments has been expressly agreed to.

390. The Tribunal explained above that it would consider the requirement of Article 25 of the Articles on State Responsibility, to the effect that the act in question not seriously impair an essential interest of the State towards which the obligation exists in the context of the Treaty obligations. In the light of the discussion above about changing interpretations, it does not appear that the Government's invocation of Article XI or of a state of necessity generally would be taken by the other party to mean that such impairment arises.

391. Be that as it may, in the context of investment treaties there is still the need to take into consideration the interests of the private entities who are the ultimate beneficiaries of those obligations, as was explained by the English court in the *OEPC* case noted above. The essential interest of the Claimant would certainly be seriously impaired by the operation of Article XI or a state of necessity in this case.

5. Temporality and Compensation

392. There are still two other aspects of the "state of necessity" which the Tribunal needs to discuss. There is first the question posed by necessity being a temporal condition and, as expressed in Article 27 of the Articles on State Responsibility, its invocation being without prejudice to "(a) compliance with the obligation in question, if and to the extent that the circumstance precluding wrongfulness no longer exists." This premise does not seem to be disputed by the parties, although the continuing extension of the emergency, discussed above, does not seem to be easily reconciled with the requirement of temporality. This in turn results in uncertainty as to what will be the legal consequences of the Emergency Law's conclusion.

393. The second question is posed by the fact that Article 27 also provides that necessity is without prejudice to "(b) the question of compensation for any material loss caused by the act in question." This other premise has been much debated by the parties, as noted above. The Respondent does not share this premise because the record shows that there would eventually be no compensation for past losses or adverse effects originating in the emergency measures, either in the context of the renegotiations undertaken or otherwise. As put by the Respondent's witness Mr. Simeonoff, "[t]he answer is a single one. The Argentine State will not recognize any compensation for damages."[152]

394. The Respondent's view appears to be based on the understanding that Article 27 would require compensation only for the damage arising after the emergency is over, and not for that taking place during the emergency period. Although that Article does not specify the circumstances in which compensation should be payable because of the range of possible scenarios, it has also been considered that this is a matter to be agreed with the affected party.[153] The Article thus does not exclude the possibility of an eventual compensation for past events. The 2007 agreements between the Respondent and the Licensees appear to confirm this interpretation insofar as they cover, as noted, the period running from January 6, 2002 until the end of the License. This could mean that the tariff adjustment scheduled to begin on January 1, 2008 has been conceived as including past damages.

395. The question of compensation has been discussed at various points by the parties in the context of an eventual issue of double recovery resulting from, on the one hand, the compensation which the investor would receive as a result of arbitration and, on the other hand, the compensation which the company would receive in the context of a renegotiated adjustment of tariffs or some other mechanism. The Tribunal believes that this is actually not likely to since Government negotiators will make sure that any recovery obtained from one source is not duplicated by means of a separate recovery from another source. In answer to a question from the Tribunal with respect to the multiple possible sources of recovery, a company executive appearing as a witness for

---

[152] Testimony of Mr. Jorge Gustavo Simeonoff, Hearing Transcript, Vol. 2, February 7, 2006, p. 336.

[153] James Crawford: *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, (ed., Cambridge University Press) (2002), p. 190.

the Claimant explained at the hearing that "these two sources are mutually exclusive, and I don't think there is any possibility for a double compensation to exist."[154] This interpretation proved to be correct as the 2007 agreements with the Licensees, as explained, expressly envisage that the Respondent shall be kept free of any adverse consequences arising from compensation that the Claimant might obtain in this arbitration or other proceedings.

396. The Tribunal also notes that this discussion is related to the broader issue of whether crisis conditions should result in the lowering of standards set under treaties and investment law, to the benefit of the State. The question was extensively discussed at the hearing in connection with the expert statement of Professor W. Michael Reisman, who in the Respondent's understanding had minimized the importance of the crisis context for the operation of investment law standards, and who was criticized for it.[155] The Respondent emphasized its view by showing a video on the Argentine crisis in 2001-2002. Professor Reisman explained in the context of this discussion that

> "of course governments in these circumstances must take measures to restore public order, but from the investment *law* standpoint – and this is for the future of all investments – international investment law says you may do it, but you must pay compensation. If exceptions are made for like these or other circumstances, the entire purpose of modern investment law, which is to accelerate the movement of private funds into developing countries for development purposes, will be frustrated."[156]

397. The Tribunal does not believe that the issue here is one of lowering the standards of protection set under the Treaty or the law. This being said, however, the manner in which the law has to be applied cannot ignore the realities resulting from a crisis situation, including how a crisis affects the normal functioning of any given society. This is the measure of justice that the Tribunal is bound to respect. The Tribunal will accordingly take into account the crisis conditions affecting Argentina when determining the compensation due for the liability found in connection with the breach of the Treaty standards.

---

[154] Testimony of Mr. Martin Juan Blanquier, Hearing Transcript, Vol. 7, February 13, 2006, pp. 1367-1370.

[155] Remarks of Dr. Osvaldo César Guglielmino, Hearing Transcript, Vol. 6, February 11, 2006, pp. 1000-1009.

[156] Expert Statement of Professor W. Michael Reisman, Hearing Transcript, Vol. 6, February 11, 2006, p. 1007.

D. Remedies

398. The Tribunal has concluded above that the Respondent breached in this case Article II2(a) and (c) of the Treaty relating to fair and equitable treatment and the respect of obligations with regard to investments. There remains for the Tribunal to determine the compensation to be paid to the Claimant as a result of such breaches.

399. In this task, the Tribunal analyzed the reports and testimonies presented by the experts retained by each side, Dr. Manuel A. Abdala and Dr. Pablo T. Spiller of LECG, LLC (hereafter "LECG") for the Claimant, and Professor Diego J. Dzodan of the Universidad Torcuato Di Tella, for the Respondent. The Respondent also submitted a valuation report prepared by Mr. Juan Carlos Fassi, Director of PA Consulting Services S.A. and dated December 5, 2005. This report was supplemented by a letter of January 19, 2006 from Mr. Fassi providing answers to questions raised by the Claimant. During the course of the hearing on the merits, the Tribunal was informed, on February 9, 2006 that Mr. Fassi could not appear as a witness. By letter of February 15, 2006 to the parties, the Tribunal decided that, notwithstanding the fact that Mr. Fassi could not be subjected to oral examination on his report by the parties and the Tribunal, his report would nonetheless be admitted in order to have the full view of the parties' position on the valuation of damages. In reaching its own conclusions on damages, the Tribunal gave careful consideration to the views expressed by Mr. Fassi in his expert report of December 5, 2005 and subsequent letter of January 19, 2006. The Tribunal was assisted by Dr. Luis Carlos Valenzuela, of Bogota, Colombia, who was appointed as expert by the Tribunal with the agreement of the parties, following the oral hearings in this case. Dr. Valenzuela produced two reports which were transmitted to the parties; their comments on each report were received by the Tribunal and given due consideration. The Tribunal wishes to express its appreciation to all the experts for their contribution.

1. The Valuation Principle.

400. The principles governing compensation under international law were well explained by the Permanent Court of International Justice in the *Chorzow Factory Case* and have been developed in numerous decisions of international courts and tribunals. As

the Permanent Court held in that case, "reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed."[157]

401. In the absence of restitution or agreed renegotiation of contracts or other measures of redress, the appropriate standard of reparation under international law is compensation for the losses suffered by the affected party. The International Law Commission Articles on State Responsibility for Internationally Wrongful Acts adopted by the United Nations General Assembly in 2002, also state in this respect that compensation is meant to cover any "financially assessable damage including loss of profits insofar as it is established."[158]

402. Article IV of the Treaty establishes the standard for the determination of compensation. It states:

> "*Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known, whichever is earlier; be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.*"

403. It must be noted that this provision addresses specifically the case of expropriation which the Tribunal has concluded has not taken place in the present case. The Treaty does not specify the damages to which the investor is entitled in case of breach of the Treaty standards different from expropriation. Although there is some discussion about the appropriate standard applicable in such a situation, several awards of arbitral tribunals dealing with similar treaty clauses have considered that compensation is the appropriate standard of reparation in respect of breaches other than expropriation, particularly if such breaches cause significant disruption to the investment made.[159] In such cases it might be very difficult to distinguish the breach of

---

[157] *Chorzów*, Judgment No. 13 (Claim for Indemnity - The Merits) of September 13, 1928, <http://www.worldcourts.com/pcij/eng/decisions/1928.09.13_chorzow1/>, para. 47.

[158] Articles on State Responsibility, Article 36 (2).

[159] *Marvin Roy Feldman Karpa v. United Mexican States* (ICSID Case No. ARB(AF)/99/1) Award of December 16, 2002; *S.D. Myers, Inc. v. Canada*, UNCITRAL Arbitration Proceeding, Partial Award of November 13, 2000, paras. 311-315; *Metalclad Corporation v. United Mexican States*, (ICSID Case No. ARB(AF)/97/1), Award of August 30,2000, para. 122; *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Award of May 12, 2005; *Azurix Corp. v. The Argentine Republic*

fair and equitable treatment from indirect expropriation or other forms of taking and it is thus reasonable that the standard of reparation might be the same.

404. Fair market value is thus a commonly accepted standard of valuation and compensation. In the present case, the Claimant made its investment in Argentina in 1996 and increased it over the years. The Tribunal is of the view that fair market value would be the most appropriate standard to apply in this case to establish the value of the losses, if any, suffered by the Claimant as a result of the Treaty breaches which occurred, by comparing the fair market value of the companies concerned with and without the measures adopted by Argentina in January 2002.

405. An internationally recognized definition of fair market value reads as follows:

> *"(…) the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and hypothetical and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.*"[160]

406. The Claimant estimates that it has suffered damages to equity value in the amount of US$143.49MM. In addition, claims are made for historical (or discrete) damages concerning the U.S. PPI adjustment in the amount of US$9.86MM, subsidies in the amount of US$38.63MM and loss on a loan in the amount of US$17.4MM; these the Tribunal will consider separately. The total amount claimed by the investor in this arbitration is US$209.38MM.

2. The Methodology Adopted.

407. Both LECG and Professor Dzodan adopted Discounted Cash flow as an appropriate methodology but they followed different paths to arrive at their conclusions.

(ICSID Case No. ARB/01/12), Award of July 16, 2006, para. 424; *Enron Corp. and Ponderosa Assets, L. P.v. Argentine Republic,* (ICSID Case ARB/01/3), Award of May 22, 2007, paras. 360-363.

[160] International Glossary of Business Valuation Terms, American Society of Appraisers, ASA website, June 6 2001, p. 4

408. Professor Dzodan's model aims at determining whether CGP and CGS created or destroyed value for the Claimant during their useful life, on the basis of the return established under the appropriate Argentine regulation. This implies calculating whether or not CGP and CGS achieved economic equilibrium. For this purpose, that model calculates:

- The present value of future free cash flow from 2005 to 2027 under the actual conditions prevailing in Argentina during that period ("the pesification scenario").
- The compounded value of historical free cash flow from 1992 to 2004.
- The compounded value in 2004 of the Claimant's investments in CGP and CGS from 1992 to 2004.

409. The value created or destroyed is established by adding the two values of cash flows measured in 2004, from which the compounded value in 1994 of the original investments is subtracted (or Value created/destroyed =A+B-C).

410. According to Professor Dzodan, in so far as the positive cash flows are equal or superior to the negative ones, or to the realized investments, there is no reason to award compensation since the investment is recoverable, even with the effects of the measures adopted by Argentina.

411. LECG, on the other hand, aims at establishing the damages suffered by the Claimant as a result of the measures adopted by Argentina in the following manner:

- It first makes an individual evaluation of the historical damages suffered by CGS and CGP as a consequence of the non-application of the U.S. PPI adjustments to the tariffs, the non-payment of subsidies owing to them under the License, and the reduction of income they suffered from the implementation of taxes which were not translated into tariff increases.
- It then establishes the discounted cash flow value of the companies in the context of the pesification scenario following the adoption by Argentina of the measures complained of.

- Finally, by utilizing discounted cash flow and book value, it establishes the value of the firms in the context where the spirit of the original contractual conditions would have been maintained for the duration of the License ("the but-for scenario").

412. The damages suffered are then arrived at by first stating the value of the firms under the but-for scenario, from which the value under the pesification scenario is subtracted and the value of the historical damages is added (or Damages = C-B+A).

413. The Tribunal has come to the conclusion that, without contesting its economic validity per se, the model proposed by Professor Dzodan does not represent an adequate instrument to establish the level of compensation which may be due to a party under the Treaty, the License and the ENARGAS regulations. The problem at hand under the Treaty and the License is not to judge whether the companies have been fairly remunerated in the past but to determine what they were worth in 2001 given their prospects over the remaining years of the licenses. International legal standards governing compensation do not normally consider past earnings to determine compensation due.

414. In light of this conclusion, the Tribunal does not need to address a certain number of criticisms raised by the Claimant's and the Tribunal's experts against some of the assumptions made in Professor Dzodan's report.

415. On the other hand, the LECG model appears to the Tribunal to be more appropriate since it differentiates between the various alleged breaches thus allowing for a closer analysis of the nature of such breaches and, thereby, the value of the damages suffered.

3. Damages valuation at December 31, 2001 (but-for scenario)

416. The Tribunal will therefore pursue its analysis of damages valuation by basing itself on the DCF model proposed by LECG. The Tribunal, however, wishes to discuss further the following factors under the model proposed by LECG

- The asset base
- The discount rate under the but-for scenario.
- The tariff increases that would have been approved under the but-for scenario.
- The consumption effect under the but-for scenario.

417. These various factors are open to discussion in view of the likely effect of the economic crisis affecting Argentina at the time on the business prospects. The Tribunal has held above that there was quite evidently a major crisis in Argentina and while this crisis does not excuse the wrongfulness of the measures taken in respect of the investment, it does have an incidence on the issue of valuation and compensation.

a) The Asset Base

418. A major factor which ENARGAS had to consider in establishing the tariffs of gas distribution companies on the occasion of its Second Quinquennial Tariff Review ("RQT II") was the asset base of the companies concerned.

419. As part of that process, ENARGAS received in December 2002 an Interagency Report.[161] This report included the results of a study it requested from an independent private consulting firm (PSI) to provide figures for the CGP and CGS asset bases as of December 2000, for the purposes of the RQT II. Those asset bases were significantly lower than those proposed by the Claimant. In fact, while the Claimant indicated an asset base for regulatory purposes of US$461.72 MM for CGP and an asset base of US$241.19MM for CGS, the PSI consultants suggested reductions of AR$ 65.2MM (parity) pesos for CGP and AR$ 44.6MM (parity) pesos for CGS.[162]

[161] ENARGAS «Interagency Report» *(Informe Interagencial)* of December 2002, Annex 1(a), p.86.
[162] Ibid., Annex 1(a), p. 86.

420. The Claimant has argued that the asset bases arrived at by PSI were not final and were only the first step towards the calculation of the companies' approved asset base. According to the Claimant, ENARGAS still had to apply the U.S. PPI adjustments and consider other relevant factors, including the efficient levels of working capital and the companies' views on the potential disallowances.

421. LECG submitted a Reconciliation of the 2000 Asset Base, which included adjustments for working capital disallowances and for PPI, which led to a PSI decrease in asset base of only 3.4% for CGP and 5.8% for CGS compared to the Claimant's proposed asset base. In addition, in bringing that asset base valuation to December 2001, the Claimant argued that it is necessary to add the actual 2001 investments (minus depreciation), look at efficient working capital variations, and adjust all figures by the U.S. PPI.

422. The Tribunal is of the view that, under the but-for scenario, ENARGAS would have had to include a proper PPI adjustment. However, it would be extremely hard to believe that, under the macroeconomic conditions that Argentina faced at the end of 2001 and in 2002, ENARGAS would not have adopted the reductions in asset base recommended by PSI.

423. As to the working capital disallowances adjustments suggested by the Claimant (US$21.10M for CGP and US$14.00M for CGS for the 2000 Asset Base), it is most likely that ENARGAS would have rejected them. Indeed, the financial statements of CGP and CGS show clearly that both companies usually had a negative working capital in normal years.

424. This is indeed the case under the classical definition of working capital (that is the difference between all current assets and all current liabilities), as shown by the 1999 and 2000 financial statements of CGP; the same conclusion is reached for CGS, once adjustments are made for unpaid subsidies. It is usually considered more informative to study the non-cash (*i.e.* disregarding cash reserves and short term debt) operations-related capital and to remove anything which might be doubtful or temporary; using that formula, the absolute numbers change but the working capital

remains negative. This would appear to be due in large part to the fact that, in normal years, the gas consumers paid their bills faster than the distributors paid the transportation companies (32 or 33 days compared with 42 or 45 days for each company).

425. In the Tribunal's view, ENARGAS would have had valid grounds in the circumstances of this case, which deals with distribution companies, to refuse an amount for working capital in arriving at the asset base. The same conclusion should apply to 2001 as well.

426. It is therefore appropriate, in the case of CGP, to deduct from the 2000 asset base of US$461.72MM proposed by the Claimant the negative adjustments of US$65.2MM (parity pesos) recommended by PSI and to add the adjustment for PPI of US$28.32MM. In the case of CGS, it is necessary to deduct from the asset base of US$241.19MM. proposed by the Claimant, the negative adjustments of US$44.6MM. proposed by PSI and to add the PPI adjustment of US$16.16MM. Using the table contained in the Claimant's letter of 18 December 2006, the adjusted asset base of CGP goes down from US$461.72MM to US$424.85MM, on December 31, 2000. Applying the same reasoning to CGS lowers the asset base from US$241.19MM to US$212.75 MM at that date.

427. However, it is still necessary to bring those figures up to December 31, 2001, by applying the 2001 U.S. PPI change of -5.84% to the 2000 asset base and by adding the actual investments (US$20.03MM for CGP and US$20,57MM for CGS) minus depreciation (US$0.94MM for CGP and US$0.67MM for CGS).

428. The total amount of the asset base at December 31, 2001 is accordingly US$419.13MM for CGP and US$220.23 MM for CGS.

b) The But-For Scenario Discount Rate

429. In all probability, ENARGAS would have considered in its tariffs reviews that distribution is a riskier business than transportation. This conclusion is reasonable in the instant case in the light of the difficulties Argentina faced, since distribution is

closer to the final consumer and the latter is more likely to be late or to default on payments than the distributor itself. Further, the transportation company can usually get some form of protection from demand variation through take-or-pay contracts. It is thus also reasonable that the cost of equity ("COE") for CGP and CGS be larger than for a transportation company. In fact, this is the exact conclusion which ENARGAS arrived at in its Notes of November 21, 2001 where it mentions that it was proposing to establish the WACC at a level 1.7% higher for gas distribution than for gas transportation, effective the first semester of 2003.[163]

430. As to the cost of equity, it was established by ENARGAS at 15.56% after the first quinquennial review of 1997 and this was the figure adopted by Professor Dzodan in his report of 15 January 2006.[164] As to the experts for the Claimant, they chose a slightly higher COE of 16.28% (yielding a WACC of 13.77%) for CGP and 16.75% (yielding a WACC of 14.12%) for CGS. The same WACC for both valuations (but-for and pesification scenarios) was used.

431. Given the fact that the parties arrive at relatively similar figures and bearing in mind the historical cost of equity, for CGP and CGS between 1992 and 2001 varied between some 16 and 22% according to the Claimant´s experts, the Tribunal believes that the COE rates proposed by the Claimant are reasonable and should be retained for both the but-for and the pesification scenario. It could even be thought that the COE should have been larger under the pesification scenario to reflect the greater uncertainty in the new regulatory context; this would have further reduced the value of the firms under the pesification scenario and increased the damages suffered by the Claimant.

432. In the context of some of the expert reports before the Tribunal, high discount rates were also envisaged as a consequence of the premium on Government bonds being very high at the end of December 2001 because these bonds were in default at that time and as a consequence they could only sell at a deep discount, if at all. However, the Tribunal believes that the case of CGP and CGS is different.

---

[163] ENARGAS Notes 5498 of November 2001 (p. 31) to CGP and CGS, produced by the Claimant on December 18, 2006 pursuant to a December 12, 2006 request to the parties by the Tribunal for additional information relating to RQT II.

[164] Analysis of SEMPRA and CAMUZZI's return on their investments in CGS and CGP, 15 January 2006, pp.7-8.

433. In fact, there is first a difference between the Argentine government's credit risk and the country risk. It has been clearly established before the Tribunal that, even in the latter part of 2001, the country risk premium required by an investor in a private company in Argentina was significantly lower than the Government's credit risk premium during the same period. The difference was even more significant in the case of energy companies like CGP and CGS, because of their regulated status and their relatively lower business risk.

434. Next, if the regulatory framework would have been maintained (no pesification of tariffs, no suspension of the PPI adjustment and other elements, or, in the alternative, pesification but with preservation of the allowed rate of return on the U.S. dollar value of assets), the companies would not have suffered the strong impact of the crisis in its entirety, their bonds would have kept trading at a better rate than the Government's bonds (as was the case even before the crisis), and their future would not have appeared compromised, especially over a long period of time extending to 2027. Discounting so many years at a very large rate implies that Argentina, and CGP and CGS with it, would have remained in a state of economic dislocation and that maintaining the initial tariff conditions would have served no purpose at all.

435. Had CGP and CGS (or Sodigas) hypothetically decided, at the end of 2001, to sell their shares on the Argentine exchange (in fact, none of them were listed), they might very well have suffered from the adverse reactions engendered by the state of economic and political difficulties. In other words, investors might very well have applied an extremely high discount rate and undervalued the equity. But the Claimant had originally not invested in CGP and CGS for trading purposes. It invested for the long term. Therefore, an unusually high market discount should not be included in the valuation of a long term investment, on the basis of a serious but temporary economic crisis.

436. This conclusion does not mean that, under the but-for scenario, CGP and CGS would have merrily sailed through the major economic crisis which Argentina suffered and brought home large returns on equity, as if nothing had ever happened. In particular, the Tribunal is of the view that CGP and CGS would have been called upon

to shoulder some of the burden of the general economic crisis and might have been faced with the need to reduce some of the increases to which they might otherwise have felt they were entitled to; moreover, and in a significant way under the but-for scenario, gas consumption and tariff rates would have been significantly impacted, with the consequent results on the value of the firm.

437. The Tribunal will therefore proceed to discuss projected tariff changes and projected consumption.

c) The Tariff Changes under the But-For Scenario

438. One of the most crucial and debatable assumption is the peso tariff increase assumed by the Claimant to take place in 2002.

439. The Claimant estimates increases of 147% (for CGP) (53% blended) and 139% (for CGS) (49% blended) for the distribution component (without a similar increase in transportation tariff and an increase in the price of gas being postponed to 2005 in the case of CGP and 2004 in the case of CGS). The result is that, at least until 2004, the income of those companies would have increased, but their costs would have been kept much lower, a fact which is considered most unlikely. This assumption is particularly unreasonable when one considers the transportation component which is covered by the same regulatory framework as the distribution component and is affected by the same macroeconomic conditions.

440. Under the Claimant's assumptions, the EBITDA in Argentine pesos increases, between 2001 and 2002, by 272% for CGP and 270% for CGS. This increase is even higher than the increase in the exchange rate during the same period.

441. The political and economic viability of such a situation would have been practically nil in the actual context of the Argentine economy at the time. In fact, a 49% (CGS) or 53% (CGP) blended tariff increase in 2002 (in its post-hearing brief, the Claimant mentions 61% for CGP and 58% for CGS) would have been out of the question from the point of view of consumers. The Argentinean currency having lost 2/3 of its international purchasing power, the cost of many items had all of a sudden

become much higher and Argentineans were suffering the consequences. Bank deposits had been forcibly converted to pesos and partly frozen, and unemployment and inflation were high. It is quite evident that 147% and 139% increases in the distribution component of the tariff would have been impossible. But even a possible smaller increase cannot be looked at in isolation from the other increases, implicit or explicit. It is realistic to think that the Government would not have added fuel to citizens' discontent, nor to inflation.

442. In addition, the Tribunal believes that, taking into account the state of the Argentine economy since 2002, it is most unlikely that, even by spreading the requested 147% and 139% increases in the distribution components over a period of years, it would have been possible to fully implement such an increase. It is true that, with the reduced asset base established above by the Tribunal, those increases become 128.43% for CGP and 131.92% for CGS. But these remain very large increases indeed. In the context of the economic crisis at the time, the Tribunal considers inevitable that the Claimant would have been called upon to carry part of the burden of that crisis.

443. In that regard, the Tribunal considers as reasonable the following measures that might have been taken by ENARGAS at that time:

- The Tribunal has already indicated the significant downward adjustments that would have been made to the asset base by ENARGAS on the occasion of RQT II, resulting in a reduction of the allowable tariff increases.
- The Tribunal is also of the view that, in the economic context of 2001-2002, ENARGAS would have been entitled to further reduce the tariff increase by recognizing no more than 85% of the allowable increases, thus producing a tariff increase of 109.17% (85% of 128.43%) for CGP and 112.13% (85% of 131.92%) for CGS.
- That increase would not have taken place in a single shot in 2002 but would have been spread over a five-year period, corresponding to the regular quinquennial review envisaged under the License, but with a 0% end-user blended tariff increase in 2002.
- In addition, the Tribunal finds it inconceivable that ENARGAS would have granted a large increase to the gas distribution sector while the tariffs in transportation sector would have remained flat. In its analysis of the impact of

tariff changes, the Tribunal will assume that equal increases would have been granted to the transportation sector. This would increase further the level of the blended tariff for the gas distribution clients and, because of its impact on price elasticity, would reduce consumption of natural gas, and hence the revenues of the gas distributors.

444. The changes in consumption considered are not the result of a sophisticated equation but of a reasonable estimate. Prudence also suggests that decreases in consumption are shifted one-year forward compared with tariff increases.

445. The Tribunal therefore arrives at the following end-user tariff average variation starting in year 2002 in the case of CGP: 0.0%, 11.9%, 18.5%, 24.9%, 24.4%, 26.9%, 3.7%, 3.4%, 3.3%, 2.9%, 1.2% and then 2.4% per year until 2027 (with the distribution and transportation component increasing by 2% per year starting in 2007, as forecasted by LECG). In the case of CGS, the figures are respectively: 0.0%, 10.2%, 15.8%, 21.3%, 43.1%, 21.4%, 3.7%, 3.4%, 3.2%, 2.8%, 1.9% and then around 2.4% until 2027 (with the distribution and transportation component growing by 2% per year starting in 2007, as forecasted by LECG). These increases in average end-user tariff factor in the changes in the price of gas forecasted by LECG.

d) Consumption Adjustments under the But-For Scenario

446. The Claimant's experts based their estimates on some low price elasticities computed by an independent organization. It is to be noted, however, that low price elasticities are valid only for relatively modest increases in a given economic context. These experts also argue that elasticity is very low because the majority of the natural gas sold by CGP and CGS is for industrial and commercial users. While this is true in terms of volume, it is the residential consumers who represent the largest income component because of the higher profit margin in the latter case. It is therefore not possible to retain the argument that income will not be affected because the largest share of volume of gas is consumed by industrial and commercial users.

447. The Tribunal believes that the elasticities used by these experts were not realistic in the context of the large immediate tariff increase proposed by the Claimant for the

distribution component of the tariff. Moreover, in the Claimant's scenario, no increase at all is provided for gas transportation before 2006; in addition, there is no increase in the price of natural gas until 2005 in the case of CGP and there is an actual significant decrease until 2004 in the case of CGS. A more plausible scenario is one where at least gas transportation would gain the same increase as gas distribution (with 0% increase in the price of gas); in such a scenario the blended overall tariff increase would have been around 90%.

448. The Claimant also argues that there was either no alternative source of energy or that, if it existed, gas, even with large price increases, would have remained competitive. There is little doubt in the Tribunal's mind that gas consumption, at such but-for scenario prices, would have been likely to decrease in the residential, commercial and industrial sectors during the first years following 2001 or CGP and CGS would have been faced with a serious increase in defaulting payments.

449. The Tribunal considers that, taking into account the tariff changes just mentioned, it is reasonable to assume the following combined (across customers) price elasticities for CGP: -0.2 in 2004, -0.25 in 2005, -0.3 in 2006, 2007 and 2008, with the resulting consumption changes: 0% in 2002 and 2003, -2.4% in 2004, -4.6% in 2005, -7.5% in 2006, -7.3% in 2007, -8.1% in 2008, 0.0% in 2009 and 2010, +1.0% in 2011 and 2.0% until 2027. As to CGS, the figures are respectively for price elasticities: -0.15 for 2004 and 2005, -0.2 in 2006, -0,25 in 2007 and -0.15 in 2008; as to consumption changes, the figures are : 0.0% in 2002 and 2003, -1.5% in 2004, -2.4% in 2005, -4.3% in 2006, -10.8% in 2007, -3.2% in 2008, 0.0% in 2009, 1.0% in 2010 and 2.0% in the following years up to 2027.

450. The net result of the above changes is that, under the but-for scenario, the equity value of CGP is US$168,240,220, and that of CGS is US$33,434,238.

4. Valuation in the Pesification Scenario

451. The Tribunal, during its first consideration of the pesification scenario, was inclined to endorse the one proposed by the Claimant. However, events intervened

subsequently to the hearings and the post-hearings briefs submitted by the parties, which led the Tribunal to accept amendments to that scenario.

452. These events are related in particular to the Agreements which the Respondent signed with the Licensees in 2007, noted further above. In fact, by letters of May 2 and June 29 2007, Argentina informed the Tribunal that on April 26, 2007, CGS and CGP had signed with Argentina Memorandums of Understanding for the Adjustment of License Agreement for Distribution of Natural Gas ("MOU").

453. It was also explained above that this MOU provides for a 25% increase in tariff for the transportation and distribution of natural gas; an additional 2% increase is subject to the implementation of certain investments. These increases were due to come into effect on July 1, 2007 for CGS and on January 1, 2008 for CGP. In addition, the MOU contains an indexation formula for the future based on a mechanism of monitoring of costs ("MMC") in the Argentinean economy.

454. It is important to recall that the MOU is however subject to a number of restrictions and conditions, including the abandonment of all arbitral or judicial claims by the Licensees or their shareholders relating to the pre-2002 regime governing gas distribution or transportation. In addition, certain categories of residences classified as R1, R2 and R3 are protected from tariff increases until the adoption of an Integral Tariff Review to take place at a later time. Finally, the average total tariff increase cannot exceed 15%, taking into account adjustments to the price of gas.

455. By letters of June 25 and July 6 2007, Sempra informed the Tribunal that it would not sign any release or discharge in favor of Argentina of any liability in relation to the events which are the subjects of this case and that it persisted in its claims in this arbitration. It also mentioned that it had initiated proceedings against the shareholders of the companies that had approved and signed the MOU; such proceedings however are, as noted, outside the purview of this Tribunal.

456. Notwithstanding the conditional, and even litigious, character of the MOU, the Tribunal agrees with Argentina that this is a development that the Tribunal should take into account in assessing the pesification (or "actual") scenario as it prompts objective consequences for the Licensees and consequently for the interests of the Claimant.

457. For instance, the first scenario proposed by the Claimant contained CPI tariff increases between 2002 and 2007 which did not materialize, but did not contain the increases now proposed by Argentina. It is quite appropriate in the circumstances to refer to the real situation as it stands today when considering the actual scenario. The MOU proposes adjustments to the pesification scenario which Argentina (albeit with certain conditions) is willing to implement in relation to the companies concerned in this case.

458. The Tribunal has therefore accepted the adjustments to the original pesification scenario, such as presented by the Claimant in its letter of July 6, 2007. In particular, the CPI indexation suggested in that scenario between 2002 and July 1, 2007 for CGS and January 1, 2008 for CGP has been removed as it did not materialize. However, from those respective latter dates, the proposed 27% tariff increase (taking into account a maximum 15% average increase in consumer price, including the price of gas) has been inserted for each company. In addition, as recognized by the Claimant in its letter of July 6, 2007, significant pesification gains of US$27,700,367 and U.S$ 12,014,617 have been made on the debts of CGS and CGP respectively and those have been taken into account in establishing the equity value loss of those companies. The cash flows are discounted with WAACs of 13.77% and 14.12% for CGP and CGS respectively.

459. The result is an estimated equity value of US$21,510,284 for CGP and -US$58,030,252 for CGS (in practice 0 for the shareholders and the rest affecting the creditors).

5. The Equity Value Loss

460. The total equity value loss in the case of CGP is thus in the amount of US$146,729,936 and in the case of CGS of US$33,434,238.

461. The share of equity belonging to the Claimant being 37.10% in CGP and 38.78% in CGS, its damages for equity value loss amount to US$54,436,806 for CGP and US$12,965,797 for CGS, for a total of US$67,402,603.

6. The loss on the Loan

462. The Tribunal has already decided that the Claimant was entitled to claim in this case for the value of the loss on the loan granted in December 2001.

463. In this case, the Tribunal needs only to concentrate on the pesification scenario, the question being to determine whether the debt of CGS and CGP could have been reimbursed in those conditions.

464. In fact, the problem arises only for CGS for as it has been explained CGP has a positive equity value; this means that its debt will have been reimbursed in full during the duration of the License and there will still be some money left for the shareholders. For CGS, however, the situation is quite different, the firm having a large negative equity value.

465. In December 2001, the Claimant and Camuzzi loaned US$56,017,000 and US$73,983,000 respectively to the Licensees, which totaled US$130,000,000 (Sempra therefore providing 43.1% and Camuzzi 56.9% of the loan). Of that amount US$50,812,056 went to CGS, which represented 63.77% of the net debt of the company. Consequently, the combined loss for Sempra and Camuzzi is that same percentage out of the negative equity value of US$58,030,252, that is US$37,005,892 (63.77% x 58,030,252).

466. In the case of the Claimant, as creditor of 43.1% of the loan, this loss represents a sum of US$15,949,540.

7. Historical Damages

a) PPI Adjustments

467. The Claimant is entitled to the payment of the PPI adjustments which were suspended and not allowed to them in 2000 and 2001.

468. In its expert report submitted by the Claimant, LECG has valued those damages, as at December 31, 2001, at US$15,746,004 for CGP and US$10,339.626 for CGS, for a total of US$26,085,630. In its closing statement, the Claimant has reduced that total amount to US$13.6MM for CGP and US$9.3MM for CGS, for a total of US$22.9MM. The Respondent has not challenged the validity of those latter figures and this is the

amount that the Tribunal will retain for the purpose of assessing damages under this section.

469. The 37.10% held by the Claimant in CGP represents US$5.045,600 and its 38.78% share of CGS comes to US$3,606,540. The total amount therefore awarded to the Claimant as compensation for its share of unpaid PPI adjustments before December 31, 2001 amounts to a total of US$8,652,140.

b) Non-Payment of Subsidies

470. In the Subsidies Agreement of December 12, 2001, the parties agreed that, at October 31, 2001 an amount of AR$ 108,151,227,73 (including interest) was due for non-payment of subsidies but such amount does not include any amount for November and December.

471. In its closing statement document, the Claimant indicated that a sum of US$106.5 MM was owing as of September 2001, another US$17.3 MM up to December 31 and then US$5.4MM from January 1, 2002 to April 2002 (using currency parity under the Convertibility Law).

472. The Tribunal has already decided that damages would be established as at December 31, 2001. Damages in all cases are therefore determined as at that time, after which time the pesification and the but-for scenarios are applied. In both cases, it is assumed that, after that date, the tariffs will have been implemented fully one way or the other. The amounts of subsidies not paid between January and April 2002 should therefore be ignored for the purpose of calculating the compensation under this category.

473. The claim for unpaid subsidies will therefore only cover the period finishing on December 31, 2001. That amount has been established by the Claimant, in its Post-Hearing Brief, as of April 2002, at US$129, 187, 344 (as indicated a deduction of US$5.4 MM must be made for the January-April 2002 period).

474. From that amount, the subsidies the Respondent paid or committed to pay subsequently to that date must also be deducted.

475. For its part, the Respondent argues that the amount owing should be in AR$ and not US$ and that most of that debt has already been repaid. On the basis of this assumption, the Respondent estimates that there would be only a remaining amount of some US$3 million to be paid to the Claimant.

476. In answer, the Claimant recognizes that a certain amount has been received but that it is very far from covering the total amount of unpaid subsidies. The difference between the Parties is explainable by the fact that Argentina argues that, since the subsidies were to be paid in pesos, whatever amount it paid subsequently in that currency should be deducted from the peso debt for unpaid subsidies, while the Claimant argues that, by virtue of the principle of indifference, the amount owed by the Respondent should be calculated on the basis of parity between the two currencies which was in effect at the time the debt was incurred.

477. The Tribunal has already decided, for the reasons mentioned, that the unpaid subsidies before December 31, 2001, although established in pesos, should be paid on the basis of parity between the Argentine peso and the U.S. dollar. It will therefore proceed to calculate the amount still owed by Argentina on that basis.

478. The unpaid subsidies to December 31, 2001 shall be in the amount of US$123,787,344, leaving aside the US$5.4 MM claimed for the subsequent period up to April 2002. From that amount the sum of US$16,775,249 paid by Argentina up to January 2006 should be deducted. If it is assumed that all the amounts provided for under the Fiduciary Fund are going to be paid fully to the end of 2008 (on a currency parity basis, *i.e.* US$13,030,012 for the period of January 2006 to the end of 2008) - the Claimant itself has assumed that such payments would be made - the total amount owing for subsidies as of December 31, 2001 becomes US$93,982,083. Applying the same percentages as the ones mentioned by the Claimant for the allocation of that amount between CGP (1.13%) and CGS (98.37%), the unpaid subsidies therefore amount to US$1,061,998 in the case of CGP and US$92,450,175 in the case of CGS.

479. This is the amount which is awarded by the Tribunal as damages for unpaid subsidies. The Claimant is entitled to payment of its proportionate share of that amount, as represented by the respective interests of Sempra and Camuzzi in CGP and GGS.

This amounts for the Claimant to US$394,001 in the case of CGP (corresponding to the Claimant's share of 37.10%) and US$35,852,178 in the case of CGS (corresponding to the Claimant's share of 38.78%). The total amount owing to the Claimant under this item is therefore US$36,246,179.

480. If, for any reason, the Respondent were not to implement in full the commitments it made under the Fiduciary Fund, such pending payments must be added to the amount awarded by the Tribunal.

c) Other Discrete Claims

481. In its Memorial on the Merits, the Claimant had made a number of claims relating to various taxation matters. As noted, however, subsequently the Claimant decided not to pursue those claims and, consequently, the Tribunal does not need to address them.

8 Total Damages

482. The total damages due by the Respondent to the Claimant, as at December 31, 2001, amount to US$128,250,462.

Sempra Damages

Equity value loss	US$67,402,603
Loss on the loan of December 2001	US$15,949,540
Unpaid PPI adjustments	US$8,652,140
Non-Payment of subsidies	US$36,246,179
Total damages at 31/12/2001	US$128,250,462

9. Interest

483. In its Consolidated Memorial on the Merits and in its Reply, the Claimant, in its prayer for relief requests "(a)n order that the Argentine Republic compensate Camuzzi and Sempra for all damages they have suffered, plus interest compounded quarterly."

484. In the light of the recent Award in the *Enron* claim, this request became another contentious point in this arbitration. In *Enron*, the Tribunal decided that interests would be ordered until the date of the Award only as it understood that this was the request made by the Claimants.[165] The Claimant brought that issue to the attention of this Tribunal and argued by letter of June 22, 2007 that post Award interest be also awarded. Argentina expressed opposition to this request by letter of July 2, 2007 on the ground that such request had not been timely made nor had it been made in the memorials or the *Petitum*, which on the contrary referred to interest until the date of the Award.

485. In considering this issue the Tribunal has unanimously concluded that it is appropriate for interest to begin on January 1, 2002. Yet, the Tribunal by majority has concluded that in the light of the fact that post Award interest was not expressly requested in the memorials or their *Petitum*, and such memorials repeatedly referred to interest until the date of the Award, interest should, like in *Enron*, be awarded only until the date of the Award. In the view of the majority formal petitions for relief can only be made in the *Petitum* and the memorials which explain and support such petitions. The Tribunal will accordingly order interest until the date of the Award.

486. The Tribunal also unanimously agreed that interest on the above-noted amounts of damages will be computed at the successive 6-month LIBOR rates, plus a 2% annualized premium or portion thereof. Interest shall be compounded semi-annually.

---

[165] *Enron Corp. and Ponderosa Assets, L. P. v. Argentine Republic,* (ICSID Case ARB/01/3), Award of May 22, 2007, para. 452.

NOW THEREFORE THE ARBITRAL TRIBUNAL
DECIDES AND AWARDS AS FOLLOWS

[487.1] 1. The Respondent breached its obligations to accord the investor the fair and equitable treatment guaranteed in Article II(2)(a) of the Treaty and to observe the obligations entered into with regard to the investment guaranteed in Article II(2)(c) of the Treaty.

[487.2] 2. The Respondent shall pay the Claimant compensation in the amount of US$128,250,462. If the Respondent were not to implement in full the commitments it made under the Fiduciary Fund for the payment of owed subsidies, such pending payments shall be added to the amount awarded by the Tribunal.

[487.3] 3. The Respondent shall pay the Claimant interest at the 6 month successive LIBOR rate plus 2 per cent for each year, or proportion thereof, beginning on January 1, 2002 until the date of the Award. Interest shall be compounded semi-annually.

[487.4] 4. The Tribunal hereby confirms its Order that the Stamp Tax Claims are discontinued subject to the terms therein specified.

[487.5] 5. Each party shall pay one half of the costs of the arbitration and bear its own legal costs.

[487.6] 6. All other claims are hereby dismissed.

The Arbitral Tribunal

[signature]

Francisco Orrego Vicuña
President
September 9, 2007

[signature]

Marc Lalonde
Arbitrator
(Signed subject to the attached Partial Dissenting Opinion)
September 18, 2007

[signature]

Sandra Morelli Rico
Arbitrator
September 14, 2007

ANNEX 19

The International Centre for Settlement of Investment Disputes

Aguas del Tunari, S.A., Claimant/Investor v. Republic of Bolivia, Respondent/Contracting Party	ICSID Case No. ARB/02/3

Decision on Respondent's Objections to Jurisdiction

Members of the Tribunal
David D. Caron, President
José Luis Alberro-Semerena
Henri C. Alvarez

Representing Aguas del Tunari, S.A
Michael E. Curtin
Aguas del Tunari, S.A.

Robert G. Volterra (until February 11, 2005)
Matthew Weiniger
Herbert Smith

Ramiro Guevara
Enrique Barrios
Servicios Legales S.C.

Representing the Republic of Bolivia
Mario Moreno Viruez
Minister of Services and Public Works

Dana Contratto
Crowell & Moring

Jose Antonio Criales
Criales, Urcullo, Freire & Villegas

Washington, D.C., October 21, 2005

TABLE OF CONTENTS

Introduction and Summary **1**

Procedural History **1**

The Request for Arbitration *1*

Notice of Registration *2*

The Appointment of Arbitrators *2*

Petition of Non Governmental Organization to Intervene and for Other Forms of Involvement of Non-Disputing Parties *3*

First Session *4*

Procedural Order No. 1 .... *5*

The Postponement of the Hearing on Respondent's Objections to Jurisdiction *7*

Motions as to the Presentation of Witnesses at the Hearing *9*

The Hearing on Respondent's Objections to Jurisdiction & Post Hearing Correspondence from the Parties *9*

The Tribunal's Post Hearing Inquiry to the Netherlands, the Non-Disputing State Party to the BIT *10*

Factual Background **10**

Aguas del Tunari, S.A. *10*

The Conclusion of the Water and Sewage Concession for Cochabamba in September of 1999 .... *11*

The Terms of the Concession *12*

The Upstream Ownership of AdT in September 1999 .... *12*

The Events in the Fall of 1999 Following the Award of the Concession *13*

The December 1999 Ownership Structure of AdT *16*

The Challenges to the Concession and Its Termination *16*

The Issues Presented **17**

General Considerations Regarding Jurisdiction *17*

Claimant's Assertions as to the Basis of Jurisdiction *18*

Respondent's Objections *18*

The Applicable Law **19**

The First Objection **21**

The First Aspect of Respondent's First Objection which asserts that the Concession Agreement precludes ICSID jurisdiction. 21

Respondent's Objection *21*

Claimant's Reply *24*

The Decision of the Tribunal *25*

The Second Aspect of the First Objection which asserts that Bolivia is not a proper party 30

Respondent's Objection *30*

Claimant's Reply *31*

The Decision of the Tribunal *31*

The Third Aspect of the First Objection which asserts that Article 2 of the BIT recognizes the exclusive jurisdiction of Bolivian law over this dispute. 32

Respondent's Objection *32*

Claimant's Reply *33*

The Decision of the Tribunal *33*

The Fourth Aspect of the First Objection which asserts that the transfer of AdT's stock bars the jurisdiction of the Tribunal. 36

Respondent's Objection *36*

Claimant's Reply *36*

The Decision of the Tribunal *37*

The Fifth Aspect of the First Objection which asserts that misrepresentations by representatives of Claimant bar the jurisdiction of this Tribunal. 41

Respondent's Objection *41*

Claimant's Reply *42*

The Decision of the Tribunal *42*

The Sixth Aspect of the First Objection which asserts that Claimant's invocation of the Netherlands-Bolivia BIT is an assertion of jurisdiction not within the scope of Bolivia's consent to arbitration. 43

Respondent's Objection *43*

Claimant's Reply *45*

The Decision of the Tribunal *45*

The Second Objection 46

Respondent's Second Objection which asserts that the Claimant is not a Bolivian entity "controlled directly or indirectly" by nationals of the Netherlands as required by the Netherlands-Bolivia BIT **46**

Respondent's Objection *46*

Claimant's Reply *47*

The Decision of the Tribunal *48*
The Questions Presented *48*
The Meaning of the Phrase: "controlled directly or indirectly" *52*
The Ordinary Meaning of the Phrase: "controlled directly or indirectly" *52*
The Phrase in Its Context and in Light of the Object and Purpose of the BIT *56*
Article 31(3) of the Vienna Convention and the Significance to be Accorded to Statements of the Dutch Government *58*
Conclusion as to the Meaning of "controlled directly or indirectly" *62*
Confirming the Interpretation of "controlled directly or indirectly" *62*
The Negotiating History of the BIT *63*
The Jurisprudence Regarding Article 25(2) of the ICSID Convention *64*
The Holdings of Other Arbitral Awards Concerning "Control" *66*
The BIT Practice Generally of Both Nations *66*
Netherlands Practice *67*
Bolivian Practice *70*
Applying the Interpretation: Is AdT "controlled directly or indirectly" by IWH B.V. or IWT B.V.? *73*

Respondent's Motion for Production of Evidence **75**

Concluding Observation **76**

Decision **79**

Declaration of José Luis Alberro-Semerena **80**

Appendix I ..... **I - 1**

Appendix II ..... **II - 1**

Appendix III ..... **III - 1**

Appendix IV ..... **IV - 1**

Introduction and Summary

1. The Claimant in this proceeding is Aguas del Tunari, S.A. ("AdT"), a company organized under the laws of Bolivia.

2. AdT, under the "Contract for Concession of Use of Water and for the Public Potable Water and Sewer Service for the City of Cochabamba" (the "Concession") concluded in September 1999 and by other contracts related to this Concession, received the right to provide water and sewage services for the city of Cochabamba, Bolivia. By early April 2000, the Concession had ceased to be effective.

3. AdT claims the Republic of Bolivia ("Bolivia") through various acts and omissions leading up to, and including, the rescission of the Concession in April 2000, breached various provisions of a bilateral investment treaty, namely the Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Republic of Bolivia (the "Netherlands-Bolivia BIT" or "BIT").[1]

4. AdT initiated this proceeding against Bolivia before the International Centre for Settlement of Investment Disputes ("ICSID") invoking the Netherlands-Bolivia BIT as the basis of jurisdiction.

5. Bolivia has raised a number of objections to the jurisdiction of the Tribunal including arguments that Bolivia did not consent to ICSID jurisdiction and that AdT is not a Dutch national as defined by the BIT.

6. The Parties agreed that these objections should be considered as a preliminary matter.

7. In this Decision, the Tribunal concludes that the present dispute is within the jurisdiction of the Centre and the competence of the Tribunal.

Procedural History

The Request for Arbitration

8. AdT initiated this proceeding on November 12, 2001, when it filed a Request for Arbitration with ICSID. In the Request for Arbitration, AdT alleged that various actions attributable to Bolivia constituted an expropriation of its investment in Bolivia and were in breach of Bolivia's obligations under the Netherlands-Bolivia BIT.

---

[1] The Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Bolivia, *entered into force* November 1, 1994. The text is available online at http://www.unctad.org/sections/dite/iia/docs/bits/netherlands_bolivia.pdf. As to the national implementation of this treaty, see for Bolivia, Law No. 1586 of August 12, 1994, and for the Netherlands, Tractatenblad 1994, Nr. 239.

9. On December 5, 2001, Bolivia filed a document entitled "Memorial on ICSID Jurisdiction in the Aguas del Tunari S.A. Matter." In this document, Bolivia objected to ICSID jurisdiction on several bases and argued that the requested arbitration was "manifestly outside the jurisdiction" of ICSID.[2]

Notice of Registration

10. On February 25, 2002, the Secretary-General of ICSID provided both AdT and Bolivia with a "Notice of Registration" in the Arbitration Register of AdT's Request for Arbitration in accordance with Article 36(3) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID Convention" or "Convention").[3]

11. In issuing the Notice, the Secretary-General acknowledged Bolivia's opposition to the registration of the Request for Arbitration.[4] He also noted that the Secretariat's administrative task of registering the dispute was required under Article 36(3) of the ICSID Convention unless the dispute described in the Request for Arbitration was manifestly outside the jurisdiction of ICSID. Upon careful review of the information contained within the Request for Arbitration and supplemental correspondence made by the parties, the Secretary-General did not find the dispute to be "manifestly outside the jurisdiction of the Centre." The registration of the Request for Arbitration was made without prejudice to the rights of both parties to fully present their respective cases concerning jurisdiction to the Arbitral Tribunal that was to be convened under Articles 41 and 42 of the ICSID Convention.

The Appointment of Arbitrators

12. On April 19, 2002, after an exchange of correspondence, the parties agreed to use Article 37(2)(b) of the ICSID Convention to determine the number and method of the appointment of arbitrators. This Article provides for each party to appoint one arbitrator and the two parties to agree on a third arbitrator to serve as President of the Tribunal. On April 25, 2002, AdT appointed Henri Alvarez, a national of Canada, as a member of the Arbitration Tribunal. On April 29, 2002, Bolivia appointed Dr. José Luis Alberro-Semerena, a national of Mexico, as a member of the Tribunal. No objections were raised to either appointment.

13. On May 30, 2002, having failed to reach a consensus by a May 29 deadline set by the Secretary-General for the appointment of the President of the Tribunal, AdT requested that the Chairman of the ICSID Administrative Council designate an arbitrator to serve as

---

[2] Memorial of the Republic of Bolivia, p. 1, ¶ 1.1. (hereinafter "Resp. Mem." See Appendix I for a complete list of abbreviations used in this Decision).

[3] "Notice of Registration," February 25, 2002 to AdT and Bolivia, The Secretary-General took note of AdT's supplemental letters to the Centre of January 4, January 21, February 5, and February 14, 2002 as supplementing AdT's original Request for Arbitration.

[4] Letter of Ko-Yung Tang, Secretary-General, ICSID, February 25, 2002 to AdT and Bolivia. The Secretary-General took note of Bolivia's supplemental letters to the Centre on December 5, 2001, and January 7, January 29, February 8, and February 15, 2002.

President of the Tribunal as provided by Article 38 of the Convention and Rule 4 of the ICSID Arbitration Rules ("Arbitration Rules").

14. On June 26, 2002, absent any objection on the part of the parties, the President of the ICSID Administrative Council appointed Professor David D. Caron, a national of the United States, as President of the Tribunal. The Tribunal was officially constituted on July 5, 2002, in accordance with the Convention and the Arbitration Rules. Ms. Margrete Stevens has served as Secretary of the Tribunal.[5]

Petition of Non Governmental Organization to Intervene and for Other Forms of Involvement of Non-Disputing Parties

15. On August 28, 2002, an environmental non-governmental organization filed a Petition dated August 29, 2002, with the Tribunal on behalf of "La Coordinadora para la Defensa del Agua y Vida, La Federación Departamental Cochabambina de Organizaciones Regantes, SEMAPA Sur, Friends of the Earth-Netherlands, Oscar Olivera, Omar Fernandez, Father Luis Sánchez, and Congressman Jorge Alvarado," requesting permission to intervene in the arbitration, or for other forms of involvement in these proceedings.

16. The petitioners through their counsel, Earthjustice, requested that the Tribunal grant them standing to participate as parties in any proceedings convened to determine AdT's claim, and to afford the petitioners all rights of participation accorded to other parties. Alternatively, should party status be denied to one or more of the petitioners, the petitioners sought the right to participate in proceedings as *amici curiae*, meaning they would be allowed: (1) to make submissions concerning: the procedural aspects of the Tribunal, the jurisdiction of the Tribunal, the arbitrability of the claims raised by AdT and the merits of AdT's claims; (2) to attend all hearings of the Tribunal; (3) to make oral presentations during hearings of the Tribunal; and, (4) to have immediate access to all submissions made to the Tribunal.[6] In addition, petitioners requested that the Tribunal: (1) publicly disclose all statements, including written submissions, concerning the claims and defenses of both parties; (2) open all hearings to the public; and, (3) visit the area of Cochabamba.[7] Petitioners argued that they had standing since each petitioner had a direct interest in the subject matter of AdT's claim. Petitioners believed that their involvement would increase transparency in the international arbitral process and that they would provide "unique expertise and knowledge" during the Tribunal's proceedings and deliberations.[8]

17. On January 29, 2003, the President of the Tribunal wrote a letter to the petitioners acknowledging the petitioners' stated concerns over the resolution of this dispute. Based on

---

[5] Ms. Frutos-Peterson was designated to serve as Secretary of the Tribunal. However, Ms. Frutos-Peterson subsequently became unavailable and Ms. Margrete Stevens was designated to serve as Secretary of the Tribunal on August 29, 2002.

[6] Petition of La Coordinadora para la Defensa del Agua y Vida, La Federación Departamental Cochabambina de Organizaciones Regantes, SEMAPA Sur, Friends of the Earth-Netherlands, Oscar Olivera, Omar Fernandez, Father Luis Sánchez, and Congressman Jorge Alvarado, dated August 29, 2002, p. 19, ¶ 63.

[7] *Id.*, p. 6, ¶ 17.

[8] *Id.*, p. 2, ¶ 2.

its consideration of the petitioners' requests and the views of the parties to the dispute, the President wrote on behalf of the Tribunal that:

> [T]he Tribunal's unanimous opinion [is] that your core requests are beyond the power or the authority of the Tribunal to grant. The interplay of the two treaties involved (the Convention on the Settlement of Investment Disputes and the 1992 Bilateral Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and Bolivia) and the consensual nature of arbitration places the control of the issues you raise with the parties, not the Tribunal. In particular, it is manifestly clear to the Tribunal that it does not, absent the agreement of the Parties, have the power to join a non-party to the proceedings; to provide access to hearings to non parties and, *a fortiori,* to the public generally; or to make the documents of the proceedings public.

The Tribunal's letter goes on to observe that "the consent required of the Parties to grant the requests is not present," and that "[a]lthough the Tribunal did not receive any indication that such consent may be forthcoming, the Tribunal remains open to any initiative from the parties in this regard."

18. Finally, the Tribunal wrote that it "is of the view that there is not at present a need to call witnesses or seek supplementary non-party submissions at the jurisdictional phase of its work." It also emphasized that as far as future stages of proceedings, the Tribunal holds "this view without in any way prejudging the question of the extent of the Tribunal's authority to call witnesses or receive information from non-parties on its own initiative."[9]

First Session

19. The First Session of this Tribunal was held in Washington, D.C., on December 9, 2002.[10]

20. At the First Session, Bolivia reiterated its earlier objections and indicated that it would request the Tribunal to order the production of evidence by AdT in order for Bolivia to develop and support its objections to the jurisdiction of the Tribunal.

21. The Parties agreed, and the Tribunal concurred, that the question of the jurisdiction of this Tribunal would be decided as a preliminary matter.

22. The Tribunal indicated that although Bolivia had raised jurisdictional objections to the registration of the claim at the time of the claim's submission to the Centre, the rules and practice of the Centre called for the subsequent filing of "Objections to Jurisdiction" by Bolivia to put both AdT and the Tribunal on notice of Bolivia's objections. With this observation in mind and given Bolivia's stated intent to file a request for production of

[9] The Tribunal notes that the Petition and the letter of the Tribunal responding to it are not a formal part of the record of this proceeding. The Tribunal observes that the Petition has been electronically published by the petitioners at http://www.earthjustice.org/news/documents/boliviapetition.pdf. Given the unusual character of the letter of the Tribunal, it is reprinted as Appendix III to this Decision.

[10] The December 9th date for the First Session was agreed upon following notice from the parties on August 29, 2002, of their agreement to postpone the originally scheduled date of September 9, 2002. The agenda for the First Session was based in part on a "Joint Submission to the Tribunal Regarding Preliminary Procedural Matters," filed by the parties on November 15, 2002.

evidence by AdT, the Tribunal made the following procedural decisions and memorialized these decisions in the minutes and transcript of the First Session. Specifically, the Tribunal ordered Bolivia to file its "Objections to Jurisdiction" and any request for the production of evidence by January 17, 2003; AdT was ordered to file its response to the request for production of evidence within two weeks of Bolivia's filing or by January 31, 2003, whichever was earlier; Bolivia was ordered to file any reply to AdT's response within one week of that reply or by February 7, 2003, whichever was earlier; and AdT was ordered to file any rejoinder to Bolivia's reply within one week of that reply or by February 14, 2003, whichever was earlier.

Procedural Order No. 1

23. In accordance with the Tribunal's orders, Bolivia timely filed a document entitled "Republic of Bolivia's Objection to Jurisdiction and Requests for the Production of Evidence and for Clarification of Procedures." AdT timely filed its "Response to Bolivia's Objection to Jurisdiction and Requests for the Production of Evidence and for Clarification of Procedures." Bolivia filed its "Reply" to AdT's Response on February 5, 2003; and AdT filed its "Rejoinder" to Bolivia's Reply on February 13, 2003.

24. On April 8, 2003, the Tribunal issued "Procedural Order No. 1" on Bolivia's requests for the production of evidence and Bolivia's motion for the immediate dismissal of the claims against it.

25. As to the request for production of evidence, the Tribunal determined that Article 43 of the Convention and Arbitration Rule 34(2) granted the Tribunal a substantial measure of discretion regarding the production of documentary evidence or witnesses from the parties although such discretion was guided by several considerations:

> 13. The Tribunal interprets Article 43 as granting the Tribunal a substantial measure of discretion in the ordering of the parties to produce documentary evidence or witnesses. *See* CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY 647 (Cambridge Univ. Press, 2001) (stating that the "tribunal has complete discretion in . . . exercising the power to summon further evidence"). The Tribunal finds that its exercise of this discretion is not without limits, however, and that Article 43 provides some guidance as to the exercise of its discretion. In general, the Tribunal's discretion to order the production of evidence is informed by concepts of materiality, relevance and specificity present in the laws of evidence generally and by the customs of evidentiary production in international arbitration generally. More particularly, Article 43 provides that the Tribunal may order the production of evidence at any stage of the proceedings when in the Tribunal's judgment such an order is "necessary."
>
> 14. As a consequence, the Tribunal bears in mind a number of considerations in evaluating whether or not to order the production of evidence. These considerations include: the necessity of the requests made to the point the requesting party wishes to support, the relevance and likely merit of the point the requesting party seeks to support, the cost and burden of the request on the Claimant and the question of how the request may be specified so as to both fulfill legitimate requests by a party while not allowing inquires that are an abuse of process.
>
> 15. At the close of the First Session, the Tribunal encouraged the Respondent in making its request for documents to provide "specificity in [its] identification of documents." Transcript of First Session at p. 58. The Tribunal notes that the requests for documents by

> the Respondent in the main do not specifically identify documents but are instead general. The Tribunal acknowledges that it would be difficult for the Respondent to be more specific given the broad factual context that it asserts must be examined in order to develop its second objection to jurisdiction. The Tribunal also notes that it is within its power under Article 43 of the ICSID Convention to employ its discretion to tailor and narrow Respondent's general requests, taking into account the considerations outlined in paragraph 14.

26. After considering AdT's asserted basis for, and Bolivia's objections to, jurisdiction, the Tribunal determined that neither party's arguments as to the necessity of the various requests for the production of evidence were sufficiently developed or clear so that the Tribunal could grant or deny these requests. The Tribunal wrote:

> 30. It is the view of the Tribunal that neither party's arguments as to the necessity of the various requests for production of evidence are sufficiently developed or clear that the Tribunal may order or deny such production at this time. The argument advanced by Respondent to support its requests for the production of documents requires the Tribunal to undertake consideration of the merits of Respondent's second jurisdictional objection without the benefit of full briefing by the parties or the opportunity of the Tribunal to put questions to the parties during a hearing. A review of Respondent's second jurisdictional objection is required (1) to decide the likely merit of that objection even if the objection were factually supported, and therefore the necessity of ordering of documents in support of the development of that objection, and (2) to ascertain the exact scope of that objection so that appropriate limits might be placed on the requests for documents made by Respondent. Without such an estimation of the likely legal merit of Respondent's objection and without criteria for the narrowing of Respondent's requests for production of evidence, the Tribunal is faced with a factually intense, and consequently expensive and lengthy, factual inquiry that ultimately may not be necessary to the resolution of this case. Therefore, although the Tribunal concludes that it is within its power to undertake such an incidental preliminary review of the merits of the second jurisdictional objection in order to decide upon a request for production of evidence, the Tribunal concludes in its discretion that such a decision by the Tribunal at this point would be premature and that the Tribunal's capacity to decide upon this important request would be enhanced greatly by both briefing and oral argument before the Tribunal.

27. Bolivia, along with its request for production of evidence, filed a motion to dismiss premised on the basis that AdT had "rested its case" on jurisdiction. The Tribunal found that AdT had not in any previous submission to ICSID waived its right to present its jurisdictional arguments, but had instead, at various points, offered to expand and elaborate its case. As a result, Bolivia's motion for an immediate dismissal was denied.

28. The Tribunal created a schedule for submissions from the parties on the subject of Bolivia's two main objections to jurisdiction. The written submissions pertaining to the "Objections to Jurisdiction" ordered by the Tribunal in Order No. 1 were subsequently filed in timely fashion: Claimant filed its "Memorial on Jurisdiction" on June 4, 2003; Respondent filed its "Counter-Memorial on Jurisdiction" on August 4, 2003; Claimant filed its "Reply" on September 4, 2003; and Respondent filed its "Rejoinder" on October 6, 2003.

The Postponement of the Hearing on Respondent's Objections to Jurisdiction

29. In Procedural Order No. 1, the Tribunal requested the ICSID Secretariat to work with the Tribunal and the Parties to decide a mutually convenient time and place for a three-day hearing on Bolivia's "Objections to Jurisdiction" in either November or December 2003. An agreement was reached and a hearing was scheduled in Washington, D.C., for November 17-19, 2003.

30. In a letter dated October 22, 2003, Respondent noted that "certain events in Bolivia over the past several weeks have required the priority attention of the Bolivian Government," and requested that the "hearing scheduled for 17, 18, and 19 November be postponed."[11] Bolivia argued that these events had diverted the focus and attention of the Bolivian government and would continue to do so for some time. AdT in a letter dated October 23, 2003, objected to any postponement stating that: Bolivia's request was "unnecessary and unreasonable", Bolivia's counsel would have had standing instructions to proceed, there would be no material changes to previously submitted arguments, and the events in Bolivia would have no impact on Bolivia's presentation of its legal case on jurisdiction.[12]

31. On November 5, 2003, the Tribunal issued "Procedural Order No. 2" ("Order No. 2") on Bolivia's motion for postponement of the hearings scheduled to begin on November 17, 2003. The Tribunal took notice of the severity and seriousness of the disruptions in La Paz and in other parts of Bolivia during September and October 2003. The Tribunal noted that, as a general matter, a request for postponement of a hearing by only one of the parties is not to be granted without sufficient cause especially where a request for postponement is made on short notice. Hearings are scheduled months in advance with attention paid to the schedules of the parties, their counsel, and the Members of the Tribunal. The Tribunal noted that the requirement of "sufficient cause" is particularly strict when a request for postponement is made shortly before the scheduled date.

32. In issuing Order No. 2, the Tribunal emphasized that Counsel for Bolivia did not assert that the seriousness of the events in September and October 2003 directly necessitated the postponement of the hearing. Rather, the possibility that Bolivia's counsel did not have adequate opportunity for final consultations with necessary Bolivian officials constituted sufficient cause to postpone the hearing.

33. The Tribunal, invoking its general authority over arbitral procedure, in cases where the Arbitration Rules do not provide specific direction and the parties are not in agreement, decided that the severity of events in Bolivia and the closeness in time of those events to the scheduled hearing might prevent Counsel for Bolivia from consulting with the responsible Bolivian officials whose attention would be justifiably diverted by domestic matters.

34. The Tribunal disagreed with AdT's argument that there would be no prejudice in denying Bolivia's motion since the jurisdictional issues to be addressed at the hearing were primarily legal issues. Although the scope of the hearing was to be limited to already

[11] Letter of Dana Contratto, counsel to Bolivia, October 22, 2003, to ICSID.
[12] Letter of Matthew Weiniger, counsel to AdT, October 23, 2003, to ICSID.

submitted written arguments, it was not unusual, in the Tribunal's view, in arbitration for subtle aspects of a party's oral presentation and emphasis of its arguments to be altered in final consultations between a party and its counsel. Moreover, the Tribunal cautioned that the attorney-client relationship could be adversely affected if counsel was compelled to present an oral argument without having the opportunity for final consultation.

35. The Tribunal emphasized that its "conclusion that a lack of opportunity for counsel to consult with its client could be prejudicial does not, however, necessarily indicate that a postponement is justified." The Tribunal wrote:

> 13. * * *. The inability of counsel to consult with its client is not in and of itself sufficient cause to postpone a hearing because that circumstance ordinarily is within the control of the party. Both states and private parties encounter demands to which they may prefer to give a priority over the demand of counsel to confer on a matter subject to arbitration. The inability of counsel to consult with its client therefore can be a sufficient cause to postpone a hearing only in extraordinary circumstances.

In reviewing the particular facts of this case, the Tribunal found the circumstances cited by Counsel for Respondent to be extraordinary. The Tribunal wrote that

> 14. * * * . [I]t is not unreasonable that the severity of events in Bolivia over these recent weeks required the focus of the Government of Bolivia and diverted such focus from the present arbitration. The combination of this diverted focus and the closeness of the events in Bolivia to the scheduled Hearing may effectively prevent Counsel for Bolivia from consulting with the relevant Bolivian officials. Simultaneously, the Tribunal also observes that its recognition of Bolivia's special duty to public order will diminish quickly as the events of the past several weeks recede into the past.

36. The Tribunal thus concluded that the severity and extraordinary nature of the events in Bolivia constituted sufficient cause to postpone the hearing.

37. In making this determination, the Tribunal noted that up to that point, each party had fully met all the requests of the Tribunal including those for written submissions. The Tribunal noted that requests for extensions and postponements may be employed as dilatory tactics. Noting that these types of tactics could threaten the integrity of the entire arbitral process, the Tribunal acknowledged its duty to guard against them. However, there was no indication whatsoever that Bolivia's request for postponement was an example of such a dilatory tactic.

38. Order No. 2 recommended that the hearing on Bolivia's Objections to Jurisdiction be scheduled for January 12-14, 2004 subject to consultation by the Secretariat with the Parties. Subsequently, in accordance with Arbitration Rule 13(2), the Tribunal Secretary conferred with each party, and, noting various scheduling conflicts, February 9, 10, and 11, 2004, were set as the dates for the hearing.

Motions as to the Presentation of Witnesses at the Hearing

39. The Tribunal, in Order No. 2, advised each Party to notify each other and the Tribunal by December 15, 2003, if they wished to present witnesses at the February 9-11 hearing.

40. On December 15, 2003, Bolivia filed its Response to Order No. 2 and indicated that it intended to present two expert witnesses at the hearing - Professor Rudolf Dolzer and Professor Merritt B. Fox. Bolivia also requested that all witnesses relied upon by AdT be made available for cross-examination. AdT also filed a response on December 15, 2003, indicating that it did not intend to present at the hearing any expert witnesses and objecting to Bolivia's request that all witnesses be made available for examination since cross-examination is expensive and unnecessary for expert witnesses offered to explain a point of law rather than a matter of fact.

41. On December 31, 2003, the Tribunal issued "Procedural Order No. 3" ("Order No. 3"). The Tribunal observed that it is, in its view, customary in international arbitration that such witnesses, whether they are experts in law or witnesses of fact, be made available for examination if so requested. The Tribunal also noted that, if need be, it may be acceptable to examine witnesses via videoconference or other such means. However, the Tribunal found it presumptively preferable that witnesses appear in person. The Tribunal thus granted Bolivia's motion that witnesses relied upon be made available for examination at the hearing.

42. Order No. 3 also set forth the order of presentations for the hearing and the maximum allowable time for each respective presentation. Order No. 3 provided that, absent agreement of the parties to the contrary, a witness with evidence to be offered on a particular issue should be presented and cross-examined during that party's "first round presentation." Any time taken by direct examination or cross-examination of a witness would be counted against the overall time allotted to the examining Party. The Tribunal advised each Party that they could each decide to devote the time allocated to their oral proceedings to the presentation of a witness whose statement was already a part of the written record. If a witness was presented, the other Party could decide whether to examine the witness noting that such cross-examination would count against their own time.

The Hearing on Respondent's Objections to Jurisdiction & Post Hearing Correspondence from the Parties

43. The Hearing on Respondent's Objections to Jurisdiction was held in Washington, D.C., on February 9, 10 and 11, 2004.

44. The Tribunal notes that the Parties jointly requested on a monthly basis from March 2004 through June 2004 that the Tribunal not render a decision.

The Tribunal's Post Hearing Inquiry to the Netherlands, the Non-Disputing State Party to the BIT

45. At various stages of these proceedings the parties presented evidence and made arguments addressing several public statements made by the Government of the Netherlands regarding various provisions of its BIT with Bolivia.[13]

46. Given that the Government of the Netherlands is not a party to, or otherwise present in this arbitration, the presentation of its statements was left to the Parties.

47. The Tribunal concluded that specific information from the Government of the Netherlands would assist the work of the Tribunal. Acting under Rule 34 of the Arbitration Rules, the Tribunal on October 1, 2004, wrote to Johannes G. Lammers, Legal Advisor to the Foreign Ministry of the Netherlands, posing specific questions.

48. The Tribunal advised the Parties of this inquiry in a letter dated October 4, 2004, to which the Tribunal's letter of October 1st was attached. The October 4th letter advised the Parties that they would be provided, as appropriate, an opportunity to comment on any reply from Mr. Lammers.

49. On December 14, 2004, the Tribunal received a reply letter from Mr. Lammers dated October 29, 2004, to which there was attached a document entitled "Interpretation of the Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Republic of Bolivia, signed on 19 March 1992 and entered into force on first November 1994." This letter and its attachment were transmitted via "Procedural Order No. 4" ("Order No. 4") to the Parties with the request that they provide by January 5, 2005, any comments they might have on those aspects of Mr. Lammers' letter which were responsive to the Tribunal's limited inquiry. Both Parties submitted timely comments.

Factual Background

50. The following section summarizes the factual background regarding the parties and transactions that led to this proceeding. The particular factual circumstances summarized are those that surface as aspects of the arguments Bolivia advances in its jurisdictional objections.

Aguas del Tunari, S.A.

51. AdT, the Claimant in these proceedings, is a legal person constituted in accordance with the laws of Bolivia.[14]

---

[13] See *infra* at ¶¶ 259-260.

[14] AdT has submitted to the Tribunal (1) The Act constituting AdT (Escritura Publica de Constitución de una Sociedad) dated August 23, 1999, (Ex. 1 to the Request for Arbitration), (2) The Modification of the statutes of AdT (Modificación de Estatutos) dated September 2, 1999, (Ex. 2 to the Request for Arbitration), and (3) Registration of AdT at the Commercial Registry (Matrícula de Inscripción) (Ex. 3 to the Request for Arbitration). Bolivia does not question that AdT is a Bolivian legal entity.

The Conclusion of the Water and Sewage Concession for Cochabamba in September of 1999

52. In 1998, Bolivia opened an international tender process to privatize water and sewage services as well as an electricity generation license for its third largest city, Cochabamba. By April 1999, only one bid was made by a consortium called "Aguas del Tunari"[15] and led by International Water Ltd.[16] That one bid did not comply with the requirements of the tender process and that process ended without success. The consortium approached Bolivia to open negotiations concerning the concession[17] and by April 19, 1999, a negotiation committee was formed by decree.[18] By Supreme Decree dated June 11, 1999, the Bolivian Water and Electricity Superintendencies were given authority to negotiate the water concession and an electric generation license.[19]

53. On September 2, 1999, AdT, the locally incorporated vehicle for the consortium's foreign investment, was formally registered as a Bolivian company, thereby completing a formation process begun in July 1999.[20]

54. On September 2, 1999, the Bolivian government approved the text of the Concession clearing the way for its conclusion.[21] And on September 3, 1999, the Concession was concluded and signed by Mr. Luis Guillermo Uzin Fernández, Superintendent of Water, and Mr. Geoffrey Richard Thorpe of AdT, and formally ratified by an Administrative Resolution.[22] AdT notes that several related contracts were also concluded at approximately the same time.[23]

55. The Concession took effect on November 1, 1999.[24]

56. The public's response to the Concession is described below.[25]

---

[15] Request for Arbitration, November 12, 2001, ¶¶ 8-9.

[16] Resp. Counter Mem., p. 8, ¶ 15.

[17] *Id.*, ¶ 16.

[18] Supreme Decree No. 25351, April 19, 1999,(Ex. 17 to the Request for Arbitration).

[19] Supreme Decree No. 25413, June 11, 1999,(Ex. 18 to the Request for Arbitration).

[20] Registration of AdT at the Commercial Registry (Matrícula de Inscripción) (Ex. 3 to the Request for Arbitration).

[21] Resp. Counter Mem., p. 15, ¶ 27.

[22] Concession Contract between the Superintendence of Water and the Consortium, Aguas del Tunari, (Ex. 20 to Request for Arbitration); Administrative Resolution SA No. 24/99, (Ex. 21 to Request for Arbitration).

[23] Request for Arbitration, p. 6, note 15. Claimant lists the other contracts as: The "SEMAPA Property System Contract" entered between AdT and the Municipal Potable Water and Sewer Service of Cochabamba (SEMAPA) (the commercial leasing and transfer of SEMAPA's property to AdT), the "Misicuni Property System Contract" entered between AdT and the Misicuni Company (the commercial leasing of the main tunnel of the Multipurpose Misicuni Project), and the "Contract for Transfer of Facilities for the Titiri Pumping Station" entered between AdT and the Misicuni Company (the sale of the Titiri Pumping Station to AdT). Also, there are two contracts for licenses as granted by "Joint Resolution" by the Superintendencies of Water and Electricity: "License to Generate Electricity and the Concession for Use of Water from the Misicuni, Visacha, and Putucuni Rivers and from their tributaries," and "License Contract for Generation of Electricity with the Superintendencies of Water and Electricity."

[24] Administrative Resolution SA No. 39/99 (Ex. 24 to Request for Arbitration)

[25] *See* ¶¶ 62 to 70.

The Terms of the Concession

57. The Concession provided for a 40-year relationship between AdT and the Bolivian Water and Electricity Superintendencies. AdT agreed to provide a regular volume of drinkable water of a certain quality for the city of Cochabamba in exchange for a negotiated return on its investment. The Concession contemplated the possibility of AdT expanding operations to meet the needs of a larger population.[26] The contracts related to the Concession and referred to in paragraph 56, among other things, involved AdT in water projects with electricity generation components.

58. The Concession provided for dispute settlement in its Article 41 entitled, "Resolution of Controversies." In relevant part, Concession Article 41 provides:

> Article 41.2 [AdT] recognizes the jurisdiction and competence of the authorities that make up the System of Sectoral Regulation (SIRESE) and of the courts of the Republic of Bolivia, in accordance with the SIRESE law and other applicable Bolivian laws.
>
> Article 41.3 The provisions of the present Contract are not to be interpreted as a renunciation on the part of the Shareholders, the Founding Shareholders, including the Ultimate Shareholders, of methods of dispute resolution established in International Treaties recognized by the Republic of Bolivia
>
> Article 41.4 [...]
>
> Article 41.5 The Parties [the Superintendency of Water and AdT] recognize that the Shareholders and Ultimate Shareholders including the Founding Shareholders are free to have recourse to those methods of dispute resolution which are legally available to them in accordance with Bolivian Law (such as, for example, arbitration under the rules of the ICC, ICSID or UNCITRAL or other similar international organizations). The Parties agree to cooperate in the above-mentioned process, to the extent permitted by Law.[27]

This article is a basis for part of Bolivia's objections to jurisdiction.

59. The Concession also has several provisions addressing the ownership structure of AdT. Article 37.1 reads in relevant part:

> [E]very Founding Stockholder has to keep more than 50% of the original equity percentage in voting shares of the Concessionaire at least over the first seven (7) years of the Concessions.[28]

The Upstream Ownership of AdT in September 1999

60. At the time the Concession was concluded in September 1999, the 'upstream' ownership of AdT was as follows:

1. Twenty percent of the shares in AdT were divided between four Bolivian companies;[29]

---

[26] Concession at Annex 6.
[27] Concession (Ex. 20 to Request for Arbitration). The passages of the Concession relevant to this Decision are reproduced in the original Spanish at Appendix II.
[28] *Id.*

2. Riverstar International, S.A. of Uruguay owned twenty five percent of the shares; and[30]

3. The remaining fifty five percent of the shares were owned by International Water (Tunari) Ltd ("IW Ltd") of the Cayman Islands. The shares of IW Ltd were 100 percent owned by Bechtel Enterprise Holding, Inc., a company organized under the laws of the United States of America.

61. This upstream ownership structure is depicted by the following chart:

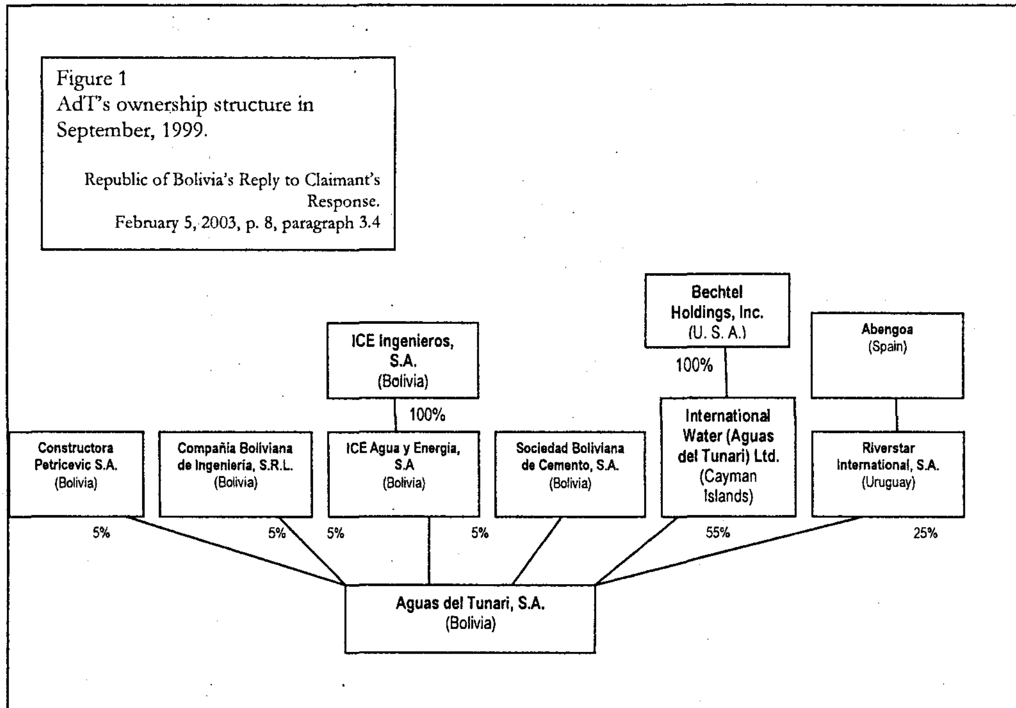


Figure 1
AdT's ownership structure in September, 1999.

Republic of Bolivia's Reply to Claimant's Response.
February 5, 2003, p. 8, paragraph 3.4

The Events in the Fall of 1999 Following the Award of the Concession

62. Two lines of events in the Fall of 1999 are relevant to this proceeding. First, there is the reaction of the public to the awarding of the Concession and the responses of both Bolivia and AdT to that reaction. Second, there is planning for, and the eventual effectuation of, a corporate reorganization of the upstream ownership of AdT. The Parties disagree about the details or significance of each of these lines of events and whether there is a connection between the two.

63. As to the first line of events, it appears from the record before the Tribunal that citizen groups were aware generally of the negotiation of a concession but sought more specific information concerning that process. Thus on September 3, 1999 (the day the Concession was concluded), a news article reported that the Defense of Water Committee

[29] Those companies are comprised of Constructora Petricevic, S.A.; Compañía Boliviana de Ingeniería, S.R.L.; ICE Agua y Energía, S.A.; and, Sociedad Boliviana de Cemento, S.A., each at 5 percent.
[30] Riverstar is 100 percent owned by Abengoa of Spain.

criticized the negotiations as lacking transparency and requested that the Bolivian government publicize the true rates that would govern before it concluded the Concession.[31]

64. Respondent writes: "In fairness, no one negotiating the Concession agreement could have anticipated the intensely hostile reaction that greeted AdT immediately upon the Agreement's signing."[32] On September 14, 1999, a news article reported the statements of the government and the concerns of citizen groups as to what the new rates would be. The government indicated they would take effect on December 1, 1999.[33] In October, an article discussed both company, governmental and private views on how the Concession would possibly affect private water wells in the Concession area, noting citizen concerns.[34]

65. The record before the Tribunal suggests that the level of criticism of the Concession by citizen groups became greater after the Concession came into effect in November 1999. In an article dated November 17, 1999, the rate increases and their possible impacts are discussed. The article notes calls for the annulment of the Concession.[35]

66. Respondent writes that "representatives of the Waters Superintendency held meetings and discussions with Cochabamba community groups in an attempt to clarify the scope of AdT's authority within the concession area."[36] On November 28, 1999, AdT attempted to respond to public criticism by publishing an "Open Letter" in several Bolivian newspapers, including the Cochabamba press, seeking to provide clearly its view on seven points.[37] A news article dated November 29, 1999 describes how various labor organizations from Cochabamba were expected to present claims of unconstitutionality against the Potable Water and Sewage Service Law and to demand rescission of the Concession.[38] As the new rates took effect on December 1, 1999, a news story emphasized how politicians, unionists, and neighborhood leaders of Cochabamba raised their voices against the rate increases.[39] A further newspaper story dated December 5, 1999 reported that the Superintendent of Waters had indicated that the new rates would remain in force unless a new Administrative Resolution was adopted.[40]

67. As to the second line of events, on November 9, 1999, Bechtel announced that it had reached an agreement with Edison, S.p.A. of Italy whereby Edison and Bechtel would join their respective water management projects, including IW Ltd, together in a single joint venture. As a consequence, Edison would assume a 50 percent interest in IW Ltd.

68. On November 24, 1999, Bechtel wrote to Waters and Electricity Superintendencies informing them of proposed changes in AdT's ownership as a consequence of Edison's

---

[31] Resp. Counter Mem., Ex. 5.
[32] Resp. Counter Mem., p. 16, ¶ 30.
[33] Resp. Counter Mem., Ex. 7.
[34] Resp. Counter Mem., Ex. 8.
[35] Resp. Counter Mem., Ex. 10.
[36] Resp. Counter Mem., p. 18, ¶ 35.
[37] Resp. Counter Mem., Ex. 28.
[38] Resp. Counter Mem., Ex. 12.
[39] Resp. Counter Mem., Ex. 14.
[40] Resp. Counter Mem., Ex. 18.

involvement.[41] In that letter, Bechtel wrote that "[f]rom our review of the contracts in connection with the Project, in order to complete the Transaction, your acceptance of the transfer of the Shares appears to be necessary." On December 3, 1999, local Bolivian counsel for Bechtel wrote to the Waters Superintendency stating that "given that such change has to do with tax requirements outside of Bolivia," it was his opinion that the transfer would leave AdT "under the same control," have "no adverse impact" for Bolivia, and that he saw "no reason why approval should not be granted."[42] The Waters Superintendency gave its approval to the proposed transfer of IW Ltd's shares in AdT to a Dutch company on December 3, 1999, although Bolivia disputes the content and legal effect of that act.[43]

69. Claimant states that it discontinued its effort to transfer the shares from IW Ltd, a Cayman Islands corporation, to a new Dutch corporation as described in the previous paragraph. Claimant states it instead decided to migrate the company from the Cayman Islands to Luxembourg. Respondent disagrees with the distinction made between transfer and migration. (The Tribunal addresses this difference between the Parties as the fourth aspect of the First Objection beginning at paragraph 156.)

70. In anticipation of the corporate reorganization anticipated as a part of the joint venture with Edison, Baywater Holdings, B.V., ("Baywater") was incorporated under Dutch law on November 25, 1999. On December 8, 1999, International Water Holdings B.V. ("IWH B.V.") and International Water (Tunari) B.V. ("IWT B.V.") were incorporated under Dutch law by Baywater and IWH B.V., respectively. On December 21, 1999, IW Ltd of the Cayman Islands "migrated" to Luxembourg where it became known as International Water (Tunari) S.a.r.l. (IW S.a.r.l."). Finally, on December 22, 1999, IWT B.V. became the 100 percent shareholder of IW S.a.r.l.

---

[41] Resp. Counter Mem., Ex. 1.

[42] Resp. Counter Mem., Ex. 2.

[43] Resp. Counter Mem., pp. 26 and 43. Respondent states that "Based on Mr. Guevara's representations, the Water Superintendent gave his approval for Bechtel to proceed with the transfer of ownership shares." *See* Resp. Counter Mem. pp. 25-26, ¶¶ 47-48. Respondent also states the Water Superintendency did not possess the authority to approve the proposed transfer of shares. *Id.* , p. 26, ¶ 48.

The December 1999 Ownership Structure of AdT

71. AdT claims the resulting structure after the December 1999 reorganization was as depicted in the following chart:

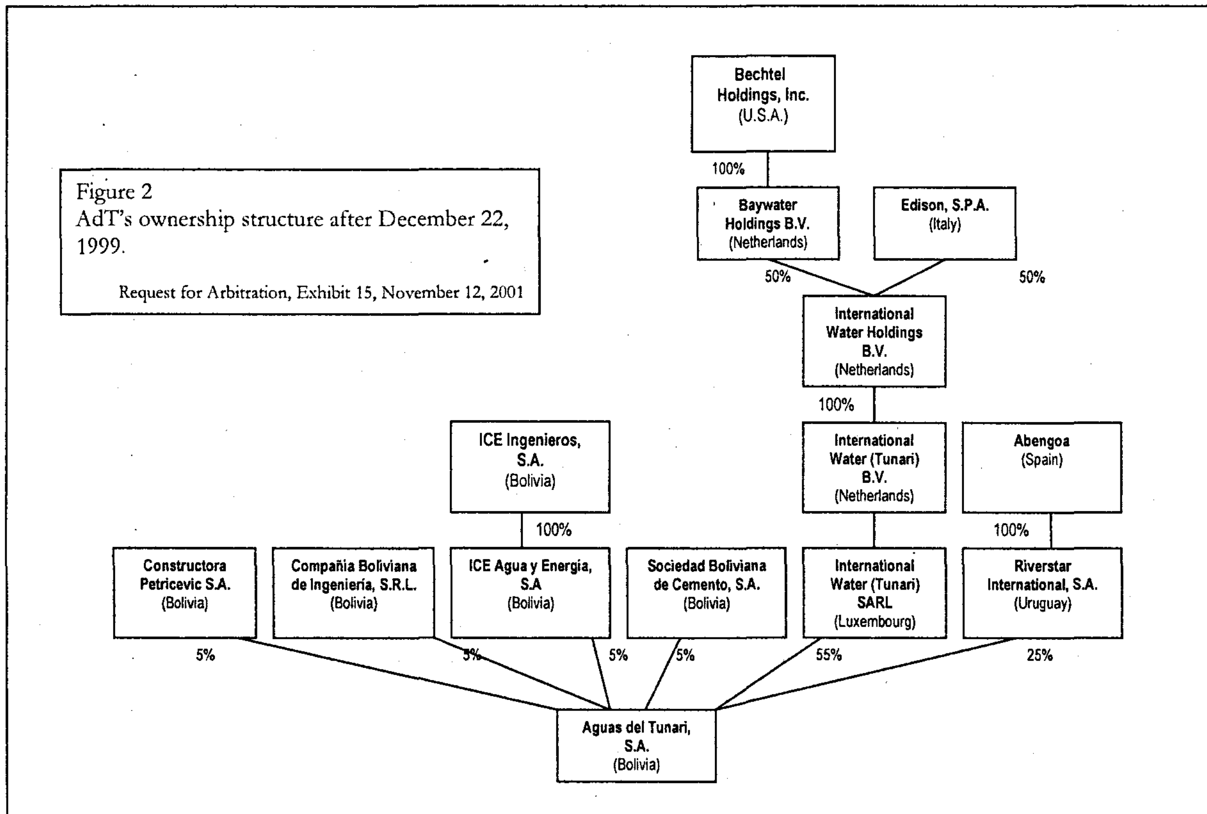


Figure 2
AdT's ownership structure after December 22, 1999.

Request for Arbitration, Exhibit 15, November 12, 2001

72. Although Respondent does not question this chart, it also is not clear that Respondent accepts the accuracy of this chart. For the purposes of the jurisdictional objections raised at this stage of the proceedings, the Parties agree that these changes meant that as of December 1999 AdT was no longer held by a Cayman Islands corporation. Finally, although the Parties also appear to accept that 55 percent of AdT's upstream ownership passed through Dutch companies after December 22, 1999, Bolivia disputes the substance of these Dutch entities, describing them as mere shells.

The Challenges to the Concession and Its Termination

73. The Parties agree that there was significant opposition to the Concession after January 1, 2000 in various parts of Bolivia, and particularly in Cochabamba. The Parties disagree as to the reasons for this opposition. The Parties also disagree as to whether either party violated its obligations under the Concession in responding to opposition groups. The Parties agree that the opposition movement grew in intensity in the early months of 2000 after AdT began operations in January 2000 and that the Concession was terminated in early April 2000 after major violent protests.

The Issues Presented

General Considerations Regarding Jurisdiction

74. This Tribunal is constituted under the ICSID Convention to which both Bolivia and the Netherlands are State Parties.[44] Jurisdiction in ICSID arbitration requires the consent of both the Claimant and the Respondent. Article 25(1) of the ICSID Convention provides:

> The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, *which the parties to the dispute consent in writing to submit to the Centre.* When the parties have given their consent, no party may withdraw its consent unilaterally. (Emphasis added)

75. The consent of the parties required in Article 25(1) can be expressed in a variety of written instruments. Moreover, the offer to arbitrate may be contained in one type of written instrument, the acceptance in another. It is for the Claimant to establish the bases of jurisdiction of an ICSID Tribunal.

76. AdT bases the jurisdiction of the Tribunal on the Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Bolivia.[45] In such bilateral investment treaties, the two State parties provide their consent to arbitration. This consent is contained in the form of an offer to arbitrate claims of investors based in a contracting State who allege breaches of the treaty by agents of the other contracting State.

77. Under Rule 41(1) of the Arbitration Rules, objections to jurisdiction "shall be made as early as possible." Bolivia raised a series of objections when AdT filed its Request for Arbitration and continued to object in subsequent filings. Bolivia's objections to jurisdiction are timely.

78. The Tribunal notes that Arbitration Rule 41(2) provides that: "[t]he Tribunal may on its own initiative consider, at any stage of the proceeding, whether the dispute or any ancillary claim before it is within the jurisdiction of the Centre and within its own competence."[46] The Tribunal views this authority as necessarily including the power to consider ways in which an ambiguous or unclear objection may bear on jurisdiction and to restate such objections, as appropriate, so as to allow a full examination of jurisdiction.

---

[44] Bolivia signed the Convention on May 3, 1991; ratification took place on June 23, 1995; and the Convention entered into force for Bolivia on July 23, 1995. The Netherlands signed the Convention on May 25, 1966; ratification took place on Sep. 14, 1966; and the Convention entered into force for the Netherlands on October 14, 1966 (see http://www.worldbank.org/icsid/constate/c-states-en.htm).
[45] See *supra* note 1, the Treaty will hereinafter be referred to as the "BIT" or Netherlands-Bolivia BIT."
[46] See ICSID Rules of Procedure for Arbitration Proceedings, Chapter 5, available at: http://www.worldbank.org/icsid/basicdoc/partF-chap05.htm#r41.

Claimant's Assertions as to the Basis of Jurisdiction

79. Claimant seeks arbitration before ICSID on the basis of the Netherlands-Bolivia BIT.[47] Specifically, Article 9(6) of the BIT states:

> If both Contracting Parties have acceded to the Convention on the Settlement of Investment Disputes between States and Nationals of other States of 18 March 1965 [ICSID Convention], any disputes that may arise from investment between one of the Contracting Parties and a national of the other Contracting Party shall, in accordance with the provisions of that Convention, be submitted for conciliation or arbitration to the International Centre for Settlement of Investment Disputes.

80. AdT asserts that it is a "national" of the Netherlands as defined by the BIT. Articles 1(b)(ii) and (iii) of the BIT define "nationals" as:

> (ii)without prejudice to the provisions of (iii) hereafter, legal persons constituted in accordance with the law of that Contracting Party;
> (iii)legal persons controlled directly or indirectly, by nationals of that Contracting Party, but constituted in accordance with the law of the other Contracting Party.

81. AdT identifies itself as a legal person constituted in accordance with the laws of Bolivia which is "controlled directly or indirectly" by nationals of the Netherlands, that is, IWT B.V. and IWH B.V. of the Netherlands.[48]

82. AdT contends that given that both Bolivia and the Netherlands are parties to the ICSID Convention and that AdT is a national of the Netherlands as defined by the BIT, ICSID is an available forum for AdT in its investment dispute with Bolivia.

Respondent's Objections

83. Respondent presents two objections to the jurisdiction of the Tribunal.

84. Respondent's First Objection is that Bolivia did not consent to the jurisdiction of ICSID. Respondent's First Objection has numerous aspects that are argued both separately and in their totality. Even though Respondent's First Objection is not presented clearly, the Tribunal has gone to great effort to consider the various possible aspects of Respondent's First Objection. The Tribunal has identified six aspects to the First Objection:

1. First, that the circumstances surrounding the negotiation of the Concession and the dispute settlement clause contained in the Concession preclude ICSID jurisdiction,
2. Second, that Bolivia is not the proper party to be named in this proceeding,
3. Third, that the BIT, through Article 2, refers the Tribunal to limits existing in Bolivian law and regulations and those limits preclude ICSID jurisdiction in this case,

---

[47] Request for Arbitration, p. 2, ¶ 3.
[48] Request for Arbitration, pp. 3-4, ¶ 6.

4. Fourth, that the Concession fixed AdT's ownership structure and that AdT's reorganization in December 1999 breached the Concession and bars the jurisdiction of this Tribunal,
5. Fifth, certain representations as to the legal implications of a proposed transfer of AdT's ownership were breached and that these breaches preclude ICSID jurisdiction, and
6. Sixth, Bolivia's consent to the BIT did not encompass the situation presented in this proceeding.

85. Respondent's Second Objection is more specific. In this Objection, Respondent argues that AdT is not a "national" of the Netherlands as defined by Articles 1(b)(ii) and (iii) of the BIT in that AdT is not "controlled directly or indirectly" by nationals of the Netherlands.

The Applicable Law

86. The applicable substantive law is to be found in the BIT between Bolivia and the Netherlands, in particular Articles 1(b)(iii), 2 and 9(6). The BIT entered into force between Bolivia and the Netherlands on November 1, 1994.

87. Inasmuch as Article 9(6) of the BIT involves consent to arbitration before ICSID, jurisdiction under the BIT is limited by the jurisdictional provisions of the ICSID Convention.

88. The applicable law for interpretation of the BIT is that to be found in customary international law. The Netherlands, but not Bolivia, is a party to the Vienna Convention on the Law of Treaties ("Vienna Convention").[49] The parties, however, agree that the provisions of the Vienna Convention relating to the interpretation of treaties reflect customary international law. The Tribunal agrees with this view and applies the Vienna Convention on this basis.[50]

89. The Tribunal notes that the BIT was done in three languages: Spanish, Dutch and English. The Treaty in its closing clause states the three texts are equally authentic, but that in case of a difference of interpretation, "the English text will prevail." Therefore the Tribunal should interpret all three texts with special reference to the English text in the case of difference. Both Bolivia and AdT, apparently seeing little benefit in doing otherwise, present their arguments as to the meaning of the BIT on the basis of the English text. The Tribunal does likewise.

90. Article 31 of the Vienna Convention provides the "general rule of interpretation."

---

[49] The Vienna Convention on the Law of Treaties, *adopted and opened for signature on* 23 May 1969, *entered into force* 27 January 1980 (1155 United Nations Treaty Series 331) was signed by Bolivia on May 23, 1969 but has not been yet ratified. The Vienna Convention was acceded to by the Netherlands on April 9, 1985. As to the status of ratifications, see:
http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterXXIII/treaty1.asp#N8.
[50] *See,e.g,* Cl. Mem., pp. 51-53, ¶¶ 142-146; Resp. Counter Mem., p. 71, ¶ 149; Resp. Rej., p. 48, ¶ 91.

Article 31. General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

91. Interpretation under Article 31 of the Vienna Convention is a process of progressive encirclement where the interpreter starts under the general rule with (1) the ordinary meaning of the terms of the treaty, (2) in their context and (3) in light of the treaty's object and purpose, and by cycling through this three step inquiry iteratively closes in upon the proper interpretation. In approaching this task, it is critical to observe two things about the general rule of interpretation found in the Vienna Convention. First, the Vienna Convention does not privilege any one of these three aspects of the interpretation method. The meaning of a word or phrase is not solely a matter of dictionaries and linguistics. As Schwarzenberger observed, the word "meaning" itself has at least sixteen dictionary meanings.[51] Rather, the interpretation of a word or phrase involves a complex task of considering the ordinary meaning of a word or phrase in the context in which that word or phrase is found and in light of the object and purpose of the document. Second, the Vienna Convention represents a move away from the canons of interpretation previously common in treaty interpretation and which erroneously persist in various international decisions today. For example, the Vienna Convention does not mention the canon that treaties are to be construed narrowly, a canon that presumes States can not have intended to restrict their range of action.[52] Rather than cataloging such canons (which at best may be said to reflect a *general pattern*), the Vienna Convention directs the interpreter to focus upon the *specific case* which may, or may not, be representative of such general pattern. To say a canon reflects a widespread practice does not mean it reflects a universal one. The Vienna Convention's directive to look to the ordinary meaning of a word in its context and in light of the object and purpose of the treaty is intended to (1) to find the intent of the parties in the specific instrument, (2) to respect the possibility that the parties have used the instrument to address issues of mutual concern in innovative ways, and (3) to not forcibly conform the specific aims of a treaty to general

---

[51] Georg Schwarzenberger, *Myths and Realities of Treaty Interpretation: Articles 27-29 of the Vienna Draft Convention on the Law of Treaties,* 22 CURRENT LEGAL PROBLEMS 205, 219 (1969). Barak writes: "From the standpoint of language, one meaning does not have preference over another. Any meaning which is possible in a semantic sense is also permissible semantically. It would be a mistake to base a doctrine of legal interpretation on dictates, as it were, of linguistics." AHARON BARAK, JUDICIAL DISCRETION 341-342 (1987).

[52] Both parties at various points in their submissions refer to canons of interpretation.

assumptions about the intent of states, assumptions which necessarily are based on assessments of past practice.[53]

92. Article 32 of the Vienna Convention addresses "supplementary means of interpretation." That article provides:

> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
> i. leaves the meaning ambiguous or obscure; or
> ii. leads to a result which is manifestly absurd or unreasonable.

The ILC Commentary on its earlier draft of this article notes that the "supplemental" role of Article 32 serves to emphasize the centrality of Article 31: "that the text of the treaty must be presumed to be the authentic expression of the intentions of the parties, and that the elucidation of the meaning of the text rather than an investigation *ab initio* of the supposed intentions of the parties constitutes the object of interpretation."[54]

93. The Tribunal in applying the Vienna Convention, particularly as to the interpretation of "controlled directly or indirectly," therefore:

> First, considers the meaning of a word of a text in accordance with Article 31 of the Vienna Convention,
> Second, confirms the resulting interpretation in accordance with Article 32 of the Vienna Convention, and,
> Third, applies that interpretation to the case at hand.

The First Objection

The First Aspect of Respondent's First Objection which asserts that the Concession Agreement precludes ICSID jurisdiction

Respondent's Objection

94. Respondent argues that the text and negotiating history of the Concession as well as the laws of Bolivia all indicate that disputes concerning the Concession were to be resolved in Bolivian courts in accordance with Bolivian laws.

---

[53] Lauterpacht amidst the situation prevailing before the Vienna Convention observed: "The view which is gaining increasing acceptance seems to be that some of the current rules of construction of treaties * * * instead of aiding what has been regarded as the principal aim of interpretation, namely, the discovery of the intention of the parties, they end up by impeding that purpose." Hersch Lauterpacht, *Restrictive Interpretation and the Principle of Effectiveness in the Interpretation of Treaties,* 26 BRITISH YEARBOOK OF INTERNATIONAL LAW, 48, 52 (1949).

[54] I.L.C. Report on the Work of Its 8th Session, 1966 I.L.C. YEARBOOK (II) 223, Commentary to Article 28, para. 18.

95. Respondent first argues that the text of the Concession requires that this dispute be resolved in Bolivian courts in accordance with Bolivian laws.[55]

96. Respondent points generally to Concession Article 41 (entitled "Resolution of Controversies") and, in particular, argues that Article 41.2 constitutes an exclusive jurisdiction clause selecting Bolivian courts that bars AdT from pursuing arbitration before ICSID.[56] Article 41(2) provides:

> [The Concessionaire] recognizes the jurisdiction and competence of the authorities that make up the System of Sectoral Regulation (SIRESE) and of the courts of the Republic of Bolivia, in accordance with the SIRESE law and other applicable Bolivian laws.[57]

According to Bolivia, Article 41 contains "very carefully constructed dispute resolution mechanics"[58] which should govern dispute resolution relating to the Concession. Bolivia asserts that the Concession "explicitly limits" AdT to the jurisdiction of the regulatory authorities and courts of Bolivia[59] and by signing the Concession, AdT "committed" itself to the "jurisdiction and competence of the regulatory authorities and courts of Bolivia."[60]

97. Respondent argues that its interpretation of Article 41.2 is supported by the provisions of Article 41 taken as a whole. Bolivia notes the use of the term "Concessionaire" in Article 41.2 and the term "shareholders" in Article 41.3 was intentional.[61] Bolivia also notes that Articles 41.3 and 41.5 explicitly recognize that the shareholders of AdT may invoke the jurisdiction of ICSID. In contrast, Article 41.2, addressing the resolution of disputes by the Concessionaire, does not mention ICSID. Bolivia argues that the difference between Articles 41.2 on the one hand, and Articles 41.3 and 41.5 on the other hand, implies that AdT, as a "Concessionaire," is precluded from invoking the jurisdiction of ICSID.

98. Second, the Respondent contends that the negotiating history of the Concession supports this argument. Referencing the Bolivian Constitution, Bolivia argues that it was made clear to all parties that "...it was inconceivable, and equally unacceptable, that this company [the Concessionaire] could bring any dispute it had with the Bolivian government *outside* of Bolivia, or be subject to any law other than the law of Bolivia, consistent with Section 24 of the Bolivian Constitution."[62] Respondent emphasizes that it would only have

---

[55] Resp. Counter Mem., pp. 10-11, ¶¶ 18-19.
[56] *Id.,* p. 14, ¶¶ 25-26.
[57] The original text is in Spanish and is reproduced in Appendix II.
[58] Bolivia's Obj., p. 3.
[59] *Id.*
[60] *Id.* In its oral submissions, Bolivia extends its interpretation of the Concession explaining that AdT, as the concessionaire, is subject exclusively to the System of Sectoral Regulation ["SIRESE."] and subject to the jurisdiction of the Supreme Court of Bolivia *See infra* at paragraphs 96 and 100. The SIRESE system is a regulatory system complete with its own administrative adjudication process. Oral Statement of Bolivia's Counsel, Jose Antonio Criales, (February 11, 2004), pp. 574-577.
[61] Bolivia's Obj., p. 3. The relevant Spanish text is reproduced at Appendix II.
[62] Resp. Counter Mem., p. 11, ¶ 19, (emphasis in original). The English translation of Article 24 of the Bolivian Constitution provides:

> Foreign subjects and enterprises are subject to Bolivian laws, and in no case may they invoke exceptional position or have recourse to diplomatic claims.

considered Bolivian corporations in awarding any concession concerning Cochabamba's water services.[63] Since AdT was a Bolivian Corporation operating within the laws and regulations of Bolivia, AdT should not have expected to be within the ambit of any bilateral investment treaty that gave it access to ICSID.

99. Respondent supports its position by citing an internal Bolivian negotiation report dated June 8, 1999. Respondent points in particular to the report's description of the efforts of AdT's consortium to incorporate a general referral to ICSID of disputes arising out of the Concession.[64] Respondent notes that the June 1999 report records Bolivia's view that "arbitration is not permitted under the norms of the [SIRESE] regulatory system and the laws covering the subject matter."[65]

100. Third, Respondent argues that its interpretation of the Concession as giving exclusive jurisdiction to Bolivia is necessitated by Bolivian law. Respondent directs the Tribunal's attention to: (1) Article 136 of the Bolivian Constitution, which places Bolivia's natural resources (including water) within the "original dominion" of the State, and, (2) the statutory SIRESE system which implements Article 136.[66] Because AdT voluntarily complied with the requirements of the SIRESE system in order to be considered for the Cochabamba concession, Bolivia argues that AdT also agreed to be bound exclusively to the dispute resolution process of the SIRESE system.[67]

---

[63] Resp. Counter Mem., pp. 10-11, ¶ 19.

[64] In particular, Respondent points to paragraph 27 of the "Report from the Negotiating Committee formed to Negotiate with the Aguas del Tunari Consortium" (Ex. 38 to Resp. Rej.) as stating:

> On May 31, 1999, AGUAS DEL TUNARI raised for consideration by the Negotiating COMMISSION certain matters it wished to incorporate into the contracts in order to obtain the financing required for the SEMAPA concession and the performance of the MISICUNI project, which are summarized below.... (a) Arbitration before international entities, such as ICSID, for the resolution of any dispute over revisions of tariffs, payments for termination of the contract, compliance with quality standards and similar matters.... (unofficial translation from the Spanish).

[65] Oral Statement of Bolivia's Counsel, Alexandre de Gramont, (February 9, 2004), pp. 137-41. "And the [negotiating] committee reported its response to AdT specifically. After analyzing these proposals, the Committee communicated to the consortium that arbitration is not permitted under the norms of the [SIRESE] regulatory system and the laws covering the subject matter. And that position is reflected in the Concession Agreement...", p.138, Lines 6-12.

[66] Article 136 of the Bolivian Constitution reads:

> Within the regional original domain of the State, in addition to property to which the law gives that character, are the soil and the subsoil with all their natural resources: lake, river and thermal waters; and all physical elements and forces susceptible of utilization. Laws shall establish the conditions of such ownership, and those for their concession and allotment to private individuals.

The Spanish text may be found at Appendix II.

[67] Oral Statement of Bolivia's Counsel, José Antonio Criales, (February 9, 2004), pp. 176-87. "...Concessionaires will be Bolivian entities subject only to SIRESE and the Supreme Court of Bolivia, while foreign shareholders to such Concessionaires in some appropriate cases may pursue international arbitration under BITs," *Id.,* p. 186, Lines 6-10.

101. Bolivia argues that the language of Article 41.2 of the Concession in relation to the other sections of Article 41, the negotiating history of the Concession and the legal context in which those negotiations took place – namely Articles 24 and 136 of the Bolivian Constitution, all indicate that the Concession required that AdT be a Bolivian national subject exclusively to Bolivian laws and tribunals "that would *not* fall within the foreign 'control' terms of the Bolivian-Netherlands Bilateral Investment Treaty (or other BITs like it)."[68]

Claimant's Reply

102. AdT argues that this aspect of Respondent's First Objection is misplaced. Claimant emphasizes that the claims it raises in its Request for Arbitration are brought under the BIT and not under the Concession.[69] Even assuming *arguendo* that Article 41.2 of the Concession was an exclusive forum selection clause, it would not be relevant to the Tribunal's consideration of its jurisdiction under the BIT.[70]

103. In particular, Claimant argues that its action against Bolivia is an "entirely separate cause of action" distinct from claims brought under the Concession.[71] As such, Claimant states: "[a]n exclusive jurisdiction clause under a concession contract will thus have no effect on any action brought under a bilateral investment treaty."[72]

104. AdT refers the Tribunal to previous ICSID Awards that it argues support this proposition.[73] First, Claimant cites to *Compañía de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic* ("*Vivendi*")[74] in support of its argument that, even where an explicit and affirmative exclusive jurisdiction clause exists within a concession contract, such a clause does not affect the jurisdiction of an ICSID tribunal in respect to a claim made under a BIT.[75] Second, Claimant likewise refers the Tribunal to *Lanco International, Inc. v. The Argentine Republic* ("*Lanco*").[76] AdT analogizes its case to that of *Lanco* where the tribunal found that a forum selection clause in the concession contract did not exclude the jurisdiction of ICSID based upon a BIT between the United States and Argentina.[77] Relying on *Lanco*, AdT asserts that its claim against Bolivia is based upon the "breach of the Respondent's International Law obligations under the terms of the BIT [and] not on breaches of the Concession Contract."[78]

---

[68] Resp. Counter Mem., p. 33, ¶ 63.
[69] Request for Arbitration, pp. 2-4, ¶¶ 3-7.
[70] Cl. Mem., p. 29, 31-35 ¶¶ 90, 94-101.
[71] *Id.*, p. 34, ¶ 98.
[72] *Id.*
[73] *Id.*, p. 31, ¶ 94.
[74] *Compañía de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic*, Award of November 21, 2000, *reprinted at* 40 ILM 426 (2001) , 5 ICSID Rep. 299 (2002); Decision on Annulment, July 3, 2002, *reprinted at* 41 ILM 933 (2002), 5 ICSID Rep. 240 (2002).
[75] Cl. Mem., p. 31, ¶ 94.
[76] *Lanco International, Inc. v. The Argentine Republic*, "Preliminary Decision: Jurisdiction of the Arbitral Tribunal" dated December 8, 1998, *reprinted at* 40 ILM 457 (2001), 5 ICSID REP. 370 (2002).
[77] Cl. Mem., p. 34, ¶ 99.
[78] *Id.*, p. 35, ¶ 101.

105. Respondent does not address the Claimant's view of these two cases as they bear on this aspect of Respondent's objections.[79]

106. Claimant further argues that if the Tribunal were to consider the Concession relevant, Bolivia's characterization of Concession Article 41 is an attempt to "convert" a clause that "recognizes the rights of the Respondent, on a non-exclusive basis, to regulate water affairs in its territory into an exclusive jurisdiction clause."[80] AdT argues that the text of Concession Article 41 should be read instead as a clause where the parties "...expressly preserved any rights to resort to international arbitration legally available."[81]

107. AdT argues that the language of Concession Article 41 is not a waiver or limitation of ICSID jurisdiction.[82] Rather than reading Concession Article 41.2 as an exclusive forum selection clause, AdT argues that Article 41.2 serves only to recognize the regulatory rights that Bolivia possessed over domestic water matters under the SIRESE regulation system.[83]

108. Claimant argues that the negotiations between AdT and the Government of Bolivia resulted in an "arms-length" agreement over the terms of the Concession.[84] AdT states that its negotiation team was unaware from the June 1999 round of negotiations of Bolivia's alleged position that the "awardee of the Concession Agreement not be controlled by any foreign entity whose BIT would allow the Bolivian company access to ICISD."[85] Moreover, AdT objects to the use of "subjective statements of original intent" saying they should have "no part" in interpreting the Concession.[86]

The Decision of the Tribunal

109. This objection involves the legal interplay of forum selection clauses in contractual relationships and the availability of arbitration under a bilateral investment treaty. The Tribunal notes that several other tribunals have addressed these questions in the past few years. The Tribunal, as discussed below, in general, agrees with the direction taken by previous tribunals, although the reasoning employed here differs in several respects.

110. Claimant refers to the BIT between Bolivia and the Netherlands as the basis for bringing this case before this Tribunal. Respondent objects to jurisdiction before this Tribunal on the basis that the Concession places all disputes raised by AdT within the exclusive jurisdiction of appropriate Bolivian courts and thereby precludes AdT from invoking the jurisdiction of ICSID.

---

[79] However, Bolivia responds to *Vivendi* and *LANCO* in terms of the question of majority shareholding and control, calling AdT's reliance on these cases as "misplaced." Resp. Counter Mem., pp. 65-66, ¶ 137.
[80] AdT's Response, p. 4, ¶ 7.
[81] *Id.*, and Cl. Mem., p. 30, ¶ 92.
[82] AdT's Response, p. 4, ¶¶ 7-8.
[83] *Id.*; Cl. Mem., p. 30, ¶ 91.
[84] Cl. Mem., p. 5, ¶ 14.
[85] Cl. Reply, p. 10, ¶ 26 quoting Resp. Counter Mem., pp. 34-35, ¶ 66.
[86] *Id.*, at ¶ 27.

111. Two questions are presented. First, as a threshold matter, the Tribunal observes that in order for the separate document raised by the Respondent to be in conflict with this Tribunal's exercise of jurisdiction, that document must both deal with the same matters and parties and contain mandatory conflicting obligations. Second, if a true conflict exists, there then arises the question of what effect such a document has on the Tribunal's jurisdiction.

112. As to the requirement that the separate document contain mandatory conflicting obligations, the Tribunal concludes that Article 41.2 of the Concession does not place all disputes concerning the Concession within the *exclusive* jurisdiction of Bolivian courts. Article 41.2 provides:

> [The Concessionaire] recognizes the jurisdiction and competence of the authorities that make up the System of Sectoral Regulation (SIRESE) and of the courts of the Republic of Bolivia, in accordance with the SIRESE law and other applicable Bolivian laws.

This clause differs in wording and structure from other forum selection clauses encountered by the members of the Tribunal and those present in other ICSID proceedings where the issue of the effect of a contractual forum selection clause on ICSID jurisdiction has been considered. For example, in *Vivendi* the forum selection clause at issue provided:

> For purposes of interpretation and application of this Contract, the parties submit themselves to the exclusive jurisdiction of the Contentious Administrative Tribunals of Tucumán[87]

Two phrasings discussed in the *Vivendi* clause are frequently seen and noteworthy for this proceeding. First, the selection of a particular court is explicitly "exclusive." Second, the parties, in exclusively choosing a court, delineate explicitly the matters given to that court – in this instance "interpretation and application of this Contract." Article 41.2 of the Concession in the current case lacks the explicitness of both of these aspects. This Tribunal need not decide whether the Claimant is correct that Article 41.2 only serves to recognize the regulatory rights that Bolivia possessed over domestic water matters under the SIRESE regulation system. It is sufficient that the Tribunal concludes that Article 41.2 of the Concession does not constitute an exclusive reference to the Bolivian legal system of all disputes arising under, not to mention those related to, the Concession.

113. Similarly to this case, the *Lanco* tribunal appears to have viewed the relevant clause in that case as not creating a mandatory conflicting obligation. The forum selection clause at issue in *Lanco* provided:

> For all purposes derived from the agreement and the BID CONDITIONS, the parties agree to the jurisdiction of the Federal Contentious-Administrative Tribunals of the Federal Capital of the ARGENTINE REPUBLIC.[88]

The *Lanco* tribunal held that this clause was not a "previously agreed dispute settlement provision" within the meaning of the applicable BIT inasmuch as "the contentious – administrative jurisdiction cannot be selected or waived [. . .]."[89]

---

[87] *Vivendi* Award of November 21, 2000, ¶ 27.

[88] *Lanco* Award, ¶ 6.

114. As to the requirement that the separate document deal with the same matters and parties, the Tribunal finds that the jurisdiction of the Bolivian courts recognized under Article 41.2 of the Concession, even if it were found to be exclusive, does not extend to the same obligations or parties raised by the Claimant under the BIT. Claimant in the instant proceeding does not raise a claim against the Water Superintendency, as a party to the Concession, but rather raises a claim against the Republic of Bolivia itself as party to the BIT. Likewise, assuming that Article 41.2 was an exclusive forum selection clause for disputes arising under the Concession, the Claimant in the instant case does not allege a breach of an obligation under the Concession but rather alleges a breach of an obligation existing under the BIT.[90] The circumstance that a claim under the Concession against the Water Superintendency and a claim under the BIT against Bolivia could both point to the same set of facts should not blur the legal distinction between the two types of claims. It is often the case that one set of facts may give rise to disputes under different laws in different fora. The Tribunal notes that its conclusion accords with the reasoning of the tribunal in *Compañía de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic,* Award of November 21, 2000,[91] and the subsequent decision of the *Ad Hoc* Committee appointed for the Annulment Proceeding in the same matter which in denying annulment of this aspect of the award indicated its agreement with the reasoning of the award.[92]

115. As to the second question posed in paragraph 111 above, the Tribunal holds that the question of whether a conflicting mandatory obligation in a separate document can affect the jurisdiction of an ICSID tribunal is a question of the intent of the Parties in concluding the separate document. As an inquiry into the intent of the parties, the Tribunal observes that this inquiry turns on the facts of the specific case. Nonetheless, the Tribunal finds it particularly helpful in such an inquiry to distinguish between: (1) a separate document that waives the right to invoke, or modifies the extent of, ICSID jurisdiction (where the intent of the parties to alter the possibility of ICSID jurisdiction is direct); and, (2) a separate document that contains an exclusive forum selection clause designating a forum other than ICSID (where the intent of the parties to alter the possibility of ICSID jurisdiction must be implied).

116. As to the former case of a separate document that waives the right to invoke, or modifies the extent of ICSID jurisdiction, the Tribunal notes that Claimant at the Hearing in this case stated as a general matter that "scholarly opinion is divided" on the issue of

---

[89] *Id.,* ¶ 26. As one commentator wrote recently "[t]he most attractive and not least plausible explanation why the reasoning turned on Article 26 is that the forum clause was being seen as non-exclusive and so did not imply a waiver of the right to international arbitration in the first place." Ole Spiermann, *State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties,* 20 ARBITRATION INTERNATIONAL 179, 191 (2004).

[90] An exclusive forum selection clause in a contact is generally regarded as severable from the contract of which it is a part. And although it is usually the case that such a clause only refers to disputes arising under the contract, it can be broader in scope. For example, some clauses refer not only to disputes "arising under" the contract but also disputes "related to" the contract.

[91] *Vivendi,* Award, ¶ 53.

[92] *Vivendi,* Decision on Annulment Proceedings, ¶¶ 73, 76, 80, and 95 to 97. "In accordance with this general principle (which is undoubtedly declaratory of general international law), whether there has been a breach of the BIT and whether there has been a breach of a contract are different question." *Id.,* at ¶ 96.

whether such a waiver is possible,[93] and directed the Tribunal's attention more specifically to the Decision on Jurisdiction in *Azurix Corp. v. The Argentine Republic*[94] ("*Azurix*").

117. The *Azurix* Award, however, does not address the question of whether an investor may waive its right to arbitration before ICSID, but rather holds that jurisdictional clauses contained within a set of Bidding Terms, a Concession Agreement, and Commitment Letters did not constitute such a waiver.[95] The several clauses in question in *Azurix* were similar to one another and are exemplified by clause 1.5.5. of the Bidding Terms and Conditions which provided for the exclusive jurisdiction of the courts for contentious-administrative matters of the city of La Plata "for all disputes that may arise out of the Bidding, waiving any other forum, jurisdiction or immunity that may correspond."[96] The *Azurix* tribunal held that this clause was not a waiver of a claimant's right to arbitration before ICSID for two reasons. First, the waiver clause was a part of a contract to which the respondent was not a party and, consequently, claimant's contractual obligation to waive access to certain other fora was not made "in favor of Argentina."[97] Second, the analysis of the waiver clause was held to be analogous to that made with regard to forum selection clauses in that the waiver of other fora was limited to claims under the contract just as the selection of an exclusive forum was limited to claims under the contract.[98] The *Azurix* tribunal therefore concluded that the waiver clause did not present a conflicting mandatory obligation. Both of the conclusions of the *Azurix* tribunal turned upon the particular facts of that case. Both conclusions are the consequence of an inquiry into the intent of the parties and an inclination to require specific language of a waiver of the right to invoke the jurisdiction of ICSID for claims of treaty rights under a BIT, an inclination with which this Tribunal agrees.[99]

---

[93] Oral Statement of AdT's Counsel, Matthew Weiniger, (February 9, 2004), p. 38, Lines 13-14.

[94] *Azurix Corp. v. The Argentine Republic*, "Decision on Jurisdiction" dated December 8, 2003, *available at* http://www.asil.org/ilib/azurix.pdf.

[95] "Since the Tribunal has found that the waiver does not cover the claim of Azurix in the dispute before it, the Tribunal does not need to comment further on the issue of renunciation by individuals of rights conferred upon them by treaty." *Id.*, ¶ 85.

[96] *Id.*, ¶ 26.

[97] *Id.*, ¶ 85.

[98] *Id.*, ¶¶ 80-81.

[99] In *Société Générale de Surveillance v. Republic of the Philippines* (January 29, 2004) (available at www.worldbank.org/icsid/cases/SGSvPhil-final.pdf) ("SGS"), the tribunal gave effect to a forum selection clause. The Tribunal emphasizes that the facts of the SGS case are distinct from the present proceeding.

First, the contractual forum clause at issue in SGS was found to contain mandatory conflicting obligations. The clause provided that "actions concerning disputes in connection with obligations of either party to this Agreement shall be filed at the Regional Trial Courts of Makati or Manila." The SGS tribunal found the clause to be a "binding exclusive jurisdiction clause" for "all actions concerning disputes in connection" with contractual obligations. (Of note, SGS did not object to this clause being effective and binding upon both parties.) The present proceeding does not involve a forum selection clause of this character.

Second, the applicable law was different. SGS presented its claim under the Swiss-Philippine BIT. The SGS tribunal gave effect to the forum selection clause. The tribunal did so – even though it recognized that SGS's claims were claims of a breach of the treaty obligations contained in Article X(2) (the "umbrella clause") of the Swiss-Philippine BIT -- because it viewed SGS's claims as being essentially contractual in nature. The present proceeding does not involve an umbrella clause.

Despite these differences, the Tribunal also recognizes that its reasoning differs from that of the SGS tribunal. The Tribunal observes that its view is closer to that of paragraph 11 of the dissenting Declaration of Arbitrator Antonio Crivellaro in *Société Générale de Surveillance v. Republic of the Philippines.*

118. Assuming that parties agreed to a clear waiver of ICSID jurisdiction, the Tribunal is of the view that such a waiver would be effective. Given that it appears clear that the parties to an ICSID arbitration could jointly agree to a different mechanism for the resolution of their disputes other than that of ICSID, it would appear that an investor could also waive its rights to invoke the jurisdiction of ICSID.[100] However, the Tribunal need not decide this question in this case.

119. As to the latter case of a separate document containing an exclusive forum selection clause that designates a forum other than ICSID, the Tribunal notes that the specific intent of the parties to preclude ICSID jurisdiction will be more difficult to ascertain than in the case of explicit waiver. The Tribunal is of the view that it is not the existence of the exclusive forum selection clause that would be given effect by an ICSID tribunal, but rather that the tribunal could, at most, give effect to a waiver implied from the existence of an exclusive forum selection clause. The Tribunal does not find the authority under the ICSID Convention for it to abstain from exercising its jurisdiction simply because a conflicting forum selection clause exists. To the contrary, it is the Tribunal's view that an ICSID tribunal has a duty to exercise its jurisdiction in such instances absent any indication that the parties specifically intended that the conflicting clause act as a waiver or modification of an otherwise existing grant of jurisdiction to ICSID. A separate conflicting document should be held to affect the jurisdiction of an ICSID tribunal only if it clearly is intended to modify the jurisdiction otherwise granted to ICSID. As stated above, an explicit waiver by an investor of its rights to invoke the jurisdiction of ICSID pursuant to a BIT could affect the jurisdiction of an ICSID tribunal. However, the Tribunal will not imply a waiver or modification of ICSID jurisdiction without specific indications of the common intention of the Parties.

120. Relying on Article 41 as a whole, the negotiating history of the Concession, and the requirements of Bolivian law, Respondent argues that AdT in agreeing to the Concession also agreed not to invoke the jurisdiction of ICSID. The Tribunal does not find the evidence submitted sufficient to prove this assertion.

121. First, the Tribunal notes that Respondent does not argue that there exists an explicit waiver of ICSID jurisdiction by AdT. Even assuming Concession Article 41 were an exclusive jurisdictional grant, the Article does not constitute an explicit waiver of ICSID jurisdiction.

122. Second, the Tribunal finds that there is not a sufficient basis in the written and oral submissions presented to the Tribunal as to the text of the Concession and Bolivia's record of its negotiating position to imply such a waiver. Both parties have presented conflicting arguments over what was and was not concluded during the Concession negotiations. Article 41 is silent as to the issue of the availability to AdT of ICSID and arbitration generally. Respondent asks that the Tribunal imply from this silence, the structure of Article 41 generally, and the laws of Bolivia including its Constitution, a waiver by AdT of any right it may have to invoke the jurisdiction of ICSID. Having considered the language of Article 41 and the disputed nature of the negotiating history, the silence of Article 41 as to the right of AdT to invoke arbitration before ICSID reflects just as likely an impasse in the negotiations between the parties on this point. Consequently, the Tribunal finds neither common

---

[100] *See* Spiermann, *supra* note 89.

intention of the Parties to exclude ICSID jurisdiction in the case of a claim by AdT nor any clear waiver on the part of AdT in Article 41 or the Concession generally of its rights to pursue its claims before ICSID. The Tribunal will not read an ambiguous clause as an implicit waiver of ICSID jurisdiction; silence as to the question is not sufficient.

123. For the foregoing reasons, the Tribunal denies the first aspect of Respondent's First Objection.

The Second Aspect of the First Objection which asserts that Bolivia is not a proper party

Respondent's Objection

124. Respondent argues it is not the proper party to this dispute.

125. Referring to ICSID Convention Article 25(1) and 25(3), Bolivia argues that the Waters Superintendency should have been specifically designated by the Government of Bolivia as a "constituent agency or sub-division" in order for ICSID jurisdiction to apply. Bolivia did not at any time designate the Water Superintendency as a "constituent agency or subdivision" or consent to ICSID jurisdiction for actions by the Water Superintendency.[101]

126. Bolivia asserts that the Water Superintendency is a "separate and autonomous legal entity," that exists apart from the Republic of Bolivia.[102] All actions and interactions upon which AdT bases its claims were actions of the Water Superintendency, including the rescission of the Concession.[103]

127. In support of this objection, Bolivia relies upon the ICSID award in *Cable Television of Nevis, Ltd. and Cable Television of Nevis Holdings, Ltd. v. Federation of St Kitts and Nevis* ("*Cable TV*").[104]

128. Bolivia reads the *Cable TV* award as a refusal on the part of an ICSID tribunal to find ICSID jurisdiction over a party who was not designated as a "constituent subdivision or agency" by a Contracting State under Article 25(1). Respondent suggests that the Tribunal should find that the relationship between the Water Superintendency and Bolivia parallels in important aspects the relationship between the Nevis Island Administration and the Federation of St. Kitts and Nevis.

129. Thus, Respondent objects to the jurisdiction of this Tribunal on the ground that the Republic of Bolivia was not a party to the Concession Agreement and the Water Superintendency was never designated as a "constituent subdivision or agency of Bolivia for the purposes of ICSID jurisdiction.[105]

---

[101] Resp. Counter Mem., p. 46, ¶¶ 91- 92.
[102] *Id.*, p. 47, ¶ 94.
[80] *Id.*, p. 48, ¶ 96.
[104] *Id.*, p. 47, ¶ 95; *Cable Television of Nevis Ltd. and Cable Television of Nevis Holdings Ltd. v. Federation of St Kitts and Nevis*, Award of January 13, 1997, *reprinted at* 5 ICSID REP. 106 (2002).
[105] Resp. Counter Mem., p. 51, ¶ 103.

Claimant's Reply

130. AdT affirms that its claim is brought against Bolivia, not the Water Superintendency.[106] AdT also contends that the legal status of the Water Superintendency and Respondent's references to ICSID Convention Article 25(1) and 25(3) are irrelevant to the jurisdictional basis of this proceeding.

131. Claimant disagrees with the conclusions Respondent draws from *Cable TV*. Claimant emphasizes that, unlike in the current proceeding, the case in *Cable TV* was brought under a concession agreement agreed to by the parties and not under a bilateral investment treaty as is the case in these proceedings.[107] AdT asserts that Bolivia consented to ICSID jurisdiction by its ratification of the BIT. In emphasizing that its claim is against Bolivia for actions in violation of Bolivia's obligations under the BIT, AdT argues it does not seek, nor is there any need to look into, substituting Bolivia for the Water Superintendency as a party to the Concession.

132. AdT acknowledges that it will be its task at the proceedings on the merits to establish the State responsibility of Bolivia under the BIT for its alleged expropriation of AdT's investments.[108] AdT also acknowledges that it will be its task, where necessary, to establish the basis for attribution of the actions of the Water Superintendency to Bolivia.[109] AdT observed in this regard that: (1) the Concession was negotiated under the supervision of Bolivian officials with authority independent of the Water Superintendent,[110] (2) the Concession was only one of six contracts concluded between AdT and various agencies of Bolivia,[111] (3) the breadth of its investment can only mean there was coordination by the Bolivian government itself,[112] and, (4) it was deprived of its investment not only by the acts of the Water Superintendency, but also through Bolivia's failure to provide security for AdT's property and staff during the disturbances in Cochabamba and the transfer of AdT's property to a publicly owned company.[113]

The Decision of the Tribunal

133. Respondent objects to ICSID jurisdiction on the ground that the Water Superintendency, not the Republic of Bolivia, is the proper party to this arbitration. The Tribunal notes that this aspect of the Respondent's First Objection is related to the first aspect in that it is premised on the view that this dispute arises out of the Concession (to which the Water Superintendency was a party) rather than the BIT (to which Bolivia is a party).

---

106 Cl. Reply, p. 26, ¶ 72.
107 *Id.*, p. 27, ¶ 74.
108 *Id.*, p. 26, ¶ 72(b).
109 *Id.*, p. 28, ¶ 77.
110 *Id.*, p. 33, ¶ 90, citing Request for Arbitration, Ex. 16 to 19.
111 *Id.*, p. 28, ¶ 77.
112 *Id.*
113 *Id.*, p. 29, ¶ 78 citing Request for Arbitration, ¶¶ 33-35.

134. Bolivia relies on the ICSID award in *Cable TV*. The jurisdictional basis of that case, however, is distinct from that presented in this proceeding.

135. In *Cable TV*, the Claimant cable corporation invested more than a million U.S. dollars on the Island of Nevis as part of a contract with the Government of Nevis. The dispute clause in the Agreement indicated that disputes relating to the contract would be referred to arbitration under the rules and procedures of the ICSID Convention. The tribunal in *Cable TV* held that it had no jurisdiction over the case because (1) the Federation of St. Kitts and Nevis was incorrectly named as a party in a dispute arising out of a contract involving only the Nevis Island Administration and (2) there was no other basis to find the consent of the Federation to arbitration either as a party itself or on behalf of the Nevis Island Administration.[114]

136. The Tribunal acknowledges Bolivia's argument that the Water Superintendency is similar to the Nevis Island Administration as a somewhat autonomous unit within a larger State. More critically, however, the jurisdictional basis asserted in *Cable TV* was a clause in a concession contract and not, as in this proceeding, a bilateral investment treaty. The dispute brought by AdT before this Tribunal is based on alleged acts by Bolivia in violation of the BIT between the Netherlands and Bolivia. Unlike the situation in *Cable TV*, AdT has not named as a Respondent an entity which is not a party to the document containing the jurisdictional clause. The holdings in *Cable TV* do not bear on the situation presented in this proceeding.

137. The Parties raise a number of issues which require more extensive findings based on additional evidence. At this jurisdictional phase of the proceedings, the Tribunal need not determine the questions of (1) attribution and State responsibility under the BIT, or (2) the precise relationship between the Republic of Bolivia and the Water Superintendency. These questions will be determined later, as needed, at the merits phase of the Tribunal's proceedings.

138. The Tribunal denies the second aspect of Respondent's First Objection.

The Third Aspect of the First Objection which asserts that Article 2 of the BIT recognizes the exclusive jurisdiction of Bolivian law over this dispute

Respondent's Objection

139. In the third aspect of its First Objection, Bolivia argues that Article 2 of the BIT contains references to Bolivian law which in this case preclude ICSID jurisdiction. Respondent observes that Article 2 explicitly acknowledges that in protecting and admitting investments, Bolivia does so "within the framework of its law and regulations" and "subject to its laws and regulations."[115] Bolivia thus argues:

> Article 2 of the BIT refers to the Bolivian law as the framework under which these powers and regulations will be in effect over the investment and over the private investor invited to

[114] *Cable TV* at Section 8.01.
[115] Oral Statement of Bolivia's Counsel, Alexandre de Gramont, (February 9, 2004), p. 142, Lines 9-11.

> come to Bolivia. So there is AdT's obligation to be subject to Bolivian laws, SIRESE, and the Supreme Court of Bolivia. . . .[116]

140. Respondent thus objects to the jurisdiction of this Tribunal on the ground that Article 2 of the BIT incorporates a reference to Bolivian law and the application of that law to this case requires AdT to submit to the exclusive jurisdiction of the applicable Bolivian courts and tribunals.

Claimant's Reply

141. Claimant disagrees with Respondent's interpretation of Article 2 of the BIT. AdT asserts that Article 2 of the BIT is a standard "admission clause." AdT argues that the reference in Article 2 to the laws and regulations of Bolivia does not have bearing on any matters other than the admittance of an investment into the Bolivian market. Claimant maintains that Article 2 is meant only to shepherd foreign investment into Bolivia. Respondent's interpretation, in Claimant's view, goes beyond the original purpose of Article 2 and cannot be supported by relevant comparative practice. AdT claims that if Respondent's interpretation of Article 2 were to be followed to its logical end, then there would "never be an ICSID arbitration."[117] AdT goes on to assert that such an interpretation would also permit an indirect resurrection of the Calvo Doctrine.[118]

The Decision of the Tribunal

142. The first aspect of the First Objection argues that the terms of, and the circumstances surrounding, the Concession indicate that AdT agreed to be bound to dispute resolution governed by domestic Bolivian law within Bolivia.[119] In contrast, this aspect of the First Objection asserts that Article 2 of the BIT contains a reference to Bolivian law which places the claim raised by AdT within the exclusive jurisdiction of Bolivia's courts and tribunals. Respondent in its First Objection often passes back and forth between these two aspects of objection. The Tribunal recalls that in its consideration of the Concession-based first aspect of the First Objection, it denied Respondent's arguments that the circumstances surrounding the tender offer, the negotiation of the Concession or the actual language of the Concession placed the current dispute within the exclusive jurisdiction of the Bolivian courts and tribunals. Separating the strands of Respondent's arguments, the Tribunal thus focuses in this aspect solely on the argument concerning Article 2 of the BIT.

---

[116] Oral Submission of Bolivia's Counsel, José Antonio Criales, (February 9, 2004), pp. 177-78, Lines 19-21 and 1-5.
[117] Oral Submission of Claimant's Counsel, Matthew Weiniger, (February 9, 2004), p. 247, Lines 8-12.
[118] The Tribunal need not address the Calvo Doctrine except to note that Bolivia has concluded various BITs and is a Contracting State of ICSID. For more on the doctrine, *see generally*, D. SHEA, THE CALVO CLAUSE: A PROBLEM OF INTER-AMERICAN AND INTERNATIONAL LAW AND DIPLOMACY (1955) and INTERNATIONAL ARBITRATION IN LATIN AMERICA (Nigel Blackaby, David Lindsey & Allessandro Spinillo, eds., 2002).
[119] Resp. Rej., p. 22, ¶ 10.

143. Article 2 of the BIT provides:

> Either Contracting Party shall, within the framework of its law and regulations, promote economic cooperation through the protection in its territory of investments of nationals of the other Contracting Party. Subject to its right to exercise powers conferred by its laws or regulations, each Contracting Party shall admit such investments.

144. Both sentences in Article 2 of the BIT contain a reference to the laws and/or the regulations of Bolivia. Respondent appears to refer to the language of both references, although the first mention appears to predominate in Respondent's arguments.

145. As to the first sentence, the Tribunal observes that if one omits the reference to Bolivian law, the first sentence states that both Bolivia and the Netherlands "shall . . . promote" economic cooperation by protecting in its territory the investments of nationals of the other contracting State. This sentence thus contains the obligation to "promote economic cooperation" as a fundamental goal of the BIT[120] through the protection of investments. The BIT in its other provisions provides a forum and applicable substantive law for claims that an investment was not so protected. Article 2, in this sense, importantly requires that the host State take efforts to protect investments in its territory before such a dispute arises.

146. Given this interpretation of the first sentence, what meaning is to be given to the subordinate phrase "within the framework of its law and regulations?" The BIT not only provides a remedy for breaches, but also attempts to facilitate the creation of a climate in which economic cooperation can flourish. Thus, the Tribunal reads the reference to "the framework of its laws and regulations" as a reference limited to the details of how each contracting party undertakes in its national laws and regulations to promote economic cooperation through the protection of investments.

147. As to the second sentence, the Tribunal observes that if it omits the reference to Bolivian law, the second sentence states that both Bolivia and the Netherlands "shall admit" the investments of nationals of the other Contracting Party. This obligation to allow the entry of foreign investment is a common provision in bilateral investment treaties, and is often termed an "admission clause." The obligation to admit is "subject to" the decision of Bolivia ("its right") to "exercise powers conferred by its laws or regulations." The Tribunal concludes that the inclusion of the term "subject to" indicates that the duty to admit investments is limited by "the right to exercise powers conferred by its laws or regulations." The Tribunal notes that the reference specifically subjects the State's duty to admit investments not to the laws and regulations of Bolivia, but rather to the "right to exercise powers" conferred by such laws or regulations. The Tribunal finds this language significant as it implies an act at the time of admittance in accordance with the laws or regulations in force at that time.

[120] Specifically the Preamble to the BIT notes that the two governments enter into the agreement "[d]esiring . . . to extend and intensify the economic relations between them particularly with respect to investments by the nationals of one Contracting Party in the territory of the other Contracting Party" and "[r]ecognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties [. . .]."

148. The Tribunal thus concludes that (1) there is an effective reference to Bolivian law in both the first and second sentences of Article 2 of the BIT, but (2) that both references are of limited scope. The Tribunal now turns to the more ambiguous question of the precise scope of these limited references to Bolivian law.

149. Bolivia argues for a broad interpretation of the role to be given the references to Bolivian law in Article 2. It argues that these references allow it to condition the basis on which a foreign investment enters its market. For example, Bolivia argues that Article 2 authorizes a local incorporation requirement. More broadly, Bolivia contends that the references to Bolivian law can serve to place an investment within the exclusive jurisdiction of Bolivian courts and tribunals.

150. Bolivia's expert witness, Professor Rudolph Dolzer, spoke in support of Bolivia's interpretation.[121] He asserted that the question of admission of an investment into a destination country cannot be separated from the question of jurisdiction.[122] Professor Dolzer argued that the Bolivian practice of requiring investors to incorporate locally and be subject to the Bolivian legal system is a respected and established practice. Moreover, Professor Dolzer points to the "specific reference" to the Bolivian legal framework contained within Article 2 of the BIT.[123]

151. The Tribunal disagrees with the breadth of Bolivia's interpretation of Article 2.

152. The Tribunal notes that it need not decide whether the Bolivian requirement to locally incorporate the vehicle of foreign investment is authorized by Article 2 of the BIT. First, it is clear that there is no question that AdT, the vehicle for foreign investment in the Concession, was locally incorporated. Second, as discussed in the first aspect of this Objection, the Tribunal does not accept Bolivia's argument that local incorporation of an investor in and of itself establishes the exclusive jurisdiction of Bolivian courts and tribunals.[124]

153. As to the more pertinent question of whether the references to Bolivian law in Article 2 reach so far as to encompass the conclusion that Bolivian courts and tribunals possess exclusive jurisdiction, the scope of the two references in Article 2 must be understood in terms of their context and purpose. In this regard, it need be recalled that a primary objective of the BIT, measured both in terms of the motivation for its conclusion and in terms of its substantive provisions, is agreement upon ICSID as an independent and neutral forum for the resolution of investment disputes in accordance with a substantive applicable law specified in the BIT. In this light, the Tribunal concludes that the State Parties

---

[121] Oral Statement of Bolivia's Expert, Professor Rudolph Dolzer, (February 9, 2004), pp. 188-211.
[122] *Id.,* p. 197, Lines 13-15.
[123] *Id.,* p. 198, Lines 6-14.
[124] See *supra* ¶¶ 109-123. The Tribunal observes that it is common practice as an investment pre-condition that the vehicle for foreign investment be locally incorporated. The Tribunal also observes that such local incorporation is not in practice a bar to ICSID jurisdiction. Indeed the ICSID Convention specifically contemplates the possibility of claims being brought by a locally incorporated investor, see Article 25(2)(b) of the Convention. *See, e.g.,* Nigel Blackaby, *Arbitration Under Bilateral Investment Treaties in Latin America,* in INTERNATIONAL ARBITRATION IN LATIN AMERICA 379, 388-89 (Nigel Blackaby, David Lindsey & Allessandro Spinillo eds., 2002).

cannot have intended the references to national law in Article 2 to be so encompassing as to defeat the object and purpose of the Treaty. Respondent's interpretation would permit a host State to take its affirmative responsibility to "promote economic cooperation through the protection in its territory of investments of nationals of the other Contracting Party" and transform it into an opportunity to introduce exclusive local jurisdiction for investment disputes.

154. The Tribunal therefore concludes that the references to Bolivian law in Article 2 of the BIT do not extend, at a minimum, to aspects of Bolivian law that in turn would assert exclusive jurisdiction over disputes under the BIT.

155. The Tribunal denies the third aspect of Respondent's First Objection.

The Fourth Aspect of the First Objection which asserts that the transfer of AdT's stock bars the jurisdiction of the Tribunal

Respondent's Objection

156. Respondent argues that the Concession was carefully structured to preclude changes in the foreign ownership of AdT that might bring it within the coverage of a BIT. Respondent observes that in December 1999 IW Ltd, an immediate foreign owner of 55% of the shares of AdT, moved its place of incorporation from the Cayman Islands to Luxembourg and changed its name to International Water (Tunari) S.a.r.l. ("IW S.a.r.l.").[125] Bolivia also notes that there simultaneously were further changes in the upstream ownership with IW S.a.r.l. in turn being owned by a Dutch corporation, IWT B.V., which is itself a subsidiary of IWH B.V., a second Dutch corporation. Bolivia argues each entity was a new legal entity and a new undefined shareholder of AdT. The resulting ownership structure was not the same as the one provided for by the Concession. Respondent characterizes these actions as a series of "unilateral private share transactions" that were unauthorized by Bolivia.[126]

157. Respondent argues that the transfer of AdT's stock from the Caymanian holding company was a breach of the Concession. On the basis of this alleged breach of the Concession, Respondent objects to the jurisdiction of this Tribunal.

Claimant's Reply

158. Claimant argues that the actions taken in December 1999 did not breach the Concession's restrictions on change in ownership of AdT. Claimant concedes that a change in ownership by a Founding Shareholder would have required the permission of Bolivia. However, Claimant argues that the December 1999 transaction did not involve a sale of shares and change of ownership, but rather the "migration" of a corporation from the Cayman Islands to Luxembourg.

[125] Resp. Rej., pp. 18-20, ¶¶ 34-36.
[126] Bolivia's Obj., p. 3.

159. As for the changes in corporate structure that occurred upstream of IW S.a.r.l., Claimant argues that the Concession does not address ownership changes above the first tier of owners of AdT, the Founding Shareholders.[127] Moreover, AdT argues that the Concession "placed no restriction on the transfer of shares by 'Final Shareholders,'" that held shares in the "Founding Shareholders."[128] Thus, the Concession did not touch or concern these Ultimate Shareholders.[129]

The Decision of the Tribunal

160. Article 37.1 of the Concession requires "[e]very Founding Stockholder keep more than 50% of the original equity percentage in voting shares of the Concessionaire at least over the first seven (7) years of the Concessions."

161. Annex 13 of the Concession lists IW Ltd, a wholly owned subsidiary of Bechtel Enterprises Holdings, Inc. (which owned 55 percent of AdT), as one of the "Founding Stockholders."

162. In December 1999, IW Ltd of the Cayman Islands changed its place of incorporation to Luxembourg. This was accomplished without the permission of Bolivia.

163. Bolivia argues that this change of place of incorporation is a breach of Article 37.1 of the Concession. AdT argues that it is not a breach because IW Ltd of the Cayman Islands and IW S.a.r.l. of Luxembourg are the same entity. It argues that it is not the case that one entity went out of existence to be replaced by another, but rather that the same entity "migrated" from one jurisdiction to another.

164. We first must ask precisely what Article 37.1 of the Concession required of the Founding Shareholders. The text of Article 37.1 requires each Founding Shareholder to "keep more than 50% of the original equity percentage in voting shares of the Concessionaire." The Tribunal understands Bolivia to argue that the intent of Article 37.1 was to ensure that AdT would remain, for the first seven years of the Concession, under the same structure of corporate control as when the Concession was signed.[130] Under this line of argument, any transfer of control over AdT during this period "would plainly be a violation" of Concession Article 37.1.[131]

165. The Tribunal disagrees with the breadth of Bolivia's interpretation. In the Tribunal's view, the Concession allows for some change in the organizational chart depicting upstream ownership without the consent of Bolivia. The restrictions of Article 37.1 apply to the Founding Shareholders, but not to the Ultimate Shareholders. Given this distinction between Article 37.1's application to the first-tier level ownership of AdT (the Founding Shareholders) and its inapplicability to the final tier of ownership (the Ultimate

---

[127] Cl. Reply, pp.21-22, ¶ 59.
[128] *Id.*
[129] The Tribunal notes that Claimant uses the term "Final Shareholders" while the Concession uses the Spanish term "Ultimate Shareholders." The Tribunal shall use the term "Ultimate Shareholders."
[130] Resp. Rej., pp. 8-9, ¶ 19.
[131] Resp. Counter Mem., p. 23, ¶ 46.

Shareholders), it follows that Article 37.1 did not restrict Ultimate Shareholders in their organization of the various tiers of ownership. The Tribunal thus concludes that Article 37.1 was not a guarantee that the organizational chart of corporate ownership would not change in any respect. Rather, the Tribunal interprets the provision to require that, among the Founding Shareholders (the first tier of upstream ownership of AdT), the same entities "keep more than 50% of" their original interest. The issue therefore is whether IW Ltd, as a Founding Shareholder, kept more than 50% of its original interest.

166. It is not disputed that if IW Ltd of the Cayman Islands had transferred all of its rights and obligations to a new corporation in Luxembourg, then the Luxembourg corporation would not be the same entity for the purposes of Article 37.1. The Parties disagree, however, whether the asserted "corporate migration" in this instance yields the same or a different entity.

167. Bolivia argues that for a corporation to be the same entity, it must remain incorporated in the same jurisdiction. Bolivia asserts that new rights and obligations accompanied the "migration" from the Cayman Islands to Luxembourg. A "new" company emerged and IW Ltd, a "Founding Shareholder," ceased to be the same legal person. AdT argues that Caymanian and Luxembourg law both recognize IW Ltd and IW S.a.r.l. as the same legal entity.[132] Respondent characterizes AdT's claim that IW S.a.r.l. of Luxembourg and the IW Ltd of the Cayman Islands are the same legal entity as "patently absurd."[133]

168. Claimant's argument is that just as a natural person may migrate from one jurisdiction to another, changing his or her nationality, so too is it possible for a legal person to migrate.

169. Claimant provided to the Tribunal expert opinions as to the laws of the Cayman Islands and Luxembourg and the application of those laws to the instant case.

170. First, the Caymanian law firm of Maples and Calder examined the Caymanian Companies Law and concluded that IW Ltd was an exempted limited liability company under Section 183 of the Cayman Islands Companies Law. Sections 226 and 227 further allow an exempted company to deregister and continue as the same corporate body in another jurisdiction so long as the receiving jurisdiction permits it.[134]

---

[132] Cl. Mem., pp. 43-44, ¶ 126; Maples and Calder Letter, August 28, 2003 in Cl. Reply, Ex. 48, at Section 3.
[133] Resp. Counter Mem., p. 27, ¶ 50.
[134] Cl. Reply, Ex. 48, Opinion Letter, Maples and Calder, August 28, 2003, at Section 3. Maples and Calder assert the Cayman Islands Companies Law (2003 Revision) was in effect at the time of deregistration. The Companies Law reads in part: Section 226. (1) An exempted company incorporated and registered with limited liability and a share capital under this Law, including a company registered by way of continuation under this Part, which proposes to be registered by way of continuation as a body corporate limited by shares under the laws of any jurisdiction outside the Islands (hereinafter called an "applicant") may apply to the Registrar to be de-registered in the Islands. (2) The Registrar shall so de-register an applicant if: (a) the applicant proposes to be registered by way of continuation in a jurisdiction which permits or does not prohibit the transfer of the applicant in the manner provided in this part [...]."

171. Second, the Luxembourg office of the firm of Allen and Overy[135] indicated that Luxembourg law does not "oppose" the transfer of the registered office and place of effective management of a company to Luxembourg "in continuation of its legal personality" so long as the laws of the transferring country state that continuation of legal personality is possible. Thus, IW Ltd "adopted" Luxembourg nationality on the day of the transfer.

172. On the issue of corporate migration, Bolivia provided the Tribunal with the expert opinion of Professor Merritt B. Fox.[136] Professor Fox is of the opinion that IW S.a.r.l. of Luxembourg is a "different corporation" from IW Ltd. Every corporation, Professor Fox asserts, is "unique" and "distinct" from another corporation because of two factors – a corporation's name and its incorporating jurisdiction. Each corporation has "property and contractual rights and duties [that] belong distinctly to it and no one else."[137] Since IW S.a.r.l. did not exist before December 1999, it cannot be deemed a "Founding Stockholder" and could not and did not hold AdT stock. Moreover, inasmuch as IW S.a.r.l. acquired AdT's stocks from IW Ltd after the execution of the Concession, Professor Fox reasons that there were two entities: one that previously held AdT stocks (IW Ltd) and one that came into possession of those stocks (IW S.a.r.l). Professor Fox thus concludes that IW S.a.r.l. is a "different corporation... and hence a different legal person."[138]

173. The Parties questioned the weight to be given to the other Party's expert opinions. Bolivia stated that the two law firms used by Claimant are not experts and are Bechtel's "corporate attorneys who have every interest in defending the transactions they carried out at Bechtel's behest."[139] Claimant questions the relevance of Professor Fox's opinion noting that he is an American lawyer with no expertise in Bolivian, Caymanian or Luxembourg law. AdT argues Professor Fox can only have "a general comparative law view."[140] Consequently, AdT maintains Professor Fox's conclusions are not reliable since he does not specify which set of laws he is comparing when he made his assessment.[141] In addition, the Maples and Calder opinion asserts that Professor Fox's statements are "incorrect as a matter of Cayman Islands law."[142] The Allen and Overy opinion likewise disagrees with Professor Fox's opinion as to the content of Luxembourg law.

174. The Tribunal finds that although Professor Fox's opinion may be accurate as a general matter, it does not bear on the particular situation presented by this case. The possibility of corporate migration between two jurisdictions appears to be relatively rare. It requires that the jurisdiction being left behind and the jurisdiction being entered both accept the possibility of migration in their legal systems. Not many national legal systems provide for corporate migration. The Tribunal concludes that, although unusual, a corporate

---

135 The Tribunal notes that Allen and Overy represented IW S.a.r.l. in connection with its "transfer of the registered office and place of effective management" and change of the company's name from IW Ltd. to IW S.a.r.l. *See* Cl. Reply, Ex. 50, Opinion Letter, Allen & Overy Luxembourg, August 28, 2003, at Section 1.
136 Resp. Counter Mem., Ex. B, pp. 14-15.
137 *Id.*, p. 15.
138 *Id.*
139 Resp. Rej., p. 20, ¶ 37.
140 Oral Statement of AdTs Counsel, Matthew Weiniger, (February 9, 2004), p. 67, Lines 7-20.
141 *Id.*, p. 68, Lines 5-10.
142 Maples & Calder, *supra* at note 134, at Section 3.5.

migration is permitted by the laws of the Cayman Islands and its continuation as a legal entity is permitted by Luxembourg law.

175. Bolivia further argues that the question of whether IW Ltd and IW S.a.r.l. are the same entity is to be decided with reference to Bolivian law, not Caymanian or Luxembourg law. Bolivia argues that its law controls corporate registration, deregistration and subsequent legal status of AdT's shareholders and that, under Bolivian law, corporate migration is not possible.[143] In Bolivia's view, "Founding Shareholder" must be understood in accordance with Bolivian law and that law does not recognize IW S.a.r.l. as being the same company as IW Ltd.[144] AdT argues that Caymanian and Luxembourg law are the only relevant laws that govern the change of IW Ltd's domicile and name-change. [145]

176. The Tribunal disagrees with Bolivia. The status of IW S.a.r.l. is first a question governed by the law of Luxembourg. It is true that each country has the choice to recognize or not recognize the corporations of other States. As a question of private international law, States in examining the status of a foreign corporation generally defer either to the law of the seat of the company or the law at the place of incorporation.[146] Whichever of these approaches is adopted in this case, the Tribunal concludes on the bases of the arguments made and evidence submitted that the law that determines the status of IW S.a.r.l. would not be the substantive corporate law of Bolivia.

177. Finally, Bolivia points to correspondence from Claimant's parent company to the Water Superintendency seeking "approval" for a particular series of stock transfers from IW Ltd as an admission by AdT that this type of transaction would have been an otherwise unauthorized action.[147] This correspondence is discussed by the Tribunal as the fifth aspect of the First Objection. Suffice it to say for this aspect of the First Objection that (1) the correspondence involved not a corporate migration but rather a direct transfer of AdT stock; (2) the transaction described in the correspondence was never executed; and (3) the Claimant concedes that such a transfer would have required the approval of the appropriate Bolivian authorities.

178. The Tribunal therefore concludes that the migration of IW Ltd from the Cayman Islands to Luxembourg with its change of name to IW S.a.r.l. did not constitute a breach of Article 37.1 of the Concession.

179. The Tribunal notes that, given its holding, it need not reach a further issue not argued by the Parties; namely, whether a breach of the Concession would bar the jurisdiction of this Tribunal. Respondent appears to assume that the appropriate remedy for a breach of certain provisions of the Concession is that this Tribunal refrain from exercising jurisdiction over a matter otherwise properly placed before it.

---

[143] Resp. Rej., p. 22, ¶ 38.
[144] *Id.*
[145] Cl. Reply, pp. 23-24, ¶¶ 61-66.
[146] U. Drobnig, *Private International Law*, in III ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 1116 (R. Bernhardt ed.1992).
[147] Letter of Michael C. Bailey, Vice President & Managing Director, Bechtel, November 24, 1999, Ex. 1 to Resp. C. Mem.

180. The Tribunal denies the fourth aspect of Respondent's First Objection.

The Fifth Aspect of the First Objection which asserts that misrepresentations by representatives of Claimant bar the jurisdiction of this Tribunal

Respondent's Objection

181. Bolivia received two letters from representatives of Bechtel Enterprises Holdings, Inc. in November and December 1999 discussing a proposed change of ownership of AdT and making representations as to the legal effect and impact of that proposed transaction.[148]

182. Respondent claims the first of these two letters contained representations concerning a direct transfer of AdT's stocks from IW Ltd in the Cayman Islands to a different company to be based in the Netherlands.[149] Respondent notes that the letter provided that "as a result of the Transaction the shareholder shall no longer be a company established in the Cayman Islands controlled 100% by IWL, but another company established in the Netherlands and controlled by New IWL."[150] Bolivia asserts that the second of these letters, signed by Bechtel's Bolivian counsel, stated that "transferring the Founding Shareholder status" from the Cayman Islands to a "Dutch firm" would result in "no adverse effect or impact for the Bolivian Government, for Bolivian entities or the town of Cochabamba[...]".[151]

183. Respondent claims that Claimant breached the representations it made in these two letters. Under this objection, Respondent does not dispute the legality of the transfer that took place as it does in the fourth aspect of the First Objection, but instead claims that it received assurances that AdT would remain under the "same control" with no "adverse effect or impact" after the proposed transfer. Respondent claims that, in fact, a different company endowed with new rights and obligations emerged as a result of the transfer. Bolivia argues that one of the new rights possessed by the new company was the protection and availability of a BIT between the Netherlands and Bolivia.[152]

184. Respondent claims AdT subsequently breached its representations by the very act of filing a Request for Arbitration against Bolivia. Respondent argues that this breach of the representations made regarding the legal effects of the proposed stock transfer should deny AdT the benefit of ICSID jurisdiction.[153]

---

148 Letter of Michael C. Bailey, Vice President & Managing Director, Bechtel, to the Superintendencies of Water and Electricity, November 24, 1999, and Letter of Dr. Ramiro Guevara, Servicios Legales S.C., to Luis Uzin, Water Superintendent, December 3, 1999. First submitted to the Tribunal with Bolivia's Reply and found at Resp. Counter Mem., Ex. 1 and 2.
149 *Id.*
150 Letter of Michael C. Bailey, Resp. Counter Mem., Ex. 1.
151 Letter of Dr. Ramiro Guevara, Resp. Counter Mem., Ex. 2 and pp. 41-42, ¶ 81.
152 Resp. Rej., pp. 19-22, ¶¶ 35-38. As in the fourth aspect of the First Objection, Respondent has also asserted that Concession Article 37.1 barred such reorganizations and that any such reorganization would have constituted a breach of the Concession, which would thus preclude Claimant from ICSID relief, see *supra* ¶¶ 156-157.
153 Resp. Rej., pp. 19-20, ¶ 36.

Claimant's Reply

185. Claimant emphasizes that the transaction proposed within the two letters did not actually take place.[154] The proposed change of ownership discussed within these letters, Claimant argues, was abandoned and a different series of transactions took place in December of 1999.[155]

186. AdT concedes that Bolivia's approval was indeed required for the specific transaction detailed by the November and December 1999 letters since that plan would have "envisaged International Water (Aguas del Tunari) Ltd.(IWL) selling its share to a new company to be formed in the Netherlands."[156] Since IW Ltd was a "Founding Shareholder," AdT acknowledges that without the consent of Bolivia, Concession Article 37.1 would have barred this sale. Claimant argues that consent was not required for the corporate migration that actually took place as the property rights of AdT's holding company were not "altered and no transfer [took] place."[157]

187. AdT argues there were no similar consent requirements for change of ownership by "Final Shareholders."[158] Thus, "[...]when the structure of the transaction changed in that it was decided that the shares of IW S.a.r.l. would be held by a Dutch company rather than the Dutch company holding IW S.a.r.l's stake in AdT directly, the need to obtain permission was removed." AdT concludes that the letters relied upon by Bolivia are therefore "irrelevant" since the actual accomplished transaction differed significantly from the proposed course of action outlined in that correspondence.[159]

The Decision of the Tribunal

188. Bolivia argues that representations made in two letters to the Water Superintendent from representatives of Bechtel concerning the legal effect of a change in ownership of AdT were breached and that this breach bars the jurisdiction of this Tribunal. However, receipt of the letters did not mean necessarily that the proposed course of action was the one that actually took place. Rather, the evidence before the Tribunal indicates that the proposed transaction was never executed.

189. It will be recalled from the Tribunal's discussion of the fourth aspect of Respondent's First Objection that the transaction that actually occurred involved the migration of IW Ltd of the Cayman Islands to Luxembourg as IW S.a.r.l. This transaction is not the transaction proposed in the November and December letters. In those letters, there is no mention of Luxembourg. Rather the proposed transaction involved a transfer of ownership to a Dutch company. Thus, the Tribunal need not determine the precise content

---

[154] Cl. Reply, p. 11, ¶ 30.
[155] *Id.* AdT points to Ex. 8 to 14, documents related to the corporate migration of AdT's holding company, in the Request for Arbitration as evidence to support this claim.
[156] *Id.*, pp. 11-12, ¶¶ 31-32.
[157] See *supra* at ¶¶ 158-159; Oral Statement of AdT's Counsel, Matthew Weiniger, (February 9, 2004), p. 93, Line 17.
[158] Cl. Reply, pp. 11-12, ¶ 32.
[159] *Id.*

of representations contained within the correspondence as the proposal was never executed and such representations cannot have legal effect.

190. Parenthetically, Respondent accuses AdT of fraud.[160] Again, since the transaction outlined by the alleged misrepresentations never took place the Tribunal need not reach a conclusion regarding Respondent's accusation of fraud.

191. The Tribunal notes that, given its holding, it need not reach Respondent's argument that if the Tribunal found a misrepresentation of the type asserted by Respondent, then Claimant would be estopped from invoking the jurisdiction of this Tribunal.[161]

192. The Tribunal thus concludes that the fifth aspect of Respondent's First Objection fails inasmuch as the transaction proposed in the two letters was not executed.

The Sixth Aspect of the First Objection which asserts that Claimant's invocation of the Netherlands-Bolivia BIT is an assertion of jurisdiction not within the scope of Bolivia's consent to arbitration

Respondent's Objection

193. Under this aspect of the First Objection, Respondent draws upon all of the previous aspects of this objection and asserts that these aspects in their totality evidence a qualification of Bolivia's consent to ICSID arbitration.

194. In Bolivia's view, the possibility of ICSID jurisdiction must fall within the "reasonable contemplation" of the parties involved.[162] Reiterating that "consent" is the cornerstone of the ICSID system, Bolivia argues that consent should be limited to circumstances a Contracting State can reasonably contemplate:

> [N]otwithstanding the general proviso for jurisdiction contained in a BIT, the host state may invite an investment and such invitation may limit the host State's consent to ICSID jurisdiction. If the investor accepts the invitation to invest on those terms, then 'the investor's acceptance may not validly go beyond the limits of the host's offer.' [163]

---

[160] Bolivia has further asserted that the Water Superintendent's approval was "obtained solely on the basis of a misrepresentation (*i.e.*, was procured by fraud)," Resp. Counter Mem., p. 43, ¶ 84.

[161] Bolivia argues Claimant is estopped from invoking the jurisdiction of this Tribunal. *See e.g.* Resp. Rej., p. 23, ¶ 42; Oral Statement, Bolivia's Expert, Professor Rudolf Dolzer, (February 9, 2004), p. 201, Lines 13-17. However, since the alleged representations discussed in the Fifth Aspect of the First Objection never occurred, such alleged representations can not serve as a basis for estoppel The Tribunal further recalls the statement of the International Court of Justice in the Temple of Preah Vihear case that the representation relied upon should be "clear and unequivocal." ICJ REPORTS (1962) pp. 143-144. *See generally* J.P. Müller & T. Cottier, *Estoppel*, in II ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW, 116 (R. Bernhardt ed., 1992) (defining estoppel restrictively).

[162] Resp. Counter Mem., pp. 36-37, ¶ 71 (Quoting SCHREUER, THE ICSID CONVENTION: A COMMENTARY, 239 (2001) and Rand, Hornick and Friedland, *ICSID's Emerging Jurisprudence*, 19 N.Y.U. INT'L L. & POL. 33, 57 (1986). (Internal citations omitted).

[163] *Id.*, p. 37, ¶ 72, (Internal citations omitted).

195. In terms of this case, Respondent argues that:

> Indeed, Bolivia specifically conditioned the award of the Cochabamba water services concession to a Bolivian company that would not fall under the Bilateral Investment Treaty (or other BITs like it.) That is, Bolivia specifically required that the awardee of the Concession Agreement not be controlled by any foreign entity whose BIT would allow the Bolivian company access to ICSID.[164]

In particular, Bolivia argues that (1) the circumstances surrounding the tender offer, (2) the terms of the Concession particularly as it limited change in the ownership of AdT, and (3) the content of Bolivian law particularly as it is relevant in light of Article 2 of the BIT all validly define the "reasonable contemplation" of the parties regarding the availability of ICSID jurisdiction in the proceedings. Respondent emphasizes that:

> To Bolivia's knowledge, the facts of this case are unique in the jurisprudence of ICSID. Bolivia is unaware of any other case in which a host country authorized the award of an investment contract on the express condition that the awardee not be subject to such foreign control as would allow the awardee to invoke ICSID jurisdiction; where the awardee specifically agreed and represented in the investment contract that it would not be subject to such control; where the awardee's controlling shareholder, in making certain post-contract changes to the awardee's upstream ownership, specifically represented that control would not change; and where the awardee, based on those post-contract changes in the upstream ownership, seeks nonetheless to invoke the Centre's jurisdiction.[165]

196. Bolivia maintains that in ratifying the ICSID treaty, it never consented to the availability of ICSID jurisdiction for an entity such as AdT with migratory ownership interests. Bolivia asserts that consent to ICSID arbitration should be measured on a case-by-case basis taking into consideration the conduct of parties to an investment agreement, the language of the investment agreement, the internal legislation of a host state, and international treaties.[166]

197. Bolivia argues that AdT's contention that Bolivia granted its consent when the ICSID Convention came into force for Bolivia in 1995 is too "simple" and ignored the "conduct" of the parties prior to and during the investment.[167] Bolivia characterizes AdT's approach to the consent issue as "simple and formulaic."[168] Bolivia submits AdT's understanding runs counter to a "basic principle" of ICSID jurisprudence, namely "[t]he inclination of ICSID to extend jurisdiction with the reasonable contemplation of the parties [...]"[169]

198. Bolivia thus argues the Tribunal should reject AdT's "rigid" formula for determining consent solely on the Treaty, the Convention and the Request for Arbitration. Rather, Bolivia argues that: "there is no support for Claimant's argument that only the Treaty, the Convention, and the Request for Arbitration are relevant for the purpose of

---

[164] *Id.*, p. 35, ¶ 66, (Emphasis in original).
[165] *Id.*, p. 36, ¶ 70.
[166] *Id.*, p. 37-39, ¶¶ 73-75. (Citing for authority MOSHE HIRSCH, THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTRE FOR THE SETTLEMENT OF INVESTMENT DISPUTES, 48 (1994))
[167] Resp. Counter Mem., pp. 37-38, ¶ 73.
[168] Resp. Rej., p. 31, ¶ 59.
[169] *Id.*, p. 32, ¶ 61.

determining consent in this case. The facts and circumstances surrounding the Concession Agreement, and the Agreement itself, are relevant."[170]

199. Last, Bolivia offers the opinion of its expert witness Professor Rudolf Dolzer that the "circles of beneficiaries" of the BIT was "carefully" described and negotiated. Thus, any shift in this circle of beneficiaries would be seen as a "very serious matter" by the governments involved. Professor Dolzer urges these basic considerations deserve special consideration within a realistic assessment of the situation that goes beyond textual formalities.[171] Professor Dolzer stresses the point that Article 2 of the BIT makes each party aware of the fact they are operating within a "specific setting" that has a "distinct legal relevance"-namely, the framework of the Bolivian legal system.[172] Professor Dolzer concludes that each party was aware of this "specific reference" and that "the investor has chosen to accept the setting of the investment within the framework of Bolivia's laws and regulations to which the BIT between Bolivia and the Netherlands makes specific reference."[173]

Claimant's Reply

200. AdT does not directly address each point of this aspect. Rather, AdT maintains that "[t]here is no requirement in either the BIT or the ICSID Convention, on which the Tribunal's jurisdiction is based, that Bolivia must consent to the Dutch control of a Bolivian national for an ICSID tribunal to have jurisdiction over disputes between that Dutch-controlled Bolivian national and Bolivia."[174]

201. Thus AdT notes that Bolivia has consented to submitting a dispute to ICSID under the BIT between Bolivia and a Bolivian company under the direct or indirect control of a Dutch national.[175] AdT reasserts its claim is based on the BIT that "constitutes a general, written consent by the Respondent, and the Request for Arbitration a general written consent by the Claimant."[176] Importantly, AdT states "[n]either party sought to limit its written consent in any way."[177]

The Decision of the Tribunal

202. Bolivia argues that its consent to ICSID jurisdiction under the BIT is qualified by the particular circumstances of the case: the negotiation and terms of the Concession, and Article 2 of the BIT read in conjunction with the laws of Bolivia. Bolivia presents this objection as an extension of all its objections that speaks to the entire situation with which it is confronted.

---

[170] *Id.*, p. 38, ¶ 71.
[171] Oral Testimony of Respondent's Expert, Professor Rudolph Dolzer, (February 9, 2004), pp. 193-196.
[172] *Id.*, p. 197, Lines 17-18.
[173] *Id.*, p. 198, Lines 8-14.
[174] Cl. Rep., p. 13, ¶ 49.
[175] *Id.*
[176] *Id.*
[177] *Id.*

203. The Tribunal by majority finds that Bolivia's objection that it limited the scope of its consent to ICSID jurisdiction by way of Article 2 of the BIT plus the structuring of the Concession, in particular requirements as to AdT's corporate structure, has already been dispensed with by way of the Tribunal's decisions regarding the first, second, third and fourth Aspects of the First Objection.[178]

204. In his Declaration, Arbitrator Alberro-Semerena dissents from the Tribunal's decision on the sixth aspect of the First Objection. The Tribunal observes that it is unanimous on the other aspects of its decision on the First Objection and that many of the points determined therein bear on the sixth aspect of the First Objection.[179] In Procedural Order No.1, the Tribunal determined that its discretion to order the production of evidence was informed by concepts of materiality, relevance and specificity. Given the Tribunal's findings on the other aspects of the First Objection, a majority of the Tribunal does not find there to be present an undecided issue that would justify the ordering of the production of documents suggested.

205. The Tribunal denies the sixth aspect of Respondent's First Objection.

The Second Objection

Respondent's Second Objection which asserts that the Claimant is not a Bolivian entity "controlled directly or indirectly" by nationals of the Netherlands as required by the Netherlands-Bolivia BIT

Respondent's Objection

206. Respondent objects to the jurisdiction of the Tribunal on the ground that AdT is not a "national" of the Netherlands as defined by Articles 1(b)(ii) and (iii) of the BIT. Respondent, in particular, argues that AdT is not "controlled by Dutch nationals".[180]

207. Respondent argues that AdT is not an entity controlled by nationals of the Netherlands in two principal respects. First, Respondent argues that "control" refers to the ultimate controller, who in this instance is Bechtel, a U.S. company.[181] Second, Respondent

[178] See *infra*, ¶¶ 109-123, 133-138, 142-155, 160-184.

[179] These are, primarily: (1) "the Tribunal finds neither common intention of the Parties to exclude ICSID jurisdiction in the case of a claim by AdT nor any clear waiver on the part of AdT in Article 41 or the Concession generally of its rights to pursue its claims before ICSID" (Paragraph 122, *supra*), (2) [t]he Tribunal . . . concludes that Article 37.1 was not a guarantee that the organizational chart of corporate ownership would not change in any respect" (Paragraph 165, *supra*), (3) [t]he Tribunal . . . concludes that the migration of IW Ltd from the Cayman Islands to Luxembourg with its change of name to IW S.a.r.l. did not constitute a breach of Article 37.1 of the Concession" (Paragraph 178, *supra*) and (4) "the Tribunal need not determine the precise content of representations contained within the [November 24, 1999] correspondence as the proposal was never executed and such representations cannot have legal effect" (Paragraph 189, *supra*).

[180] *See, e.g.,* Resp. Counter Mem., p. 51 ¶ 104.

[181] *See, e.g.,* Resp. Counter Mem., p. 72 ¶ 149-150, where Bolivia argues: "AdT's argument that the 'ordinary meaning' of 'directly or indirectly' modify 'control' in the Bilateral Investment Treaty so that a company can have multiple controllers is fanciful at best. * * *. Rather the issue is who ultimately controls and that is why the term 'indirect' is even used, to denote that control can be through another corporate entity just as Bechtel's

argues that the question of whether an entity is "controlled, directly or indirectly," is a question of fact which is not necessarily satisfied by 100 percent ownership.

208. Respondent argues that IWT B.V. and IWH B.V., the Dutch companies that Claimant alleges control it, are mere shells that do not "control" the Claimant.[182] It is on the basis of the factual exercise of control that Respondent moves for the production of documents discussed *supra* in paragraphs 26-27.

209. Respondent thus argues that "[t]he issue of control in this case is whether the Netherlands entities as a matter of fact have the power, without the permission of others, to control their own corporate destinies and, accordingly, that of the Claimant, AdT."[183] In Respondent's view, Bechtel remains in control and the Dutch companies entities are corporate "shells." [184]

Claimant's Reply

210. Claimant argues that where there is 100 percent ownership, then there necessarily exists control. Claimant asserts that the term "control" was introduced into the ICSID Convention and international investment law generally not to take away from those situations where there is majority shareholder ownership but rather to extend investment protection to situations where there is a minority shareholder interest which by virtue of voting rights or other legal factors also possesses legal control.[185]

211. Claimant asserts that AdT qualifies as a Dutch national under the BIT since it is incorporated in Bolivia but is controlled, directly or indirectly, by Dutch nationals. Specifically, Claimant states that while AdT is incorporated in Bolivia, 55 percent of AdT's shares are held by IW S.a.r.l. In turn, 100 percent of IW S.a.r.l's shares (and voting rights) are held by IWT B.V., which is a Dutch national. Moreover, 100 percent of IWT B.V.'s shares (and voting rights) are held by yet another Dutch corporation, IWH B.V.[186]

212. Claimant also strongly disputes Respondent's suggestions that IWT B.V. and IWH B.V. are mere "shells" created solely for the purpose of gaining ICSID jurisdiction. In particular, Claimant argues that the change in ownership structure of AdT was only one element of a much wider joint venture between Bechtel Enterprises Holdings, Inc. and Edison S.p.A., that that joint venture and change in structure occurred before the events that

---

control of AdT in his case is through Netherlands and Luxembourg entities." *See also id.* at p. 52, ¶¶ 106-107. At other points, Bolivia also argues that an entity must "have the power, without the permission of others, to control their own corporate destinies." *See, e.g.,* Bolivia's Reply at para 1.2. Together these propositions suggest that Bolivia argue there is only one controlling entity and that entity would be the ultimate parent corporation.

[182] *See, e.g.,* Resp. Counter Mem., pp. 56-59, ¶¶ 115-122, Resp. Rej., pp. 62-75, ¶¶ 116-134 where Bolivia argues: "[M]ajority shareholding or even majority voting rights do not *per se* constitute control. ... T]he choice of a 'control' test by the parties, as opposed to a more conventional and objective test, such as place of incorporation or seat of the company, indicates an intent by the parties to look beyond formalistic determinations of corporate nationality to consider the reality of the company."

[183] Bolivia's Reply, ¶ 1.2

[184] *Id.,* ¶ 3.10.

[185] Cl. Mem., pp. 46-50, ¶¶ 133-138.

[186] *Id.,* p. 15, ¶ 49.

would so severely affect the Concession were foreseeable, and that there is no question, that as far as Respondent's Second Objection, that both IWT B.V. and IWH B.V. could bring the claims directly under the BIT.

213. Claimant concludes that it is controlled indirectly by Dutch nationals, IWT B.V. and IWH B.V., as required by the BIT.[187]

The Decision of the Tribunal

The Questions Presented

214. Claimant seeks arbitration before the ICSID on the basis of Article 9(6) of the Netherlands-Bolivia BIT.[188]

215. The Parties do not dispute that the Claimant, AdT, is a national of Bolivia. The issue before the Tribunal is whether AdT is – for the purposes of the BIT and in accordance with the terms of the BIT – to be regarded also as a "national" of the Netherlands.

216. The Netherlands-Bolivia BIT, like the ICSID Convention and the majority of BITs, recognizes that the investor of one of the State Parties may incorporate an entity in the other State Party as a vehicle for its investment activity. Indeed, it is by no means uncommon practice that foreign investors may be required to incorporate locally by the host state.

217. To address this possible local incorporation of the investor, the Netherlands-Bolivia BIT follows the pattern of many BITs and provides that a "national" of the Netherlands as defined by Articles 1(b) includes not only:

> (i) natural persons having the nationality of that Contracting Party in accordance with its law;
> (ii) without prejudice to the provisions of (iii) hereafter, legal persons constituted in accordance with the law of that Contracting Party;

but also:

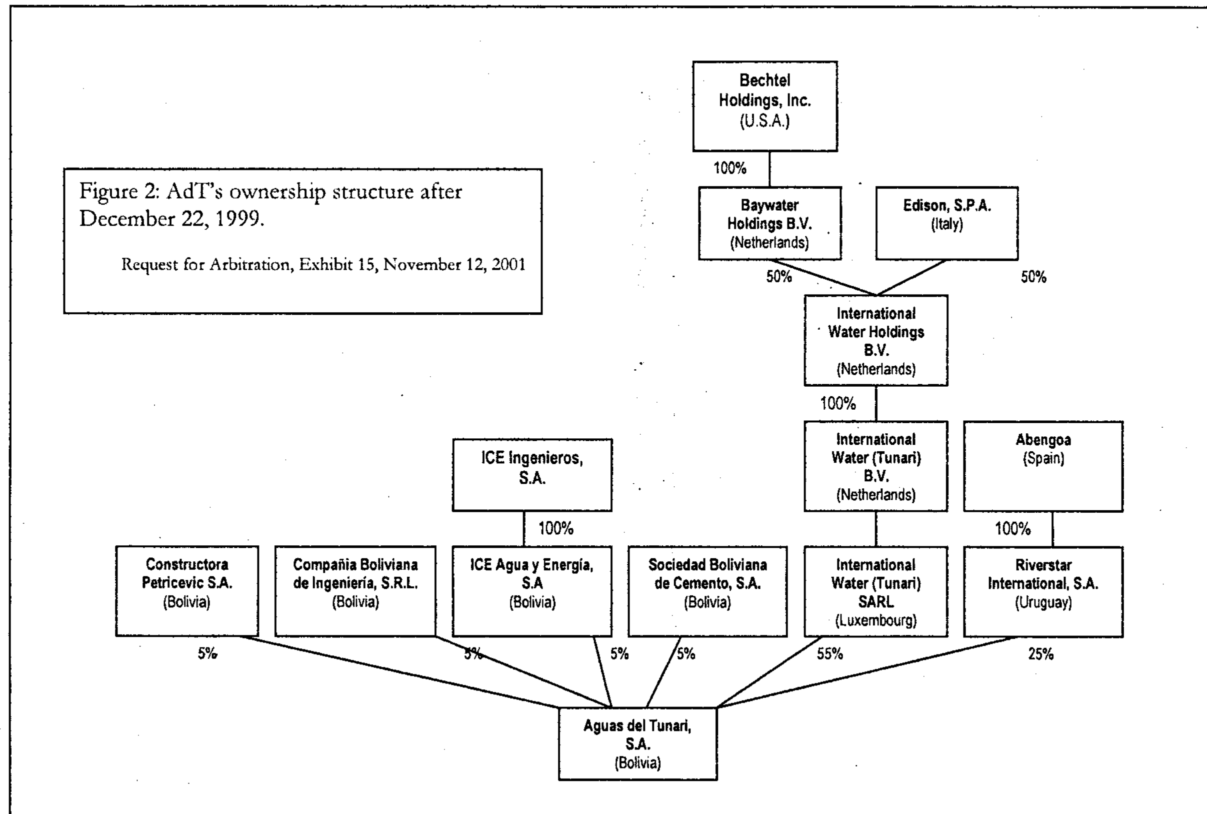
> (iii) legal persons controlled directly or indirectly, by nationals of that Contracting Party, but constituted in accordance with the law of the other Contracting Party.

---

[187] *Id.*

[188] Article 9(6) of the BIT provides:
"If both Contracting Parties have acceded to the Convention on the Settlement of Investment Disputes between States and Nationals of other States of 18 March 1965 [ICSID Convention], any disputes that may arise from investment between one of the Contracting Parties and a national of the other Contracting Party shall, in accordance with the provisions of that Convention, be submitted for conciliation or arbitration to the International Centre for Settlement of Investment Disputes."

218. It will be recalled that AdT's ownership since December 22, 1999, as depicted in Figure 2, is as follows:



219. With this ownership structure in mind, it is helpful to recognize what this objection is *not* about.

First, there does not appear to be any argument that AdT is foreign controlled, rather the disagreement is as to the location of that foreign control.[189]

Second, there does not appear to be any argument that the Dutch upstream ownership (namely IWT B.V., IWH B.V., and Baywater) are all "legal persons constituted in accordance with the law of" the Netherlands as required by Article 1(b)(ii). Respondent's first objection argued that the act of bringing the Dutch entities into the chain of AdT ownership was a violation of the Concession or representations made to the Respondent.[190] Respondent does not argue, however, that the Dutch corporations are not properly constituted in accordance with Dutch law. Although the requirement of control raised by the second objection is not relevant to these Dutch entities,

[189] Oral Statement of AdT's Counsel, Robert Volterra, (February 10, 2004), p. 407.

[190] The Tribunal concluded in the Fourth and Fifth Aspects of First Objection that these actions resulted in neither a breach of the Concession nor of a representation.

these entities were not named as claimants in this proceeding.[191] Rather, in this proceeding, it is the Bolivian entity, AdT, that is named as claimant and it is that choice that makes Article 1(b)(iii) the basis for this objection.

220. Moreover, it is noteworthy that no suggestion is made that there is yet some other entity, beyond all those mentioned in Figure 2, which controls AdT. Whatever entity (or entities) controls AdT, it (or they) is (or are) depicted in Figure 2. Claimant asserts that both IWT B.V. and IWH B.V. qualify as Dutch entities controlling AdT for the purposes of the BIT. Respondent argues that the true controller of AdT at all times was Bechtel, a U.S. corporation.

221. Recognizing what this objection does not concern, the Tribunal identifies two questions raised by the application of Article 1(b)(iii) to this case.

First, Article 1(b)(iii) requires that AdT, the Claimant and a Bolivian corporation, be "controlled directly or indirectly" by either IWT B.V. or IWH B.V. This question has been argued extensively by the Parties and is primarily a question as to the interpretation and application of the phrase "controlled directly or indirectly" found in Article 1 of the BIT.

Second, as can be seen in Figure 2, between AdT and the various Dutch companies is IW S.a.r.l., a Luxembourg corporation. IW S.ar.l. is 100 percent owned by the various Dutch entities. It, however, owns only 55 percent of AdT. For AdT to be "controlled directly or indirectly", it must be the case that IW S.a.r.l. controls AdT. This question was not argued by the Parties in their written filings, but was raised as a part of the Hearing.

222. The Parties disagree on the legal test governing the question of whether AdT is "controlled directly or indirectly" by either IWT B.V. or IWH B.V. For the Claimant, 100 percent ownership necessarily equals control and majority shareholding itself is sufficiently determinative of control.[192] For the Respondent, the word "control" means there must be *more* than "ownership." For the Respondent, control means the exercise of powers or direction, not merely the legal potential to do so.[193] Thus Respondent uses terms as "real control"[194] in its submissions to ask for "something more"[195] to determine the "reality of the

---

[191] The Tribunal notes that Respondent's First Objection would apply equally if the Dutch entities had been named as claimants. Respondent's Second Objection turns particularly, however, on the naming of AdT as Claimant. It may be that there are yet unexpressed reasons why AdT, rather that none of the Dutch entities, was named as Claimant. The Tribunal will consider the relevance of such reasons, if any, if and when they are expressed.

[192] AdT argues, for example, that: "In a situation where share ownership is clearly at a level that gives control, share ownership is the only relevant factor." Cl. Mem., p. 46, ¶ 134.

[193] Thus Bolivia replies, for example, that "AdT's claim that majority shareholding constitutes *per se* control for purposes of the Bilateral Investment Treaty is exactly the sort of formalistic result that the 'control' test is intended to avoid... Control does not in fact reside in AdT's up-the-corporate-chain Netherlands shareholders. It resides elsewhere, at a locus that would not permit ICSID jurisdiction to obtain.", Resp. Counter Mem., p. 59, ¶ 122.

[194] Resp. Counter Mem., p. 67, ¶ 140.

[195] In oral submissions made to the Tribunal, Counsel for Bolivia stated that "we believe that the answer to the question of who controls AdT requires something more than a mere showing of majority ownership of voting

corporate personality."[196] Claimant argues that 100 percent ownership entails the legal potential to control and that Respondent's use of modifiers for "control," such as effective or actual, is unwarranted.[197] Respondent contends that control is a factual question particularly relevant to situations where the company alleged to control another company in fact has little, if any, capacity to exercise such control.[198]

223. Thus the crucial point of disagreement is that Claimant, on the one hand, interprets the phrase "controlled directly or indirectly" as requiring only the legal potential to control the Claimant and that the phrase thus potentially encompasses not only the ultimate parent of AdT, but also the subsidiaries of the parent above the Claimant. The Respondent, on the other hand, interprets the phrase "controlled directly or indirectly" as requiring "ultimate" control of AdT or, if the phrase is not limited to the ultimate controller, then "effective", "actual" control of AdT. Thus the difference in view between the Parties is not between "control" and "ownership," but rather between "control" as requiring the legal potential to control and "control" as requiring the actual exercise of control.

224. Finally, it is important to observe that the framing of the issue before the Tribunal is rendered necessary by Claimant's reliance on its documentary evidence of IWT B.V.'s and IWH B.V.'s legal ownership interest in, and resultant potential to control of, AdT as sufficient proof to establish jurisdiction under the BIT. As noted above, Respondent has requested the production of documents from Claimant bearing on the control in fact of AdT by IWT B.V. or IWH B.V. Claimant opposes such a production request arguing that such documents legally are immaterial and that such a broad discovery order as a practical matter would be burdensome. In addition, as discussed in paragraph 246, *infra*, Respondent does not make clear what evidence would be sufficient to establish the exercise of control argued by Respondent to be required by the BIT. The issue as framed by Claimant might be mooted if the Tribunal ordered the production of documents and such documents established not only the legal potential to control, but also the exercise of control. But, given that Respondent has not indicated what evidence would establish effective control, there is not a basis to make an appropriately tailored order for production of documents. Moreover, it is Claimant's prerogative to structure its claim and in doing so it runs the risk of the Tribunal denying jurisdiction in this matter.

---

shares, particularly because of the unique facts and circumstances of this particular case." Oral Statement of Bolivia's Counsel, Dana Contratto, (February 10, 2004), p. 425, Lines 1-5.

196 Resp. Counter Mem., pp. 66-67, ¶ 139.

197 In oral submissions to the Tribunal, Counsel for AdT stated:, "In the claimant's pleading, the word "control" is put simply as control. But the respondent, when it discusses control, in the manner that the respondent wishes to convince the Tribunal should be, in fact, the standard of control in the BIT, they always have to modify the word "control." They use words such as "effective control, ultimate control, actual control, real control." But these words do not exist in the Bilateral Investment Treaty [. . .]." Oral Statement of AdT's Counsel, Robert Volterra, (February 10, 2004), p. 287, Lines 4-14.

198 Resp. Counter Mem., p. 67, ¶ 140.

The Meaning of the Phrase: "controlled directly or indirectly"

The Ordinary Meaning of the Phrase: "controlled directly or indirectly"

225. Article 1(b)(iii) provides that a national of a Contracting Party includes "legal persons controlled directly or indirectly, by nationals of that Contracting Party, but constituted in accordance with the law of the other Contracting Party."

226. Article 31(2) of the Vienna Convention requires that the interpreter as one part of his task look to the "ordinary meaning" of a word or phrase unless a "special meaning" was intended by the parties. The phrase requiring interpretation is "controlled directly or indirectly" where "controlled" is the past participle of the transitive verb "control." As anticipated by the Vienna Convention itself in requiring the interpreter to look not only to the ordinary meaning of a phrase, but also to the context in which it is found and in light of the object and purpose of the document, the ordinary meaning of "controlled directly or indirectly," although clearly an essential element of the task of interpretation, is not determinative in this instance.

227. To find the "ordinary meaning" of the word "controlled", the Tribunal sought guidance from standard desk dictionaries. One standard American English dictionary defined the transitive verb "control" as "to exercise restraining or directing influence over... to have power over."[199] According to another desk dictionary, the verb control can be defined as to "manage: to exercise power or authority over something such as a business or a nation."[200] Similarly, a standard British English dictionary defines "control" as both "the fact of controlling" and "the function or power of directing and regulating; domination, command, sway."[201] On the one hand, the use of the word "manage" in the second quotation seems to conform to the Respondent's view that control involves actual exercise of powers or direction. On the other hand, the words "power" and "authority" point in the opposite direction. "Authority" is defined simply as "the right or power to enforce rules or give orders"[202] and "power" as either "the ability, skill, or capacity to do something" or "the authority to act or do something according to a law or rule."[203] Thus while some definitions suggest the actual exercise of influence, others emphasize the possession of power over an object. Thus, the ordinary meaning of "control" would seemingly encompass both actual exercise of powers or direction and the rights arising from the ownership of shares.

228. The Tribunal notes that Respondent argues, among other things, that the use of the word "controlled," rather than "control," is significant.[204] Like the Tribunal, the

---

[199] Webster's On-Line Dictionary, www.m-w.com (2005); I WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY, 496 (1971)("to exercise restraining or directing influence over ... [and] [to] have power over ....")

[200] ENCARTA WORLD ENGLISH DICTIONARY, 1999, p. 395.

[201] OXFORD ENGLISH DICTIONARY III 851-52, 853 (2nd ed. 1989).

[202] ENCARTA WORLD ENGLISH DICTIONARY, 1999, p. 113

[203] *Id.* p. 411.

[204] The Tribunal notes that the Respondent itself is inconsistent on the significance of the use of "controlled," rather "control." Respondent, for example, primarily argues that the phrase "controlled directly or indirectly" in the BIT is coextensive with the phrase "foreign control" in the ICSID Convention. *See, e.g.,* Resp. Counter Mem., at ¶ 113.

Respondent starts with the definitional meaning of "control," but from that definition then argues that:

> The word used in the Treaty, "controlled," is a participle *i.e.*, a verb used in adjective form. To say that an object is "controlled" is different from saying that an object is capable of being controlled; an object that is "controlled" is actually controlled. "Controlled" is not a complex or unusual word. To apply the word in this case means that AdT must have been controlled, *i.e.* commanded, regulated, restrained, or directed, by a Dutch company or companies.[205]

Respondent thus argues that the use of the past participle 'controlled' in Article 1(b)(iii) of the BIT implies the requirement of the exercise of actual or effective control.

229. Indeed, the general definition of "controlled" rather than "control" is supportive of Respondent's argument. The word "controlled" in some instances is defined simply as the past participle of "control" and the reader is referred to the definition of control. But in other instances, "controlled" is defined more specifically as "[r]estrained, managed or kept within bounds,"[206] and "held in check, restrained, dominated."[207] Thus the past participle in some instances carries with it a reference to the actual exercise of restraint.

230. The Tribunal notes that Article 31(4) of the Vienna Convention indicates that a special meaning shall be given to a term if the parties so intended the special meaning. There is no indication in the record that any special meaning for the word "controlled" was intended by these contracting parties. The Tribunal observes, however, that the negotiators of the Netherlands – Bolivia BIT likely possessed a sophisticated knowledge of business and law. For such persons, the ordinary meaning of a word or phrase also includes the legal meanings given to such words or phrases. The Tribunal thus turns to consider the legal meaning of "control" and controlled."

231. The legal definition for the verb "control" provides several meanings for control.[208] The first definition for "control" is "to exercise power or influence over <the judge controlled the proceedings>." The second definition is "to regulate or govern <by law, the budget officer controls expenditures>." The final definition is "to have a controlling interest in <the five shareholders controlled the company>." The first definition of control suggests the actual exercise of control with emphasis on the right to exercise control over an object but does not suggest ownership of the object. The second definition similarly points to a right to control but not ownership of that which is controlled. The third definition of control ties control to ownership interest providing that a "controlling interest" is understood as a "legal share in something ... sufficient ownership of stock in a company to control policy and management; especially a greater-than-50% ownership interest in an enterprise."[209]

---

205 Resp. Rej., at ¶ 92. The only other reference to the significance of adjectival past participle use of "control" was made during the hearing, *see* Transcript (February 10, 2004), p. 422-423.
206 MERRIAM WEBSTER'S INTERNATIONAL DICTIONARY 497 (1993).
207 Oxford English Dictionary III 853 (2nd ed. 1989).
208 BLACK'S LAW DICTIONARY, 353 (8th Ed., 2004).
209 *Id.*, at 828.

232. The legal definitions of "controlled" are particularly instructive as they cut directly against the significance to the adjectival past participle usage suggested by Respondent. The phrase "controlled group (controlled corporate groups)" is defined as "two or more corporations whose stock is substantially held by five or fewer persons.[210] "Controlled corporation (controlled company)" is defined as a "corporation in which the majority of the stock is held by one individual or firm"[211] And "controlled foreign corporation" is defined as "a foreign corporation in which more than 50% of the stock is owned by U.S. citizens who each own 10% or more of the voting stock." All three of these definitions refer solely to the power to control and not its actual exercise.

233. The Tribunal thus concludes that the word "controlled," like the word "control," is not determinative. The adjective "controlled" may indicate that "control" was actually exercised at some point in the past or it may mean that another possessed the capacity to control that company in the past (or indeed at the present moment). On the one hand, "controlled" may mean that an entity was subject to the actual control of another. On the other, "controlled" may mean that an entity was subject to the controlling capacity of another.

234. The Tribunal observes that there is no indication from any of the dictionaries consulted that "control" necessarily entails a degree of active exercise of powers or direction. If the parties had intended this result, a better choice of word for the BIT would have been "managed" rather than "controlled." In addition, although the contracting states would have eliminated uncertainty by utilizing phrasing such as "under direct or indirect control of" or "subject to the direct or indirect control of," rather than "controlled directly or indirectly" by another company, the ambiguous meaning of "controlled" leads the Tribunal to find the difference in phrasing to be not determinative.

235. Respondent argues that in light of the lack of a specific definition for "control" in the BIT, the Tribunal should look to the concept of "control" as it has been used in defining corporate nationality under international law. Bolivia states that there are four traditional tests for determining corporate nationality of an entity. Both the corporate seat test and the incorporating jurisdiction test "focus on objective factors for the purposes of simplicity, and ignore the possibility that the assigned nationality may not reflect the reality of the company's activities."[212] The other two tests focus respectively on control and on predominant interest in the company and, Bolivia argues, states select the "control" test because it is "designed to focus on the reality behind the corporate personality . . . [and is] often used 'to avoid inequitable results.' "[213] There is, however, no indication in the record that the contracting parties had such a particular special meaning for control in mind. Nor should such intent be assumed since the Tribunal finds the contexts of foreign investment protection and the regulation of corporate activity to be sufficiently distinct.[214]

---

210 BLACK'S LAW DICTIONARY, 353 (8th Ed., 2004).
211 *Id.,* at 365.
212 Resp. Counter Mem., p. 57, ¶ 116.
213 Resp. Counter Mem., pp. 57-58, ¶ 118 (citations omitted).
214 It is perilous to transfer meaning from one regulatory framework to another where the motivations underlying the choice of terminology often will be determinative. For example in the taxation area, the Tribunal found the legal definitions which emphasize the capacity to control (see para. 230 of the Decision) to be utilized in the definition of "controlled" corporations in the several taxation statutes. According to the U.S.

236. The word "controlled" is modified by the phrase "directly or indirectly." This phrase clearly indicates that one entity may control another entity in one of two ways. An entity that is *directly controlled* implies that there is no intermediary between the two entities, while an entity that is *indirectly controlled* implies that there is one or more intermediary entities between the two.

237. As stated above, one prong of Respondent's interpretation is that the phrase "controlled directly or indirectly" points to the "ultimate controller." In juxtaposition to Respondent's interpretation, Claimant argues that "[p]ursuant to the BIT test, it is possible for more than one entity to be a controlling entity for the purposes of the BIT."[215] The Tribunal agrees with the Claimant's view. The phrase, "directly or indirectly," in modifying the term "controlled" creates the possibility of there simultaneously being a direct controller and one or more indirect controllers. The BIT does not limit the scope of eligible claimants to only the "ultimate controller."

238. This conclusion, however, does not necessarily exclude the second prong of Respondent's interpretation, namely that any controller, whether it be a direct or indirect controller, must exercise actual control. Claimant in applying this phrase does so with an emphasis on the legal capacity to control that flows from ownership. Thus IW Sa.r.l. is the direct controller of AdT as it is the first entity in the chain of controlling ownership above AdT. IWT B.V. and IWH B.V., as entities above IW S.a.r.l., would both be indirect controllers. Respondent, in contrast, in applying this phrase emphasizes actual control and argues that Bechtel actually controls AdT, and that the legal intermediate entities are not relevant in that they exercise no control over AdT.

239. The Tribunal continues the task of interpretation by considering the other two core elements of the method of interpretation contained in the Vienna Convention: the context in which the phrase "controlled directly or indirectly" is found and the object and purpose of the BIT.

Internal Revenue Service, a "controlled foreign corporation" is "any foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned directly, indirectly, or constructively by U.S. shareholders on any day during the taxable year of such foreign corporation or more than 50% of the total value of the stock is owned directly, indirectly or constructively by U.S. shareholders on any day during the taxable year of the controlled foreign corporation" Internal Revenue Manual, Section 4.61.7.3, at http://www.irs.gov/irm/part4/ch46s07.html. Likewise, Canada in its Corporation Capital Tax Act defines a "subsidiary controlled corporation" as "a corporation of which more than fifty per cent of the issued share capital, with full voting rights under all circumstances, is owned, directly or indirectly, by another corporation." An Act Respecting A Tax on the Capital of Certain Financial Corporations, Revised Statutes 1989, amended 1990, c. 10, s. 2; 1992, c. 15, s. 2; 1993, c. 17; 2004, c. 3, s. 3, available at http://www.gov.ns.ca/legi/legc/statutes/corpct.htm Section 2(z). The motivations in taxation that might suggest such a definition are unknown to the Tribunal, however, and the Tribunal, as stated in the text, declines to drawn inferences in such cases. The Tribunal similarly declines to draw inferences from other definitions of "control" in the U.S. regulatory contexts of its Securities Exchange Act or the American Law Institute Principles of Corporate Governance, as cited by Respondent's Expert Professor Fox.

[215] Cl. Mem., p. 53, ¶ 148.

The Phrase in Its Context and in Light of the Object and Purpose of the BIT

240. It is in the consideration of the context in which the phrase "controlled directly or indirectly" is found, and in light of the object and purpose of the BIT, that the Tribunal finds the basis for the interpretation of the phrase.

241. As to the object and purpose of the BIT, the Tribunal notes that the Preamble to the BIT provides:

> The Government of the Kingdom of the Netherlands and The Government of the Republic of Bolivia,
>
> Desiring to strengthen the traditional ties of friendship between their countries, to extend and intensify the economic relations between them particularly with respect to investments by the nationals of one Contracting Party in the territory of the other Contracting Party.
>
> Recognizing that agreement upon the treatment to be accorded to such investments will stimulate the flow of capital and technology and the economic development of the Contracting Parties and that fair and equitable treatment of investment is desirable[...].[216]

Thus the object and purpose of the treaty is to "stimulate the flow of capital and technology" and the Contracting Parties explicitly recognize that such stimulation will result from "agreement upon the treatment to be accorded to ... investments" by "the national of one Contracting Party in the territory of the other Contracting Party."

242. As to the context in which the phrase "controlled directly or indirectly" is found, the Tribunal notes that Article 1 in defining the concept of "national" not only defines the scope of persons and entities that are to be regarded as the beneficiaries of the substantive rights of the BIT but also defines those persons and entities to whom the offer of arbitration is directed and who thus are potential claimants. Given the context of defining the scope of eligible claimants, the word "controlled" is not intended as an alternative to ownership since control without an ownership interest would define a group of entities not necessarily possessing an interest which could be the subject of a claim. In this sense, "controlled" indicates a quality of the ownership interest.

243. The question therefore is how the term "controlled" in Article 1(b)(iii) is meant to qualify "ownership." Claimant argues that "control" is a capacity that the ownership interest possesses. If one entity owns 100% of another entity, then the first entity, in Claimant's view, possesses the capacity to control the other entity and that entity is a "controlled' entity. For the Claimant, the word "control," rather than simply "ownership," is employed in the BIT to address the situation where a minority shareholder through, for example, voting rights possesses the capacity to control the other entity. Respondent argues that "control" is a capacity that the ownership interest must exercise. Moreover, Respondent appears to argue that that exercise of control must be done by the owning entity itself.[217]

---

[216] It is widely accepted that the preamble language of a treaty can be particularly helpful in ascertaining the motive, object and circumstances of a treaty. Dolzer and Stevens note in their book on BITs that even though preambles rarely contain binding obligations, they may serve as "useful aids to interpretation of the treaty." RUDOLF DOLZER AND MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES, 20 (1995).

[217] *See e.g.* Oral Statement Counsel for Bolivia, Dana Contratto, (February 9, 2004), pp. 422-423, Lines 17-21.

244. The Tribunal does not find Respondent's view to be persuasive for three reasons.

245. First, Claimant's view that "control" is a quality that accompanies ownership finds support generally in the law. An entity that owns 100% of the shares of another entity necessarily possesses the power to control the second entity. The first entity may decline to exercise its control, but that is its choice. Moreover, the first entity may be held responsible under various corporate law doctrines for the actions of its subsidiary, whether or not it actually exercised control over that subsidiary's actions. Respondent contends that IWT B.V. and IWH B.V. are mere "shells" which cannot even decline to exercise its possible control. Holding companies (if that is all IWT B.V. and IWH B.V. are in this case) owning substantial assets (here the rights under the Concession) are, however, both a common and legal device for corporate organization and face the same legal obligations of corporations generally.[218] The Tribunal acknowledges that the corporate form may be abused and that form may be set aside for fraud or on other grounds. As outlined in paragraph 331, *infra*, the Tribunal finds no such extraordinary grounds to be present on the evidence.

246. Second, Respondent's argument that "control" can be satisfied by only a certain level of actual control has not been defined by the Respondent with sufficient particularity. Rather, the concept is sufficiently vague as to be unmanageable. Respondent asserts that the phrase "controlled directly or indirectly" referred to the "ultimate controller" provides a defined standard, but as stated in paragraph 237, the Tribunal rejects this interpretation as inconsistent with the language "directly or indirectly." Once one admits of the possibility of several controllers, then the definition of what constitutes sufficient "actual" control for any particular controller, particularly when an entity may delegate such actual control, becomes problematic. This becomes apparent with Respondent's difficulty in offering the Tribunal the details of its "actual" control test. In response to a question of the Tribunal as to the details of an actual control test, counsel for Respondent stated that "[c]ontrol is not a – a objective – there is not an objective bright –line test for control in a corporate organization control sense. You have to know details."[219] Indeed, Respondent's argument that "control" can be satisfied by only a certain level of actual control by one entity over another entity ignores the reality that such exercise of control may be delegated to a subsidiary or even to an independent subcontractor.[220] Moreover, the many dimensions of actual control of a

[218] The Tribunal agrees with the *Aucoven* tribunal which, although working in the different context of Article 25 of the ICSDI Convention, when faced with a similar argument concerning the substance of the entity said to "control" the claimant in that dispute, wrote: "Although [respondent] views [the corporation said to control the claimant] as a mere formality, this formality is the fundamental building block of the global economy. *Autopista Concesionada de Venezuela CA v. Bolivarian Republic of Venezuela* (hereinafter referred to as *"Aucoven"*), in its Decision on Jurisdiction of September 27, 2001 at ¶ 67, *reprinted at* 16 ICSID Rev.—FILJ 469 (2001), 6 ICSID 419 (2004).

[219] Oral Statement by Respondent's Counsel, Dana Contratto, (February 11, 2004), p.595, Lines 9-12; Reasoning similar to that of Tribunal can be found in *Aucoven, supra* note 217, where the tribunal stated:

> 69. The thicket into which Venezuela would lead the Arbitral Tribunal is precisely what the drafters of the ICSID Convention decided to avoid. Finding the "ultimate", or "effective", or "true" controller would often involve difficult and protracted factual investigations, without any assurance as to the result.

[220] The Tribunal is aware that the Respondent in particular asserts that IWT B.V. and IWH B.V. are in its view mere shells that do not oversee the operations of Claimant at all. For that limiting case, there could be an administrable factual test of managerial control. However, the vagueness of Respondent's factual inquiry would

corporate entity range from day to day operations up to strategic decision-making. Would the minutes of one Board of Directors meeting delegating to a consulting firm the management of a majority owned company be evidence of actual control of that company? Would the minutes of one Board of Directors meeting delegating to a parent or subsidiary company management of a majority owned company be evidence of actual control of the company? Would the day to day direction by one company of the operations of a majority owned company not be sufficient evidence of actual control if a parent company dictated which business opportunities would be taken up by the majority owned company and which would not? The difficulty in articulating a test in the Tribunal's view reflects not only the fact that the Respondent did not provide such a test, but also the possibility that it is not practicable to do so and that, as discussed in the next paragraph, the resultant uncertainty would directly frustrate the object and purpose of the BIT.

247. Third, the uncertainty inherent in Respondent's call for a test based on an uncertain level of actual control would not be consistent with the object and purpose of the BIT. The BIT is intended to stimulate investment by the provision of an agreement on how investments will be treated, that treatment including the possibility of arbitration before ICSID. If an investor can not ascertain whether their ownership of a locally incorporated vehicle for the investment will qualify for protection, then the effort of the BIT to stimulate investment will be frustrated.

248. Before reaching a conclusion as to the interpretation of the phrase "controlled directly or indirectly" under Article 31 of the Vienna Convention, the Tribunal turns to a unique aspect of this proceeding, namely its consideration of the relevance of several statements of the Netherlands, the non-disputing State party to the BIT.

Article 31(3) of the Vienna Convention and the Significance to be Accorded to Statements of the Dutch Government

249. Respondent places great emphasis upon various statements of the Government of the Netherlands made in 2002. Respondent argues these statements support Respondent's interpretation of the BIT. Moreover, Respondent argues that the statements of the Dutch Government result in the unprecedented situation where both State Parties to the BIT agree that the Tribunal does not possess jurisdiction over the dispute before it: "This is the only ICSID case that we know of in which both state parties to the Treaty that's being invoked by the Claimant are on record as saying that that Treaty does not apply to this case."[221]

250. The Tribunal observes that Article 31(3) of the Vienna Convention provides that "[t]here shall be taken into account, together with the context: (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its

---

apply to all assertions that one entity controls another entity. The BIT does not suggest that there be one test for "shells" and another for all situations other than shells. More importantly, the pejorative use of the poorly defined word "shell" points to hypothetical situations more appropriately addressed by doctrines created to address the fraudulent or abusive use of corporate form, and, as found by the Tribunal at paragraph 331, *infra*, neither of these situations is apparent in this case.

[221] Oral statement of Bolivia's Counsel, Alexandre de Gramont, (February 9, 2004), p.121, Lines 16-20.

provisions; (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation [. . .]."

251. The position taken by Bolivia in this proceeding and the statements made by Ministries of the Government of the Netherlands to the Parliament of the Netherlands, despite the fact that they both relate to the present dispute, are not a "subsequent agreement between the parties." The coincidence of several statements does not make them a joint statement. And, it is clear that in the present case, there was no intent that these statements be regarded as an agreement. The Tribunal therefore examines whether the Bolivian position in these proceedings and the internal statements of Ministries of the government of the Netherlands constitute "subsequent practice . . . which establishes the agreement of the parties" regarding the interpretation of the BIT.

252. The Dutch statements were made a part of these proceedings via the expert opinion of Professor Nico Schrijver, submitted by Claimant. According to Professor Schrijver, it is the custom in the Netherlands that a Member of Parliament may submit a question in writing to a Ministry of the Government of the Netherlands. That Ministry will take the lead in preparing a written reply, and that process may involve consultation by that Ministry with other Ministries. Professor Schrijver's opinion drew the attention of Respondent and the Tribunal to three parliamentary questions and replies made between February 21, 2002 and June 5, 2002. It is the third question and reply that is argued by the Respondent to be potentially relevant.[222] The last exchange must be approached, however, in light of the first two exchanges.

253. The first exchange was initiated on February 21, 2002, when Dutch MP Van Bommel posed several written questions to the State Secretary for Economic Affairs and the Minister for Development Cooperation concerning, *inter alia*, whether certain corporations could invoke the Dutch-Bolivian BIT in the specific dispute addressed by this Tribunal.[223] On behalf of the Minister for Development Cooperation and his Ministry, the State Secretary for Economic Affairs (Minister Ybema) replied on March 6, 2002. He declined to state whether the current dispute fell under the BIT, stating instead, *inter alia,* that the answer is up to the "discretion of the arbitration tribunal to which a dispute has been submitted."[224]

254. The second exchange was initiated on March 25, 2002, when MP Van Bommel submitted further written questions, requesting that the State Secretary and Minister "state clearly and unambiguously whether these multinationals can invoke the Dutch-Bolivian investment treaty in this case."[225] The State Secretary replied on April 6, 2002, and referred the MP to his March 6, 2002 reply to the earlier questions from MP Van Bommel, and otherwise only making comments of a general nature.

255. The third and final exchange was initiated on April 18, 2002, when a five member group of Dutch MPs, including MP Van Bommel, submitted further questions to the

[222] Resp. Counter Mem., pp. 27-28, ¶¶ 49-51.
[223] Parliamentary questions ("Kamervragen"), Parliamentary year 2001-2002, no. 765.
[224] *Id.,* answer 6.
[225] Parliamentary questions ("Kamervragen"), Parliamentary year 2001-2002, no. 959.

Minister of Housing, Spatial Planning and Environment, the Minister for Development Cooperation and the State Secretary for Economic Affairs.[226] The MPs asked:

> Are you familiar with the publication 'Water, Human Right or Merchandise' of the association Milieudefensie ('Friends of the Earth')? What is your general opinion on this publication?[227]

On behalf of himself and the State Secretary, the Minister for Housing, Spatial Planning and Environment (Minister Pronk) replied on June 5, 2002:

> Yes. Access to safe and clean water is important. The publication brings a number of aspects of the complicated water issue to the attention of a larger public. The topic deserves this attention. However, the formulation in this pamphlet is sometimes factually incorrect or suggestive. One particular point I would like to mention with emphasis. On p. 16 (Water war in Bolivia) it is stated that Aguas del Tunari can resort to the dispute settlement commission of the World Bank under the Dutch-Bolivian Investment Treaty. This is incorrect. As recently stated in response to questions of MP Van Bommel [citing to the previous replies to Van Bommel], the Government is of the view that the investment treaty is not applicable to this particular case.[228]

256. Claimant, through Professor Schrijver's testimony, states that there "appears to be some confusion as to the facts."[229] Professor Schrijver's view is that the third reply applies "the incorrect facts to the correct legal assessment given in the Government's earlier replies."[230]

257. The third reply from The Netherlands government is inconsistent with the first two replies and appears to refer incorrectly to the latter. As a result, little can be concluded from the three written replies of The Netherlands government. Nonetheless, noting, the great weight placed on these replies by the Respondent, the Tribunal decided that further limited information as to the basis for the written replies of The Netherlands could assist the Tribunal in its work.

258. As noted in paragraph 47, the Tribunal in a letter dated October 1, 2004, wrote to the Legal Advisor of the Foreign Ministry of the Netherlands posing several specific questions. Given that this letter is the first inquiry of a non-disputing state party to a BIT, the entire text of the letter is attached to this decision as Appendix III. The Tribunal emphasizes three aspects of this letter of inquiry, however. First, the Tribunal wrote that:

> The Tribunal recognizes the obligation of the Netherlands under [Article 27 of] the ICSID Convention to not provide diplomatic protection to its nationals in the case of investment disputes covered by the Convention. In this sense, the Tribunal wishes to emphasize that it does not seek the view of the Netherlands as to the Tribunal's jurisdiction in this matter, rather it seeks only to secure the comments of the Netherlands as to specific documentary bases for written responses which the Dutch government provided to parliamentary questions.

---

[226] Parliamentary questions ("Kamervragen"), Parliamentary year 2001-2002, no. 1229.
[227] *Id.*, question 1.
[228] *Id.*, answer 1.
[229] Cl. Mem., Ex. 46, Expert Opinion of Professor Schrijver, p. 18, ¶ 40.
[230] *Id.*

Second, the Tribunal stated:

> The ICSID Convention entrusts the Tribunal with deciding upon its jurisdiction in this matter. The parties to this arbitration have put in issue provisions of the BIT between the Netherlands and Bolivia. Given that the Government of the Netherlands is not a party or otherwise present in this arbitration, the Tribunal concludes that information from the Government of the Netherlands would assist the work of the Tribunal. Given further the above quoted Article 27 of the ICSID Convention and the fact that the Netherlands is not a party to this arbitration, the Tribunal is also of the view that such questions must be specific and narrowly tailored, aimed at obtaining information supporting interpretative positions of general application rather than ones related to a specific case. It is the opinion of the Tribunal that it possesses the authority to seek this information under Rule 34 of the ICSID Arbitration Rules.

Third, the Tribunal asked:

> With all of these considerations in mind, the Tribunal notes that the written responses to parliamentary questions, summarized [in the letter] and attached in full, do not in and of themselves provide reasons of general application. If the Government's statement replying to the Parliamentary questions of 18 April 2002 reflects an interpretative position of general application held by the Government of the Netherlands, the Tribunal requests that the Government provide the Tribunal with information (of the type suggested by Articles 31 and 32 of the Vienna Convention on the Law of Treaties as being possibly relevant) upon which that general interpretative position is based.

259. As stated in paragraph 49, the Tribunal received on December 14, 2004, a reply letter from Mr. Lammers dated October 29, 2004, to which there was attached a document entitled "Interpretation of the Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Republic of Bolivia, signed on 19 March 1992 and entered into force on first November 1994."

260. The Tribunal first observes that the document attached to Mr. Lammers' letter contained only comments of a general nature that possibly may be relevant to the task of confirming an interpretation under Article 32 ("supplementary means of interpretation") of the Vienna Convention on the Law of Treaties. It does not provide the Tribunal, however, with any information of the type suggested by Article 31 of the Vienna Convention on the Law of Treaties as being possibly relevant and upon which a general interpretative position may be based. The Tribunal has made no use of this document in arriving at its decision.

261. Second, the Tribunal observes that Mr. Lammers in his reply cover letter states that the answers given by the Dutch government to this series of parliamentary questions were based on information from the press which at the time that the answers were given "may not necessarily have been correct."[231]

262. Given these first two observations, the Tribunal can find no "subsequent practice ... which establishes an agreement of the parties" regarding the interpretation of the BIT. In addition, the response from the Netherlands provides no additional information of the type suggested by Article 31 of the Vienna Convention on the Law of Treaties as being possibly relevant and upon which a general interpretative position might be based.

---

[231] See October 29, 2004 Letter from Johan Lammers, Legal Adviser, Ministerie van Buietenlanse Zaken to David Caron, President of Tribunal.

263. The Tribunal's third final observation is that it clearly is not presented with, and therefore need not consider, the situation where the two state parties to a BIT both express the position that a tribunal lacks jurisdiction over a particular dispute before a tribunal. The inconsistency between the first and second replies of The Netherlands government, on the one hand, and its third reply, on the other hand, and the apparent incorrect reference in the latter to the first two replies does not, in the Tribunal's view, express with any clarity the position that the BIT does not apply in this case.[232] Further, and in any event, the Tribunal emphasizes, however, its firm view that it is the Tribunal, and not the contracting parties, that is the arbiter of its jurisdiction.

Conclusion as to the Meaning of "controlled directly or indirectly"

264. The Tribunal, by majority, concludes that the phrase "controlled directly or indirectly" means that one entity may be said to control another entity (either directly, that is without an intermediary entity, or indirectly) if that entity possesses the legal capacity to control the other entity. Subject to evidence of particular restrictions on the exercise of voting rights, such legal capacity is to be ascertained with reference to the percentage of shares held. In the case of a minority shareholder, the legal capacity to control an entity may exist by reason of the percentage of shares held, legal rights conveyed in instruments or agreements such as the articles of incorporation or shareholders' agreements, or a combination of these. In the Tribunal's view, the BIT does not require actual day-to-day or ultimate control as part of the "controlled directly or indirectly" requirement contained in Article 1(b)(iii). The Tribunal observes that it is not charged with determining all forms which control might take. It is the Tribunal's conclusion, by majority, that, in the circumstances of this case, where an entity has both majority shareholdings and ownership of a majority of the voting rights, control as embodied in the operative phrase "controlled directly or indirectly" exists.

265. The Declaration of José Luis Alberro-Semerena dissents to the Tribunal's decision as to the interpretation given to the phrase "controlled directly or indirectly." The difference between the majority and the dissent as to Respondent's request for production for documents follows directly from their difference in the interpretation of that phrase.

Confirming the Interpretation of "controlled directly or indirectly"

266. The Tribunal turns to an Article 32 analysis to confirm its interpretation of the phrase "controlled directly or indirectly." In doing so, the Tribunal looks to:

a. The Negotiating History of the BIT
b. The Jurisprudence regarding Article 25(2) of the ICSID Convention
c. The Holdings of Other Arbitral Awards Concerning "Control"
d. The BIT Practice Generally of Both Nations

[232] The majority of the Tribunal accepts that the first two replies by the Dutch government properly reflect its view or intention which is consistent with our view that the Tribunal must be the arbiter of its jurisdiction. It is for an arbitral tribunal to determine in specific factual circumstances whether an investor falls within the scope of a bilateral investment treaty.

267. The Tribunal is aware that the Respondent raises many of these same sources either to confirm its interpretation of the phrase "controlled directly or indirectly" or because it views the interpretation offered by the Claimant to be "manifestly absurd or unreasonable."

The Negotiating History of the BIT

268. In Order No. 1, the Tribunal requested "that both Parties submit such evidence as is available as to the interpretation and practice that the Kingdom of The Netherlands and the Republic of Bolivia have placed on the relevant portions of the Bilateral Investment Treaty."

269. The Claimant presented evidence in the form of an expert report and expert testimony from Dr. Nico Shrijver, Professor of Public International Law at the Free University in Amsterdam and a member of the Netherland's Ministry of Foreign Affairs Advisory Committee on International Law Affairs. The Respondent presented evidence in the form of oral argument. Despite such efforts, the Tribunal has before it little evidence of the negotiating history of the BIT.

270. The BIT was signed by the Netherlands and Bolivia on March 10, 1992 and went into force on November 1, 1994.[233]

271. The Dutch government submitted an Explanatory Note to its Parliament after the BIT was negotiated indicating that the agreement provides for:

> [G]uarantees...with respect to expropriation of an investment and possible disputes can be submitted to neutral international arbitration.[234]

272. The Dutch government in its Explanatory Note makes only brief comments focusing particularly on two of the differences in the text from the Model Netherlands BIT. First, Article 1 changed the expression "win natural resources" to "exploit natural resources." Second, Article 9 noted that Bolivia was not yet a party to ICSID so that references were added in Article 9 providing for *ad hoc* arbitration.

273. In oral argument, the Respondent summarized its understanding of the treaty as permitting "Bolivian entities controlled by Dutch nationals to seek the jurisdiction of ICSID."[235]

274. This sparse negotiating history thus offers little additional insight into the meaning of the aspects of the BIT at issue, neither particularly confirming nor contradicting the Tribunal's interpretation.

---

[233] List of agreements relating to the promotion and reciprocal protection of investments of the Kingdom of the Netherlands in Expert Opinion-Dutch Practice, Professor. Nico J. Schrijver, p. 22. (Ex. B to Cl. Mem.)
[234] *Id.*, at ¶ 24, footnote 18.
[235] Oral Statement by Respondent's Counsel, Alexandre de Gramont, (February 10, 2004), p. 124, Lines 15-17.

The Jurisprudence Regarding Article 25(2) of the ICSID Convention

275. The jurisdictional aspect of the ICSID Convention relevant to the present proceeding is Article 25(2)(b). It provides in relevant part:

> (2) "National of another Contracting State" means:
>
> ....
>
> (b) any juridical person . . . which, *because of foreign control*, the parties have agreed should be treated as a national of another Contracting State for purposes of this Convention. (*Emphasis added.*)

276. The parties both make reference to various tribunal awards, scholarly commentary, and the drafting history regarding the use of the word "foreign control" in the ICSID Convention at Article 25(2)(b) in order to illuminate the meaning of "controlled directly or indirectly " in the BIT.

277. Understanding how the ICSID Convention is relevant to an arbitration initiated under a BIT, illuminates why the interpretation of the term control in Article 25(2)(b) may or may not bear on the interpretation of the term "controlled" in the BIT.

278. The Netherlands-Bolivia BIT contains an offer by Bolivia and by the Netherlands to defined nationals of the other party to arbitrate specified disputes before ICSID. A claimant accepts this offer through its filing of a request for arbitration. This Tribunal is established pursuant to the ICSID Convention and its jurisdiction is limited by the ICSID Convention, as defined in Article 25. This Tribunal must therefore evaluate whether the dispute presented to it under the BIT passes through the jurisdictional keyhole defined by Article 25 of the ICSID Convention.[236] The state parties to the BIT can seek to encompass all manner of disputes. But in attempting to place disputes under their BIT before ICSID, an institution regulated by a separate instrument, the scope of the disputes which may be submitted is necessarily limited to those disputes that pass through the jurisdictional keyhole defined by Article 25.[237]

279. The image of Article 25 of the ICSID Convention as a jurisdictional keyhole makes clear that the jurisprudence concerning the phrase "foreign control" in Article 25(2)(b) is of quite limited relevance to the interpretation of the BIT.

280. Article 1(b)(iii) is an agreement of Bolivia and the Netherlands to treat a judicial person of one of them as a national of the other if that judicial person is "controlled directly

---

[236] Report of the Executive Directors on the ICSID Convention, March 18, 1965. Paragraph 25 states:

> While consent of the parties is an essential prerequisite for the jurisdiction of the Centre, *consent alone will not suffice to bring a dispute within its jurisdiction.* In keeping with the purpose of the Convention, the jurisdiction of the Centre is further limited by reference to the nature of the dispute and the parties thereto. (Emphasis added).

[237] In *Vacuum Salt Products Ltd. v. Republic of Ghana*, Award of February 16, 1994, 9 ICSID REV. - FILJ (1994), 4 ICSID REP. 329 (1997), the tribunal noted that "[t]he reference in Article 25(2)(b) to 'foreign control' necessarily sets an *objective* Convention limit beyond which ICSID jurisdiction cannot exist and parties therefore lack power to invoke same no matter how devoutly they may have desired to do so." *Id.,* at ¶ 36 (emphasis added). Yet, although there is an objective limit, a Tribunal must also remain flexible so as to accommodate the agreement of the parties as to the definition of "foreign control."

or indirectly" by nationals of the other. The question is whether this definition of control in the BIT is such that disputes under the BIT pass through the jurisdictional keyhole of Article 25. In this light, it is not at all surprising that the drafting history, commentary and arbitral awards concerning that phrase "foreign control" in Article 25 all point to "foreign control" being "flexible" so that reasonable definitions in referring instruments may pass through the jurisdictional keyhole.

281. Thus Professor Schreuer notes that national and treaty-based definitions should be deferred to, so long as they are reasonable:

> Definitions of corporate nationality in national legislation or in treaties providing for ICSID's jurisdiction will be controlling for the determination of whether the nationality requirements of Art. 25(2)(b) have been met. They are part of the legal framework for the host State's submission to the Centre. Upon acceptance in writing by the investor, they become part of the agreement on consent between the parties. Therefore, any *reasonable determination* of the nationality of juridical persons contained in national legislation or in a treaty should be accepted by an ICSID commission or tribunal.[238]

282. Respondent appears to argue that "the definition of 'control' under the Bilateral Investment Treaty would be coextensive with the definition under the ICSID Convention with an emphasis on control as an "objective element that must be determined by the Tribunal."[239] Claimant argues that Article 25(2)(b) and the definition of control in the BIT are not co-extensive and that parties had the flexibility and "latitude to define 'control' in the BIT for the purpose of Article 25(2(b) of the ICSID Convention" as long as the agreement was reasonable.[240]

283. The drafting history of Article 25 as well as arbitral awards and scholarly commentary indicate, however, that the drafters intended a flexible definition of control in Article 25 not because they regarded "control" as requiring a wide ranging inquiry, but rather – recognizing the keyhole function that would be played by Article 25 -- to accommodate a wide range of agreements between parties as to the meaning of "foreign control."

284. Aron Broches, chairman of the consultative meetings for the negotiation of the ICSID Convention and General Counsel of the World Bank and subsequently ICSID's first Secretary-General, writes that during the drafting the attempt to provide an exacting definition of foreign control was "abandoned" and that instead it was decided that "an attempt should be made . . . to give the greatest possible latitude to the parties to decide under what circumstances a company could be treated as a 'national of another Contracting State'."[241]

---

[238] Schreuer, para. 481, p. 286 (emphasis added) (internal citations omitted).

[239] Resp Counter Mem., p. 55, ¶¶ 113-114.

[240] Cl. Mem., p. 18, ¶ 57.; Cl. Rej., p. 37, ¶ 105; Oral Statement of AdT's Counsel, Robert Volterra (February 10, 2004), p. 281, Lines 13-17.

[241] Aron Broches, *The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States*, 136 RECUEIL DES COURS 331, 360 (1972-II). ; *See also Aucoven*, *supra* note 217:

> 96. ... [C]onsent in and of itself is not sufficient to ensure access to the Centre. Indeed, Article 25 of the ICSID Convention provides for additional objective requirements which must be met in addition to consent. These objective requirements are the following: . . . In the event that the investor is a corporation registered under the laws of the host State, the parties must agree

285. There is no issue in the Tribunal's view that Article 1 of the BIT under either the Claimant's or Respondent's interpretation would be an agreement as to "foreign control" that satisfies the flexible and deferential requirement of Article 25(2).

286. For the foregoing reasons, the Tribunal does not find the jurisprudence concerning the phrase "foreign control" in Article 25(2)(b) to assist the Tribunal in interpreting Article 1(b)(iii) of the BIT.

The Holdings of Other Arbitral Awards Concerning "Control"

287. Both AdT and Bolivia direct the Tribunal's attention to various ICSID decisions and awards for the criteria looked to by tribunals in order to determine "control."

288. The Tribunal finds that many of the awards cited do not bear on the issue presented in this arbitration because the facts of those cases involved a minority shareholder rather than a majority shareholder. In particular, although it is the case that the tribunals in some of these cases had the issue of control before them and considered to some degree evidence of actual control, it is unclear whether that evidence was considered because the tribunal regarded the exercise of power or direction as the test of control or whether such actual control was looked to as evidence of the existence of the capacity of a minority shareholder to exercise control. The Tribunal likewise notes that it appears that the claimants in these cases submitted such evidence of actual control; although it is again unclear whether they did so because they believed the exercise of power or direction was the test of control or that such exercise would evidence their capacity as a minority shareholder to control the corporation. The Tribunal thus finds the fact that the claimants in these various awards were minority shareholders to be a crucial difference. The tribunals in these various cases did not need to distinguish, as this Tribunal does, between the capacity to control and the exercise of control. Without access to the full records of these cases, the Tribunal does not believe it possible to assess their significance for the present arbitration.

The BIT Practice Generally of Both Nations

289. In Order No. 1, the Tribunal requested "that both Parties submit such evidence as is available as to the interpretation and practice that the Kingdom of The Netherlands and the Republic of Bolivia have placed on the relevant portions of the Bilateral Investment Treaty, on other Bilateral Investment Treaties they have concluded, and on relevant aspects of cognate practices, such as, for example, diplomatic espousal."

> to treat the locally incorporated company, because of "foreign control", as a "national" of another Contracting State for the purpose of the Convention.
>
> 97. The Convention does not contain any definition of these objective requirements. The drafters of the Convention deliberately chose not to define the terms . . . "foreign control". .... [T]hey preferred giving the parties the greatest latitude to define these terms themselves, provided that the criteria agreed upon by the parties are reasonable and not totally inconsistent with the purposes of the Convention.

Aucoven, at ¶¶ 96-97 (citations omitted).

290. Both the Netherlands and Bolivia have entered into BITs with other states. The Parties submitted many of these treaties to the Tribunal and made oral arguments as to the possible significance of these agreements for the interpretive question posed in this case. Among other things, the Parties submitted two volumes containing, in addition to the Bolivia-Netherlands BIT, seven BITs concluded by Bolivia and twenty-nine BITs concluded by the Netherlands. These BITs are not inclusive of all BITs concluded by the parties. The Tribunal indicated during the February 2004 hearing that it was sufficient for the parties to submit only "specifically referred to" BITs.[242]

291. The practice of a state as regards the conclusion of BITs other than the particular BIT involved in a dispute is not of direct value to the task of interpretation under Article 31 of the Vienna Convention. The fact that a pattern might exist in the content of the BITs entered into by a particular state does not mean that a specific BIT by that state should be understood as necessarily conforming to that pattern rather than constituting an exception to that pattern.

292. The practice of a state as regards the negotiation of BITs may be helpful, however, in testing the assertions of parties as to the general policies of either Bolivia or the Netherlands concerning BITs, and in testing assumptions a tribunal may make regarding BITs.

293. Most relevant to an assessment of state practice possibly bearing on the 1992 Bolivia-Netherlands BIT are those BITs which were negotiated contemporaneously in the early 1990s.

Netherlands Practice

294. According to one Dutch government source, the Netherlands pursued negotiating BITs with other nations as a means:

> To create a framework of rules concerning the treatment of investments which can be invoked directly by investors. By making arrangements in the form of a treaty, investors are offered the security that, during the term of the treaty, investments on the territory of the other country will be protected . . . A treaty cannot be changed unilaterally by one of the parties. By contrast, laws can be amended any moment by one of the parties.[243]

Another Dutch governmental statement describes BITs as providing guarantees that foreign investment disputes including "with respect to expropriation" could be "submitted to neutral international arbitration."[244]

295. Between 1991 and 1994 (the period most relevant to the instant case), in addition to the BIT concluded with Bolivia, the Netherlands entered into BITs with primarily developing or transitional nations including Albania, Argentina, Bangladesh, Cape Verde, the

---

[242] Statement from Arbitrator Alvarez, (February 11, 2004), p 548, Lines 14-17.

[243] "Investeringsbeschermingsovereenkomst" (Note on Investment Protection Agreement), Netherlands Ministry of Economic Affairs at www.minez.nl quoted and translated in Expert Opinion-Dutch Practice, Professor Nico J. Schrijver, para. 10. (Ex. B to Cl. Mem.)

[244] Dutch Explanatory Note in Expert Opinion-Dutch Practice, Professor Nico J. Schrijver, ¶ 24, footnote 18.

Czech and Slovak Federal Republics, Estonia, Hong Kong, Indonesia, Jamaica, Latvia, Nigeria, Paraguay, Peru, Poland, Romania, Ukraine, Venezuela, and Vietnam. The Tribunal does not have copies of the Dutch BITs with Cape Verde, Hong Kong, Indonesia, Paraguay, or Vietnam. However, the remaining thirteen BITs and the Model Netherlands BIT drafted in 1993 provide some basis for examining the practice of the Netherlands.

296. The Tribunal observes that many, but not all, of the BITs concluded by the Netherlands between 1991 and 1994 follow the language and structure of the Model Netherlands BIT.[245] Almost every BIT, for example, uses the title and preamble language of the Model BIT.[246] Of particular relevance to this proceeding, the Model Netherlands BIT defines "nationals" in the following terms:

> (b) the term "nationals" shall comprise with regard to either Contracting Party:
> (i) natural persons having the nationality of that Contracting Party
> (ii) legal persons constituted under the law of the Contracting Party
> (iii) legal persons not constituted under the law of that Contracting Party but controlled, directly or indirectly, by natural persons as defined in (i) or by legal persons as defined in (ii) above,[247]

The Tribunal notes that the language of clause (b)(iii) is broader in geographic scope than the parallel clause in the BIT between the Netherlands and Bolivia. In the Model BIT, the definition of national includes not only entities in the host state controlled by nationals of the other state, but entities wherever located and so controlled.

297. Five of the thirteen contemporaneous BITs reviewed by the Tribunal use the exact language from the Model Netherlands BIT in defining "nationals."[248] An additional four of the thirteen BITs negotiated between 1991 and 1994 emphasize a broad geographic inclusivity and application of the BITs.[249] These BITs do not use the Model BIT's language but instead substitute the equally far-reaching phrase "wherever located" for "not constituted under the law of Contracting Party."[250] A BIT concluded with the Ukraine in 1994 uses the same language as the Model BIT but drops the reference to "directly or indirectly." Ten of the BITs thus employ the broad Model BIT definition of "nationals."

---

[245] The Model BIT provides that investment interests are to be given "fair and equitable treatment" (Netherlands Model Agreement, Article 3) and protected from direct or indirect takings (Netherlands Model Agreement, Article 6). In addition, "any legal dispute arising between that Contracting Party and a national of the other Contracting Party concerning an investment of that national in the territory of the former Contracting Party" can be submitted to ICSID for settlement by "conciliation or arbitration." Netherlands Model Agreement, Article 9.

[246] The Model Netherlands BIT is titled an "agreement on encouragement and reciprocal investment of investments" and includes a preamble establishing the mutual interest of the parties "to extend and intensify the economic relations between them particularly with respect to investments by the nationals of one Contracting Party in the territory of the other Contracting Party" and to ensure "fair and equitable treatment of investment." The BITs with Jamaica and Poland do not include language in the preamble on the "fair and equitable treatment of investment."

[247] Netherlands Model Agreement, Article 1 (b)

[248] Netherlands-Albania BIT (1994), Netherlands-Estonia BIT (1992), Netherlands-Latvia BIT (1994), Netherlands-Nigeria (1992), and Netherlands-Venezuela BIT (1991).

[249] Netherlands-Bangladesh BIT (1994), Netherlands-Jamaica BIT (1991), Netherlands-Peru BIT (1994), and Netherlands-Poland BIT (1992).

[250] Jamaica does not use the expression "legal persons" but instead refers to "corporations, firms or associations."

298. The remaining three BITs differ from the Model BIT in various respects as to the definition of "national." The Tribunal, as stated above, recognizes the need for care in assessing these differences.

299. First, a BIT concluded with Romania in 1994 contains the same language as the Model BIT except that the word "owned" is also included:

> (b)(iii) legal persons owned or controlled, directly or indirectly, by natural persons as defined in (i) or by legal persons as defined in (ii) above.[251]

The Tribunal has no knowledge as to the reason that the State parties included the word "owned." Given the Tribunal's view that the word "controlled" in the context of defining the circle of eligible claimants necessarily is used not as an alternative to "owned" but rather to indicate a quality of ownership, the Tribunal views this provision as meaning "owned [established by majority ownership] or controlled [established by minority ownership plus voting rights]." However, there was no indication of the reason for the inclusion of the word "owned" in this provision and the Tribunal draws no inference from the language of this BIT.

300. Second, the Netherlands-Czech and Slovak Republic BIT concluded in 1991 defines "investors," rather than "nationals," broadly as nationals or legal persons under the laws of either of the Contracting parties:

> (b) the term 'investors' shall comprise
> i. natural persons having the nationality of one of the Contracting Parties in accordance with the law;
> ii. legal persons constituted under the law of one of the Contracting Parties.[252]

At oral argument, the Claimant referred to this BIT and agreed minutes between the Czech Republic and the Netherlands dated October 30, 2001, to illustrate the Dutch policy that changes in BITs, as opposed to clarifications of language in BITs, must be made by amendment.[253] Respondent argued that this practice is not relevant to the interpretation of the Bolivia-Netherlands BIT.[254] The Tribunal agrees with Respondent and does not find this BIT of assistance in understanding the practice of the Netherlands as that practice might bear on the Netherlands – Bolivia BIT.

301. Third, the Netherlands-Argentina BIT concluded in 1992 defines "investor" as including with regard to either Contracting Party as:

> i. natural persons having the nationality of that Contracting Party in accordance with its law;
> ii. without prejudice to the provisions of paragraph (iii) hereafter, legal persons constituted under the law of that Contracting Party and actually doing business under the laws in force

[251] Netherlands-Romania BIT (1994), Article 1.
[252] Netherlands-Czech and Slovak Federal Republic BIT Article 1(b).
[253] Oral Testimony of Claimant's Expert, Professor Schrijwer, (February 10, 2004), p. 315-316, Lines 20-21, 1-5.
[254] Oral Testimony of Respondent's Counsel Dana Contratto, (February 10, 2004), p. 424, Lines 8-13.

> in any part of the territory of that Contracting Party in which a place of effective management is situated.[255]
> iii. legal persons, wherever located, controlled, directly or indirectly by nationals of that Contracting Party.

Section (iii) uses the same language as the BITs concluded with Bangladesh, Jamaica, Peru, and Poland and is, as discussed above, geographically broad in its inclusivity of investors.

302. Unlike the other BITs described above, however, the Tribunal notes that the Netherlands and Argentina entered into an additional Protocol which indicates that the word "control" is to be understood in light of clear objective criteria. The Protocol states:

> With reference to Article 1, paragraph (b)(iii) the Contracting Party in the territory of which the investments are undertaken may require proof of the control invoked by the investors of the other Contracting Party. The following facts, inter alia, shall be accepted as evidence of the control:
>
> i. being an affiliate of a legal person of the other Contracting Party;
> ii. having a direct or indirect participation in the capital of a company higher than 49% or the direct or indirect possession of the necessary votes to obtain a predominant position in assemblies or company organs.[256]

303. The Claimant argues that the more restrictive language of Article 1 of the Protocol to the Netherlands-Argentina BIT was "inserted upon the initiative of Argentina."[257] The Respondent argues that the definition of "controlled" included in the Protocol is intended for the purposes of Argentinean and Dutch investors "to clarify that evidence of control or majority ownership of voting shares can constitute control."[258] The Tribunal observes that the definition of "controlled" provided in the Protocol is an easily administrable one, focusing on readily ascertainable criteria such as share participation and voting rights.

Bolivian Practice

304. Between 1991 and 1994, Bolivia entered into two BITs other than the one it concluded with the Netherlands; one with Peru, another with Argentina.

305. The Peruvian BIT concluded in 1993 defines nationals as including companies which are "controlled, directly or indirectly, by nationals" of a Contracting Party.[259] The

---

[255] Netherlands-Argentina BIT, Article 1(b).
[256] Protocol to Netherlands-Argentina BIT, Section B.
[257] Expert Opinion-Dutch Practice, Professor Nico J. Schrijver, para. 18, Appendix 46 to Cl. Mem.; Oral Statement of Claimant's Expert Professor Schrijver, February 10, 2004, p. 306, Lines 12-18 "[T]hey (restrictive clauses) are always inserted at the insistence of the other states' party because, as you can see, from the Dutch model BIT and from the majority of the Bilateral Investment Treaties concluded by the Netherlands that this is not its own policy line, but of course, also the conclusion of a BIT is a way of give and take."
[258] Oral Statement of Bolivia's Counsel, Dana Contratto, (February 10, 2004), p. 423, Lines 4-8.
[259] Bolivia-Peru BIT, Section 4(b) (unofficial translation by the Tribunal).

Tribunal notes that this BIT signed in 1993 is very similar in substance to the Bolivia-Bolivia-Netherlands BIT.[260]

306. The Bolivia-Argentina BIT signed in 1994 requires that an investor be "effectively controlled" by investors of the other Contracting party.[261] The language of the text reads:

> (2) The term "investor" designates:
>
> a) any natural person who is a national of one of the Contracting Parties, in accordance with its legislation;
>
> b) any juridical person constituted pursuant to the laws and regulations of a Contracting Party and which has its seat in the territory of the said Contracting Party, whether or not its activity is for profit;
>
> c) any juridical person, established pursuant to the laws of any country, which is effectively controlled by investors of the other Contracting Party.[262]

307. The term "effectively controlled" is further defined in a Protocol and is very similar to the language in the Netherlands-Argentina Protocol. Specifically, the Bolivia-Argentina Protocol reads

> II. Addendum, Article 1, Subsection (2), Subparagraph (c)
> Juridical entities referred to in Article 1, Subsection (2), Subparagraph (c), which wish to invoke this Treaty may be requested to present proof of the said control. The following facts, amongst others, shall be accepted as proof:
> (1) Being an affiliate of a juridical entity constituted pursuant to the laws of that Contracting Party.
> (2) Having a direct or indirect participation in the capital of a juridical entity which permits effective control such as, in particular, participation in more than one-half of the share capital.
> (3) The direct or indirect possession of the necessary votes to obtain a predominant position in the company organs or to influence in a decisive manner the functioning of the juridical entity.[263]

---

[260] The language in 4(b) Bolivia-Peru BIT presents an either/or scenario. Nationals include "Companies constituted pursuant to the legislation of that Contracting Party or which are controlled, directly or indirectly, by nationals of the same.".

[261] Bolivia-Argentina BIT, Section 2(c) (unofficial translation by the Tribunal).

[262] The original Spanish text reads:

> (2) El término "inversor" designa
>
> a) toda persona física que sea nacional de una de las Partes Contratantes, de conformidad con su legislación;
> b) toda persona jurídica constituída de conformidad con las leyes y reglamentaciones de una Parte Contratante y que tenga su sede en el territorio de dicha Parte Contratante, independientemente de que su actividad o no fines de lucro;
> c) toda persona jurídica establecida de conformidad con la legislación de cualquier país que esté efectivamente controlada por inversores de la otra Parte Contratante.

[263] The original Spanish text reads:

> II. Adendum Artículo I, apartado (2), inciso c).

308. Respondent argues that "effectively controlled" for the purposes of defining a national is different from "controlled" because it involves a corporate "decision-making structure."[264] The Tribunal does not find this distinction to be reflected in the definition of "controlled" in either the Netherlands-Argentina or the Bolivia-Argentina Protocols.

309. Having reviewed the practice of the Netherlands and Bolivia, the Tribunal observes four points.

310. First, the Dutch Model BIT, although followed often, was not accepted always without modification, as some popular images of bilateral investment treaty negotiations might suggest.

311. Second, the Dutch Model BIT and at least ten of the thirteen Dutch BITs reviewed contain definitions of "nationals" that seemingly are more encompassing than the one found in the Netherlands-Bolivia BIT.

312. Third, the Tribunal observes that the term "controlled" in the Netherlands-Argentina BIT is defined by those two States in an Additional Protocol by exclusive reference to the word "control":

> "With reference to Article 1, paragraph (b)(iii) the Contracting Party in the territory of which the investments are undertaken may require proof of the *control* invoked by the investors of the other Contracting Party. The following facts, inter alia, shall be accepted as evidence of the *control*:" (Emphasis Added).

Likewise, the term "effectively controlled" in the Bolivia-Argentina BIT is defined in a Protocol by exclusive reference to the word "control":

> "Juridical entities referred to in Article 1, Subsection (2), Subparagraph (c), which wish to invoke this Treaty may be requested to present proof of the said *control*." (Emphasis Added).

The Tribunal in paragraph 233 above stated that the usage of the past participle of control is not determinative of the meaning of the phrase "controlled, directly or indirectly." The Tribunal observes that both Bolivia and the Netherlands in other BITs define the proof of an entity being "controlled" by reference to "control," and not, for example, by reference to "proof that the investor was controlled." This practice is consistent with the Tribunal's view that there is no appreciable difference between a company that is "controlled directly

---

> Se podrá solicitar a las entidades jurídicas mencionadas en el Artículo I, apartado (2), inciso c) que quieran prevalerse del presente Convenio que aporten la prueba de dicho control. Se aceptarán como prueba, entre otros, los siguientes hechos:
> (1) El cáracter de filial de una entidad jurídica constituída según la legislación de esa Parte Contratante.
> (2) Un porcentaje de participación directa o indirecta en el capital de una entidad jurídica que permita un control efectivo tal como, en particular, una participación en el capital superior a la mitad.
> (3) La posesión directa o indirecta de la cantidad de votos que permita tener una posición determinante en los órganos societarios o de influir de manera decisiva en el funcionamiento de la entidad jurídica.

[264] Oral Testimony of Respondent's Counsel, Dana Contratto (February 10, 2004), p. 427, Lines 17-20.

or indirectly" by another company and a company that is "under the direct or indirect control of" or "subject to the direct or indirect control of" another company.

313. Fourth, the Tribunal observes that the Protocol to the Netherlands-Argentina BIT in defining "controlled," and the Protocol to Bolivia-Argentina BIT in defining "effectively controlled," both delineate a set of objective factors for determining who is or is not a "national" or "investor". The Tribunal in paragraph 247 above stated that the purpose of stimulating investment is furthered by clear definitions which thereby allow potential investors to ascertain whether they are, or are not, covered by a particular BIT. The Tribunal declines to speculate, as it should, as to why a Protocol was negotiated for the Netherlands-Argentina BIT and the Bolivia-Argentina BIT, but not for the Netherlands-Bolivia BIT. It does note, however, that the Tribunal's assumption that the state parties would seek to set out definitions with clear standards so as to bring about predictability as to the scope of BIT protections does appear to be borne out by the language of the Protocols.

314. The Tribunal concludes that the BIT practice of the Netherlands and Bolivia is necessarily of limited probative value to the task of interpreting the BIT between the Netherlands and Bolivia.

Applying the Interpretation: Is AdT "controlled directly or indirectly" by IWH B.V. or IWT B.V.?

315. It remains for the Tribunal to decide whether AdT is "controlled directly or indirectly" by either IWT B.V. or IWH B.V., as that phrase has been interpreted by the Tribunal.

316. The first tier of ownership above AdT is as follows:

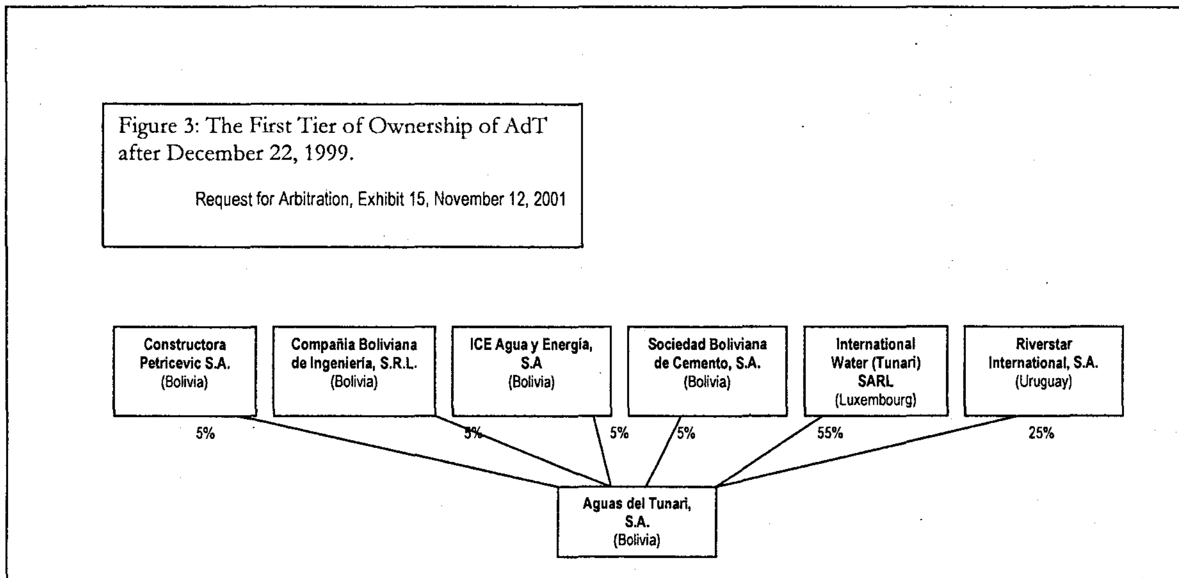


Figure 3: The First Tier of Ownership of AdT after December 22, 1999.

Request for Arbitration, Exhibit 15, November 12, 2001

317. IW S.a.r.l. of Luxembourg owns 55% of the shares of AdT. Article 15 of AdT's Constitution is entitled "Shareholders' Rights" and it provides that "the shares of the same class or series will all be equal in rights and obligations. Each ordinary share authorizes its owner to the right of one vote in the general meeting."[265] The Tribunal notes, as does Respondent, that a 2/3 majority vote of AdT's voting shares is required for the execution of certain corporate acts including (1) adopting the report of the Board of the Directors, (2) authorizing the payment of dividends or other distributions out of company funds, (3) approving plans and budget, and (4) determining what is quorum for a meeting of the AdT's Board of Directors.[266] As indicated, IW S.a.r.l. has ownership interest of 55% in AdT. The Tribunal concludes that this level of ownership does not preclude IW S.a.r.l. from controlling AdT. For all acts other than the specific acts just mentioned, IW S.ar.l. possesses the capacity to affirmatively control AdT. As to the specified acts mentioned, IW S.ar.l. possesses the capacity for an effective veto. The Tribunal concludes that IW S.a.r.l. possesses the legal capacity to control AdT.

318. The upstream ownership of AdT specifically is that set forth in Figure 4:

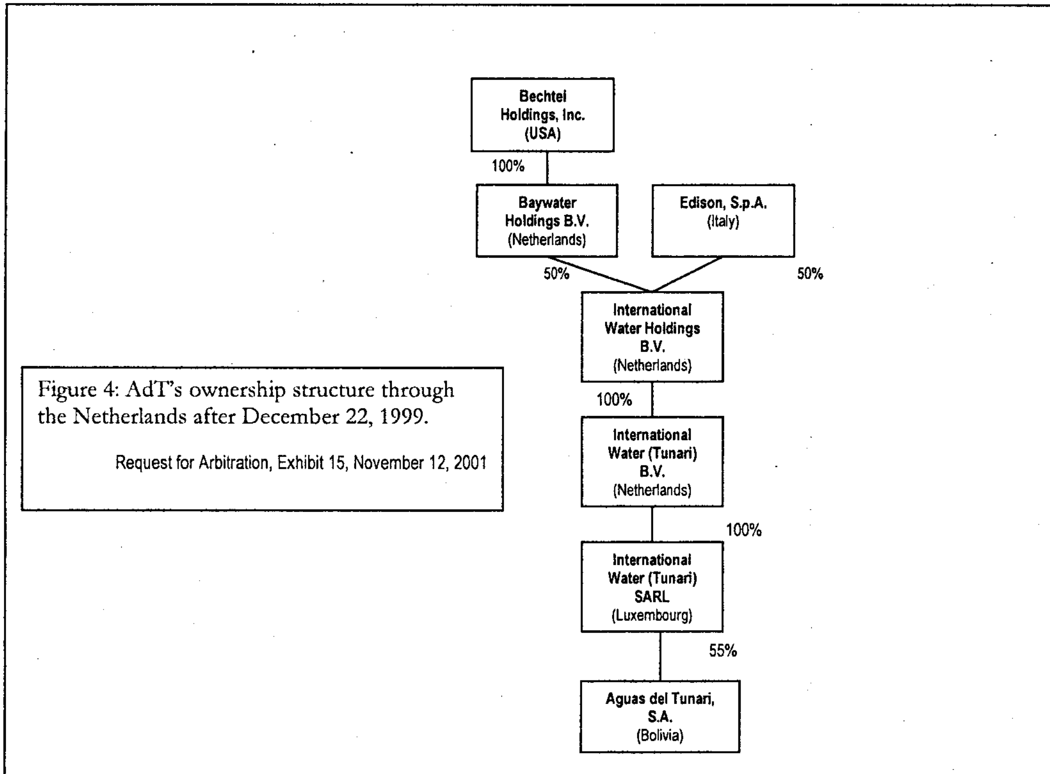


Figure 4: AdT's ownership structure through the Netherlands after December 22, 1999.

Request for Arbitration, Exhibit 15, November 12, 2001

319. IW S.a.r.l. is 100 % owned by IWT B.V., and IWT B.V. is 100 % owned by IWH B.V. Each of these companies held 100% of the voting rights which corresponded to the shares which were transferred from IW S.a.r.l..[267] Given these facts, the Tribunal finds that

[265] Request for Arbitration, Ex. 1.
[266] Request for Arbitration, Ex. 1, AdT Constitution, Article 40 (1)(5)(9)(10).
[267] Request for Arbitration, Ex. 9, Ex. 10, Article 16(7) and Ex. 13, Article 32(2).

both IWT B.V. and IWH B.V. indirectly control AdT satisfying the requirements of Article 1(b)(iii).

320. Given Respondent's allegations that IWT B.V. and IWH B.V. are mere shells, the Tribunal observes that IWH B.V. as a joint venture occupies a special place in the corporate structure above AdT.

321. On the basis of the evidence available, IWH B.V. is not simply a corporate shell set up to obtain ICSID jurisdiction over the present dispute. Rather, IWH B.V. is a joint venture 50% owned by Baywater and 50% owned by Edison S.p.A., an Italian corporation. IWH B.V. is structured so that neither Baywater nor Edison exclusively control IWH B.V., to the exclusion of the other, but rather the two entities must work together in order to direct IWH B.V.[268]

322. The Tribunal finds it noteworthy, from the oral and written submissions of the Parties and a review of the 2000 and 2001 Annual Report for IWH B.V., that in 2000, IWH B.V. had a "portfolio of 8 contracts plus two additions in early 2001"[269], "IWH and its consolidated subsidiaries employed an average of 55 employees", and "IWH generated net turnover of €8.6 million from its principal development and operations services activities."[270]

323. The Tribunal thus concludes that both IWT B.V. and IWH B.V. indirectly controlled AdT in accordance with the Tribunal's interpretation of the phrase "controlled directly or indirectly" found in Article 1(b)(iii) of the BIT.

Respondent's Motion for Production of Evidence

324. As recalled in paragraph 23 *supra,* Bolivia requested that the Tribunal order Claimant to produce evidence of the control of IWT B.V. and IWH B.V. over AdT. Bolivia's request for the production of documents corresponds in scope with its assertion that the requirement that AdT be "controlled directly or indirectly" requires an inquiry into the whether of IWT B.V. and IWH B.V. effectively and actually controlled the affairs of AdT.[271]

325. The Tribunal in Order No. 1 declined to order the production of evidence at that time writing:

---

[268] The articles of incorporation of IWH B.V. indicate an equal sharing of power in the company between Bechtel Enterprises Holding, Inc. and Edison S.p.A. The articles of incorporation are reprinted as Ex. 13 to the Request for Arbitration. Bechtel Enterprises Holding, Inc. and Edison S.p.A. each hold a 50% interest in IWH B.V. Ex. 33 to Resp. Counter Mem., 2000 Annual Report of IWH B.V. at p. 1. Both Bechtel and Edison have an equal number of Managing Directors for IWT B.V. Articles 14 and 19 of the Articles of Incorporation. The duties, and decision making process, for the Board of Managing Directors are set forth in Article 18.

[269] *See e.g.* Annual Report 2000 International Water Holdings B.V., p. 1, (Ex. 33 to Resp. Counter Mem.).

[270] The Tribunal further notes that IW S.ar.l. and IWT BV are listed in the Annual Report as principal subsidiaries to IWH BV over which IWH "directly or indirectly, has power to exercise control." *See e.g.* Annual Report 2000 International Water Holdings B.V., pp. 6-7 (Ex. 33 to Resp Counter Mem.). This particular reference is given limited significance, however, as a statement by a party in interest during the pendency of the dispute.

[271] *See, e.g.,* Resp. Counter Mem., p. 67, ¶ 140.

> It is the view of the Tribunal that neither party's arguments as to the necessity of the various requests for production of evidence are sufficiently developed or clear that the Tribunal may order or deny such production at this time. The argument advanced by Respondent to support its requests for the production of documents requires the Tribunal to undertake consideration of the merits of Respondent's second jurisdictional objection without the benefit of full briefing by the parties or the opportunity of the Tribunal to put questions to the parties during a hearing. A review of Respondent's second jurisdictional objection is required (1) to decide the likely merit of that objection even if the objection were factually supported, and therefore the necessity of ordering of documents in support of the development of that objection, and (2) to ascertain the exact scope of that objection so that appropriate limits might be placed on the requests for documents made by Respondent. Without such an estimation of the likely legal merit of Respondent's objection and without criteria for the narrowing of Respondent's requests for production of evidence, the Tribunal is faced with a factually intense, and consequently expensive and lengthy, factual inquiry that ultimately may not be necessary to the resolution of this case. Therefore, although the Tribunal concludes that it is within its power to undertake such an incidental preliminary review of the merits of the second jurisdictional objection in order to decide upon a request for production of evidence, the Tribunal concludes in its discretion that such a decision by the Tribunal at this point would be premature and that the Tribunal's capacity to decide upon this important request would be enhanced greatly by both briefing and oral argument before the Tribunal.[272]

326. The Tribunal further indicated that it intended to render a decision on Bolivia's request for production of documents as a part of its decision on Respondent's jurisdictional objections.[273].

327. Given the Tribunal's decision concerning Respondent's second objection, the Tribunal finds Respondent's request for the production of evidence to be without object. Respondent's request is therefore denied.

Concluding Observation

328. Aware of the significance of this case for states and various non state groups, the Tribunal observes that Respondent has argued imaginatively and aggressively against the assertion of ICSID jurisdiction in this proceeding. As an unintended consequence, questions possibly have been raised as to the integrity of the ICSID process. At the end of the day, the Tribunal wishes to emphasize that it does not find the more provocative arguments raised by Respondent to be supported and that it is quite clear to the majority of this Tribunal that this dispute is within the jurisdictional reach of ICSID and the BIT.

329. To the extent that Bolivia questions the timing of the transfer of ownership in Claimant in November – December 1999 suggesting that it was done in anticipation of the events to follow in the Spring of 2000, the Tribunal notes that:

a. the planning of a joint venture of the scale of the venture between Bechtel Enterprises Holding Inc. and Edison S.p.A. in November-December of

---

[272] Order No. 1, ¶ 30.

[273] *Id.*, ¶ 32 ("[I]t is the intent of the Tribunal to render at a minimum its decision on the first jurisdictional objection and Respondent's request for production of evidence.")

1999, of which the transfer was a part, likely predated the transfer by at least several months,

b. the present record indicates that in November-December of 1999 that civil society organizations expressed strong concerns about the proposed tariff structure and, in a few instances, called for the annulment of the concession, and
c. the present record does not establish that the severity of the particular events that would erupt in the Spring of 2000 were foreseeable in November or December of 1999.

330. Respondent objects to Claimant's assertion of jurisdiction implying that the availability of the BIT is the result of strategic changes in the corporate structure that somehow rise to the level of fraud or abuse of corporate form. The Tribunal observes that to the extent that Bolivia argues that the December 1999 transfer of ownership was a fraudulent or abusive device to assert jurisdiction under the BIT, that:

a. the joint venture between Bechtel Enterprises Holding Inc. and Edison S.p.A. in November-December of 1999 involved significantly more operations than AdT's concessionary rights and duties,
b. the present record does not establish why the joint venture was headquartered in the Netherlands as opposed to some other jurisdiction, although Claimant indicated that the Netherlands was chosen for reasons of taxation,
c. a decision as to where to locate a joint venture is often driven by taxation considerations, although other factors such as the availability of BITs can be important to such a decision, and
d. it is not uncommon in practice, and -- absent a particular limitation -- not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for examples, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.

331. The Tribunal does not find a sufficient basis in the present record to support an allegation of abuse of corporate form or fraud. The Tribunal, however, notes that Article 41(2) of the ICSID Arbitration Rules provides:

> The Tribunal may on its own initiative consider, at any stage of the proceeding, whether the dispute or any ancillary claim before it is within the jurisdiction of the Centre and within its own competence.

The Tribunal will bear in mind its duty to protect the integrity of ICSID jurisdiction during the merits phase as the Parties submit their full memorials and supporting evidence.

332. This Decision reflects the growing web of treaty based referrals to arbitration of certain investment disputes. Although titled "bilateral" investment treaties, this case makes clear that which has been clear to negotiating states for some time, namely, that through the definition of "national" or "investor," such treaties serve in many cases more broadly as

portals through which investments are structured, organized, and, most importantly, encouraged through the availability of a neutral forum.[274] The language of the definition of national in many BITs evidences that such national routing of investment is entirely in keeping with the purpose of the instruments and the motivations of the state parties.

333. The Tribunal by this Decision's denial of Respondent's objections to jurisdiction grants Claimant a neutral forum in which the substance of the dispute between it and Claimant may be arbitrated.

[274] Indeed, the negotiating history of the ICSID Convention indicates that the "CHAIRMAN [Aron Broches] observed that the consideration of the definition of 'national of a Contracting State' was related to the entire scope of the draft Convention. II(1) DOCUMENTS CONCERNING THE ORIGIN AND THE FORMULATION OF THE ICSID CONVENTION 395 (1968).

Decision

334. In light of the foregoing, the Tribunal decides:

a. Respondent's First Objection to the jurisdiction of the Tribunal, except as to the sixth aspect, in each of the ways in which it asserts a lack of consent, is denied;
b. By majority, the sixth aspect of Respondent's First Objection is denied;
c. By majority, Respondent's Second Objection to the jurisdiction of the Tribunal based on whether Claimant is "controlled directly or indirectly" by nationals of the Netherlands is denied; and
d. By majority, Respondent's request for the production of evidence is, as a consequence of the Tribunal's holding as to the Second Objection, without object and is denied.

335. The Tribunal's decision as to the awarding of costs will be addressed as a part of the final award in this matter.

336. The Tribunal will proceed to the scheduling of the merits phase of the proceeding.

337. The dissenting Declaration of José Luis Alberro-Semerena is appended to the present Decision.

Made in equally authentic English and Spanish versions.

(signed)

____

Henri C. Alvarez
Arbitrator

Date: October 6, 2005

(signed)

____

José Luis Alberro-Semerena
Arbitrator

Date: October 11, 2005

(signed)

____

David D. Caron
President

Date: October 3, 2005

Declaration of José Luis Alberro-Semerena

1. I do not join the Tribunal on its Decisions on jurisdiction in the cases of the sixth aspect of the First Objection and of the Second Objection.

2. The Tribunal was established pursuant to the Netherlands-Bolivia Bilateral Investment Treaty (BIT) and to the ICSID Convention. Therefore, the Tribunal must evaluate whether the dispute passes through two different jurisdictional keyholes, defined by Article 1(b)(iii) of the BIT and by Article 25 of the ICSID Convention. The parties have agreed that the provisions of the Vienna Convention relating to the interpretation of treaties reflect customary international law and they consider it to be the applicable law to interpret the BIT.

3. The first issue on which I differ from the majority of the Tribunal is whether the evidence on record is adequate to ascertain Claimant's motivations and timing for abandoning the transaction described by Bechtel in its November 24, 1999 letter to the Water and the Electricity Superintendencies, in favor of the one that was ultimately put into place.

4. This issue is crucial because AdT did not have access to ICSID arbitration before its restructuring in late 1999; because the restructuring project presented by Bechtel to the Bolivian authorities in late November 1999 included the insertion of a Dutch company in the chain of ownership and was not approved by them; because the structure that was ultimately put into place did insert a Dutch company in the chain of ownership and because "if deception or misrepresentation can be shown to have existed, no inferences as to an agreement on nationality can be drawn from the fact of consent".[1]

5. Claimant argues "there is nothing in the BIT that would deny coverage to an otherwise entitled party because it acquired an investment in the context of rumors of problems on the horizon"[2].

6. Respondent, on the contrary considers that "the straightforward question is whether Bolivia can be deemed to have consented to a scheme in which a company registered in Bolivia may at any time, under all circumstances reorganize, restructure itself so as to gain the right to bring a suit before ICSID, whenever such suit appears to be convenient and desirable from the investors perspective. We submit that the answer to this question is no".[3]

7. The dissent with the majority of the Tribunal is not about whether a corporation may or may not restructure itself in a legal manner that is not contractually prohibited so as to base itself in a jurisdiction that it perceives to provide a beneficial regulatory and legal

---

[1] *See* CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY 476 (Cambridge Univ. Press, 2001).
[2] Hearing on Respondent's Objections to Jurisdiction, February 11, 2004, Transcript, pp. 628.
[3] Hearing on Respondent's Objections to Jurisdiction, February 11, 2004, Transcript, pp. 206.

environment. The dissent is about whether it is in compliance with the BIT regardless of the circumstances.

8. The dissent comes from the fact that if AdT can restructure itself while "the Government of Bolivia engaged in a course of action outside of the Concession Contract which breached AdT's rights"[4], the balance between the benefits and obligation of the host State is broken since the later become unpredictable. "Needless to say, such a system would not be compatible with the basic concepts of appropriate reciprocity, which forms the basis of all bilateral treaties. Reciprocity is generally defined as a relationship of identical or equivalent treatment, and can only be achieved in a legal framework in which the obligations arising out of a treaty are to a reasonable extent, foreseeable and limited".[5]

9. Claimant considers, that "the parties to the Bilateral Investment Treaty clearly included within the terms of the Treaty scope for protection to extend to foreign-owned subsidiaries incorporated in their territory. As I put it to the Tribunal yesterday, the universe thereby became infinite. There is nothing in the wording of the Bilateral Investment Treaty that narrows its scope".[6] While there are instances of infinite offers of arbitration where states have investment statutes where they make a global offer to arbitrate, the notion that the universe of beneficiaries of a bilateral investment treaty is infinite has no precedent in scholarly commentary or tribunal awards, and no direct evidence of the validity of this interpretation –for example, in terms of the drafting history- was provided.

10. As early as September 1999, the public had begun protesting the Concession Agreements and there were explicit public demands to annul them in mid November 1999. Claimant states that "in December 1999, the Government of Bolivia (through the Superintendent of Water) concluded an agreement with communities within the area of Concession which, *inter alia*, purported to limit the effective area of the Concession".[7]

11. While the present record may not establish that the severity of the events of Spring 2000 was foreseeable in November or December of 1999, it is the case that the present record does not establish that the severity of the events of Spring 2000 was not foreseeable in November or December of 1999. The *prima facie* evidence of the fact that AdT was alarmed about the severity of the public demands is the publication of an "Open Letter" in the Cochabamba press defending its actions, in late November. Its preamble reflects concern about: "statements and publications circulated by different citizens, Institutions and mass media" and that "many of the pronouncements are incorrect and malicious".

12. On November 24, Bechtel wrote to Bolivia announcing "that it had signed a contract with Edison S. p. A. of Italy, whereby Edison will become a partner of Bechtel Enterprises Holdings, Inc. in its activities in the international water business". The parties intended to implement the transaction by forming a new company in the

[4] Request for Arbitration, ¶ 12.
[5] Expert Opinion of Professor Rudolf Dolzer, page 25.
[6] Hearing on Respondent's Objections to Jurisdiction, February 11, 2004, Transcript, pp. 626.
[7] Request for Arbitration, ¶ 12.

Netherlands. As a result of the transaction, the shareholders of 55% of AdT's shares and voting rights would no longer be a company established in the Cayman Islands but a new company established in the Netherlands. Given that a new Dutch shareholder would own 55% of AdT's shares, Bechtel entered a process of obtaining a waiver from the Water and the Electricity Superintendencies, in order to carry out the transaction while respecting the terms of the Concession.

13. The proposed transfer of IW Ltd's shares in AdT to a Dutch company was not authorized.

14. Social unrest and public opposition to the new rates continued during December.

15. On December 21, 1999, IW Ltd of the Cayman Islands migrated to Luxembourg changed its name and the next day a Dutch company became its 100 percent shareholder.

16. The evidence on record is inadequate to ascertain the motivations and the timing for abandoning the transaction described by Bechtel in its November 24, 1999 letter (a new direct Dutch ownership of AdT) in favor of the one that was ultimately put into place 27 days later (migration and indirect ownership by Dutch owners). The only difference one can infer from the record between the two is that the first transaction had to be authorized by the Waters and the Electricity Superintendencies while the second one was done without their knowledge after months of social unrest. In both cases, a Dutch company was inserted in the chain of ownership.

17. The Tribunal should have requested Claimant to produce the following information for the period November 24, 1999 –when Bechtel wrote to Bolivia informing of proposed changes in AdT's ownership- to December 21, 1999 - when IW Ltd of the Cayman Islands migrated to Luxembourg: (I) all documents showing the dates on which the decisions was made to migrate IW Ltd of the Cayman Islands to Luxembourg instead of the transaction announced on November 24, 1999; as well as (II) all the documents that examine the costs and benefits of each option and more generally that argue against and in favor of migrating IW Ltd of the Cayman Islands and having International Water (Tunari) B.V. acquire 100% of its shares.

18. The majority of the Tribunal denied Respondent's request for the production of evidence because it had no object given its interpretation. Thus, I conclude that Bolivia did not consent and decide that Claimant is not entitled to invoke ICSID jurisdiction under the BIT between Bolivia and the Netherlands.

19. The second issue on which I differ from the majority of the Tribunal is whether the evidence on record is adequate to determine whether Claimant was directly or indirectly controlled by Dutch nationals for jurisdictional purposes.

20. Claimant argues that this case is "about whether IWT or IWH control directly or indirectly AdT" and that majority shareholding with voting rights is the strictest possible

test of control.[8] In turn, Bolivia maintains that "controlled is unquestionably different from capable of being controlled or could be controlled"[9] and that the question is whether AdT was controlled by nationals of the Netherlands, thereby meeting the requirements of Article 1(b)(iii) of the BIT.

21. The majority found that AdT was a Bolivian legal person indirectly controlled by Dutch companies and therefore that the Tribunal has jurisdiction.

22. After examining the ordinary meaning of the phrase "controlled directly or indirectly" and reading it in light of the context and purpose of the BIT, my interpretation differs from that of the majority and I consider that the evidence submitted by Claimant is not sufficient to prove that AdT was directly or indirectly controlled by Dutch nationals. The majority of the Tribunal denied Respondent's request for the production of evidence because it had no object given its interpretation. In contrast my interpretation leads me to grant it. Thus, I dissent from the Tribunal's decision regarding Bolivia's objection to the jurisdiction of the Tribunal and consider that jurisdiction should be denied.

23. The answer to the question is in the use of the term "controlled".

24. With respect to the ordinary meaning of control, the majority of the Tribunal found that "while some definitions suggest the actual exercise of influence, others emphasize the possession of power over an object. Thus, the ordinary meaning of 'control' would seemingly encompass both actual exercise of powers or direction and the rights arising from the ownership of shares. (Paragraph 227).

25. As for its legal definition, the majority of the Tribunal relies on three definitions: "to exercise power or influence over; ... to regulate or govern and ...to have a controlling interest in." Hence, the legal meaning of control also encompasses both the actual exercise of control and the right to control. (Paragraph 231).

26. In Article 1(b)(iii) of the BIT, the word "controlled" is a passive participial adjective formed from the verb "control" which modifies the noun "legal persons". Passive participial adjectives describe nouns that receive the effects of an action. Grammar indicates that for "legal persons" constituted in accordance with the law of a contracting party to be "controlled directly or indirectly" by nationals of another contracting party, they have to receive the effects of an action by nationals of the second contracting party. Thus, while both the ordinary meaning and the legal definition of control encompass the actual exercise of control as well as the right to control, the passive participial adjective requires the effects of an action. For jurisdiction to exist, Claimant has to prove that AdT received the effect of actions by Dutch companies.

27. Article 31(4) of the Vienna Convention indicates that a special meaning shall be given to a term, if the parties so intended. There is no indication in the record that the contracting parties intended any special meaning to the word "control". I agree with the majority of the Tribunal that the negotiators who contributed to the language of the BIT

[8] Hearing on Respondent's Objections to Jurisdiction, February 11, 2004, Transcript, pp. 620-621.
[9] Ibidem, p. 422, lines 12-14.

were likely sophisticated foreign negotiators with some knowledge of business and law. (Paragraph 230). Article 1(b)(iii) of the BIT, however, does not use "control" but "controlled". The parties could have used the expression "in direct or indirect control of" or "under direct or indirect control of" or "because of foreign control" as in the ICSID Convention which was public knowledge before the BIT was negotiated and would have incorporated existing case law and scholarly commentary. In contradistinction, they chose to use the passive participial adjective "controlled", which requires the effects of an action.

28. It is in the consideration of the context in which we find the phrase "controlled directly or indirectly," and in the light of the object and purpose of the treaty that we find the basis for its interpretation. (Paragraph 240).

29. The object and purpose of the BIT is to stimulate the flow of capital and technology. Indeed, the Contracting Parties explicitly recognize that such stimulation will result from "agreement upon the treatment to be accorded to ... investments" by "the national of one Contracting Party in the territory of the other Contracting Party." (Paragraph 240). Article 1 of the BIT determines the circle of beneficiaries, which is a subset of all existing persons.

30. Article 1(b)(i) and Article 1(b)(ii) empower all natural persons having the nationality of a Contracting Party and all legal persons constituted in accordance with the law of a Contracting Party.

31. Article 1(b)(iii) extends the protection of the BIT to legal persons against the actions of their own government[10] but limits those benefits to legal persons having the special attribute of being "controlled" by nationals of the other signatory. Assuming without conceding that an entity that owns 100% of the shares and voting rights of another entity possesses the power to control the second entity, there is no reason to posit that it is more reasonable to extend the privileges concomitant to Article 1(b)(iii) to companies potentially under the control of nationals of the other signatory, as opposed to companies actually receiving the effects of an action from nationals of the other signatory. The opposite is sounder: the access mechanism to the privileges concomitant to Article 1(b)(iii) should be an actual event, an action (controlled) and not a possibility.

32. It is incorrect to equate "controlled" and "control". One should be "aware of the general principle of interpretation whereby a text ought to be interpreted in the manner that gives it effect –*ut magis valeat quam pereat.* However, this principle of interpretation should not lead to confer, *at posteriori*, to a provision deprived of its object and purpose a result that goes against its clear and explicit terms".[11] To substitute "controlled" with the term "control" is to go against the text's clear and explicit terms. The fundamental issues of foreseeability, transparency and stability accepted by parties to a BIT cannot be resolved

[10] Aron Broches, *The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States,* 358/359; CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY. ¶. 496 (Cambridge University Press, 2001).

[11] *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo* (ICSID Case No. ARB/98/7), Award of the Tribunal of September, 2000.

by limiting "control" to majority ownership and voting rights when the Treaty explicitly uses the expression "controlled directly or indirectly".

33. Neither the jurisprudence concerning the phrase "foreign control" in Article 25(2)(b) of the ICSID Convention, nor other Arbitral Awards concerning "control", nor the BIT practices of the Netherlands and Bolivia can be of assistance in interpreting Article 1(b)(iii) of the BIT.

34. Since the BIT does not provide a definition of "directly or indirectly controlled" and, unlike the case of the ICSID convention, there is little or no history or commentary on the BIT, it is the Tribunal's responsibility to interpret the meaning of the expression. Many cases underline the importance of the Tribunal's authority to interpret access provisions past formal interpretations to actual relationships. "ICSID Tribunals do not accept the view that their competence is limited by formalities, and rather they rule on their competence based on a review of the circumstances surrounding the case, and, in particular, the actual relationships among the companies involved".[12]

35. This elucidation of the meaning of "controlled" is strengthened by the fact that the identification of corporate nationality has been difficult from the point of view of international law for almost a century, as wars have shaped the meaning assigned to it by sovereign powers. Different criteria have been put forward but none has prevailed: neither place of incorporation; nor seat of the company; nor ownership and voting rights.[13] To resort to a mechanistic interpretation of control would be to go against the historical development of the concept. An interpretation that favors an action is in keeping with the search for a functional definition.

36. Claimant states that "the jurisdictional issue ...is whether share ownership and voting rights in the Claimant by a Netherlands entity at a level greater than 50% is sufficient to establish direct or indirect control"[14] and that it "rests its case on jurisdiction on the sufficiency of the controlling interest of IWH and IWT to constitute control over the Claimant for purposes of the BIT"[15].

37. To say that A is sufficient for B is to say that A cannot occur without B, or that whenever A occurs, B occurs.

38. Commentary on the drafting of the ICSID convention makes it clear that share ownership at a level greater than 50% might not be controlling: "Thus, where nationals of a Contracting State hold 35 percent of the shares of a corporation and nationals of a

---

[12] *Banro American Resources, Inc. and Société Aurifére du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo* (ICSID Case No. ARB/98/7), Award of the Tribunal of September 1, 2000.

[13] "The test was originally based solely on share ownership, but has been extended to cover nationality of principal officers, the exercise of controlling influence through means other than shareholding and the presence of substantial though not necessarily controlling interests". A. Fatouros, "National Legal Persons in International Law', in ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW, R. Bernhardt, ed. Vol 3. 1997 p. 495 cited in Professor Dolzer's expert opinion.

[14] Claimant's Memorial on Bolivia's Objections to Jurisdiction and Request for the Production of Evidence, p.73 ¶ 209.

[15] Ibidem, p. 69 ¶ 199.

non-Contracting State hold 55 percent of the shares, an agreement that the corporation has the nationality of the Contracting State may well be upheld by a tribunal".[16] "In the course of the drafting of the Convention, it was said ... even that 51% of the shares might not be controlling.".[17]

39. Previous tribunal awards have established that an investor with minority share ownership can control a company, thereby providing counterexamples to the assertion that majority share ownership and majority voting rights are sufficient to establish control. Even in the case of 100% ownership, Tribunals have examined "effective control": "This control is not only a result of the fact that LETCO's capital stock was 100% owned by French nationals as indicated by both LETCO and official documents of the Liberian Government, it also results from what appears to be effective control by French nationals; effective control in the sense that, apart from French shareholdings, French nationals dominated the company decision-making structure."[18]

40. Thus the interpretation of control advanced by Claimant is logically inconsistent. Majority shareholding and majority voting rights do not *per se* constitute control.

41. Given that "Claimant has already submitted all the documents on which it relies to show that, through majority share ownership and voting control, SARL controls the Claimant"[19] and given there is no evidence in the filings that AdT received the effects of actions of control and thus no proof that it was "controlled directly or indirectly" by Dutch nationals, the Tribunal should have requested the production of evidence to substantiate the claim that AdT was directly or indirectly controlled by IWH B.V. or IWT B.V. The tribunal in *Aucoven*, for example, listed criteria, different from share ownership, that could have been used to test control: nationality of the Board members, frequency of visits of board members of the direct shareholder, frequency of "monitoring" of *Aucoven*'s activities, and financial support.[20]

42. In order to specifically evaluate actions of control of AdT, the Tribunal should have requested Claimant to produce, *inter alia*, the following information for the period December 22, 1999 –when a Dutch company acquired International Water (Tunari) S.a.r.l. that used to be called IW Ltd of the Cayman Islands- to November 12 2001- when AdT submitted its Request for Arbitration: (I) all documents reflecting or constituting communications between AdT and (a) International Water (Tunari) S.a.r.l, (b) International Water (Tunari) B.V., (c) International Water Holdings B.V. and (d) Baywater Holdings B.V.; (II) all documents reflecting or constituting communications

[16] C.F. Amerasinghe *Jurisdiction Rationae Personae under the Convention on the Settlement of Investment Disputes between States and Nationals of other States*, 47 BYIL 227, 1976. pp. 264-265
[17] Vacuum Salt Products Ltd. v. Republic of Ghana, Award of February 16, 1994, 9 ICSID Rev.—FILJ (1994), 4 ICSID 329 (1997), ¶ 43.
[18] Liberian Eastern Timber Corp [LETCO] v Republic of Liberia, Award of March 31, 1986 and Rectification of June 17, 1986, reprinted as 26 ILM 647 (1987), 2 ICSID Rep 346 (1994).
[19] Claimant's Memorial On Bolivia's Objections to Jurisdiction and Request for the Production of Evidence, p. 73 par. 210
[20] *Autopista Concesionada de Venezuela CA v. Bolivarian Republic of Venezuela* (hereinafter referred to as "*Aucoven*"), in its Decision on Jurisdiction of September 27, 2001, *reprinted at* 16 ICSID Rev.—FILJ 469 (2001), 6 ICSID 419 (2004), p. 26, ¶ 65.

relating to AdT between or among any of the following (a) International Water (Tunari) S.a.r.l, (b) International Water (Tunari) B.V., (c) International Water Holdings B.V. and (d) Baywater Holdings B.V.; and, finally, (III) all board of director minutes and shareholder meeting minutes for (a) AdT, (b) International Water (Tunari) S.a.r.l, (c) International Water (Tunari) B.V., (d) International Water Holdings B.V. and (e) Baywater Holdings B.V.. If AdT was indeed controlled directly or indirectly by International Water (Tunari) B.V. and International Water Holdings B.V., those documents would provide evidence of such actions of control.

43. The majority of the Tribunal denied Respondent's request for the production of evidence because it had no object given its interpretation.

44. By resting its case on jurisdiction on majority stock ownership with voting rights and not offering evidence that AdT received the effects of actions of control by Dutch companies, Claimant failed to prove that this dispute is within the jurisdictional reach of the BIT.

It is for the above reasons that I disagree with the Majority's decision in favor of jurisdiction and conclude that Claimant is not entitled to invoke ICSID jurisdiction under the BIT between Bolivia and the Netherlands. I wholeheartedly join in the Tribunal's commitment to its duty to protect the integrity of ICSID jurisdiction during the merits phase, as the parties submit their full memorials and supporting evidence

(signed)

José Luis Alberro-Semerena
Arbitrator

Date: October 11, 2005

Appendix I

Abbreviations Used in this Award

Abbreviations used in the text

AdT (Claimant)	Aguas del Tunari
Arbitration Rules	Rules of Procedure for Arbitration
Baywater	Baywater Holdings, B.V.
BIT	The Agreement on Encouragement and Reciprocal Protection of Investments Between the Kingdom of the Netherlands and the Republic of Bolivia, *entered into force* November 1, 1994.
Concession	Contract for Concession of Use of Water and for the Public Potable Water and Sewer Service for the City of Cochabamba
ICSID	The International Centre for the Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *entered into force* October 14, 1966.
IWH B.V.	International Water Holdings B.V.
IWT B.V.	International Water (Tunari) B.V.
IW Ltd	International Water (Tunari) Ltd.
IW S.a.r.l.	International Water (Tunari) S.a.r.l.
Order No. 2	Procedural Order No. 2 on Respondent's Motion for Postponement of the November 17, 18 and 19, 2003 Hearing on Respondent's Objections to Jurisdiction, November 5, 2003
Order No. 3	Procedural Order No. 3 concerning February 9, 10 and 11, 2004 Hearing on Respondent's Objections to Jurisdiction, and Respondent's Request of December 15, 2003 to Examine Witnesses, December 31, 2003

Order No. 4	Procedural Order No. 4 Inviting Comments on the Letter dated October 29, 2004 of Mr. Lammers, Legal Advisor of the Foreign Ministry of the Netherlands, Responding to the Tribunal's Letter of October 4, 2004 Posing Limited Questions, December 14, 2004
Respondent	The Republic of Bolivia
SEMAPA	Municipal Potable Water and Sewer Service of Cochabamba
SIRESE	System of Sectoral Regulation

Abbreviations used in citations and footnotes

Bolivia's Obj.	Republic's of Bolivia's Objection to Jurisdiction and Requests for the Production of Evidence and for Clarification of Procedures, January 17, 2003
AdT's Response	AdT's Response to Bolivia's Objection to Jurisdiction and Requests for the Production of Evidence and for Clarification of Procedures, January 29, 2003
Bolivia's Reply	Reply of Republic of Bolivia to Claimant's Response to Bolivia's Objection to Jurisdiction and Requests for the Production of Evidence and for Clarification of Procedures and Motion for Immediate Dismissal, February 5, 2003
AdT's Rej.	AdT's Rejoinder to Bolivia's Reply, February 13, 2003.
Cl. Mem.	AdT's Memorial on Jurisdiction, June 4, 2003
Resp. Counter Mem.	The Republic of Bolivia's Counter-Memorial in Opposition to Jurisdiction and in Support of the Production of Evidence, August 4, 2003
Cl. Reply	Claimant's Reply to Bolivia's Counter-Memorial in Opposition to Jurisdiction and in Support of the Production of Evidence, September 4, 2003
Resp. Rej.	The Republic of Bolivia's Rejoinder in Opposition to Jurisdiction and in Support of the Production of Evidence, October 6, 2003

ICSID Cases Discussed & Cited

Aucoven	*Autopista Concesionada de Venezuela CA [Aucoven] v. Bolivarian Republic of Venezuela, Decision on Jurisdiction of September 27, 2001, reprinted at* 16 ICSID Rev.—FILJ 469 (2001), 6 ICSID 419 (2004).
Azurix	*Azurix Corp. v. The Argentine Republic,* "Decision on Jurisdiction" dated December 8, 2003, *available at* http://www.asil.org/ilib/azurix.pdf.
Cable TV	*Cable Television of Nevis Ltd. and Cable Television of Nevis Holdings Ltd. v. Federation of St Kitts and Nevis,* Award of January 13, 1997, *reprinted at* 13 ICSID Rev.—FILJ 328 (1998), 5 ICSID Rep. 108 (2002).
Lanco	*LANCO International, Inc. v. The Argentine Republic,* "Preliminary Decision: Jurisdiction of the Arbitral Tribunal" dated December 8, 1998, *reprinted at* 40 ILM 457 (2001), 5 ICSID Rep. 367 (2002).
Vacuum Salt	*Vacuum Salt Products Ltd. v. Republic of Ghana, Award of February 16, 1994, 9 ICSID Rev.—FILJ (1994),* 4 ICSID 329 (1997).
Vivendi	*Compañía de Aguas del Aconquija S.A. & Vivendi Universal v. Argentine Republic,* Award of November 21, 2000, *reprinted at* 16 ICSID Rev.—FILJ __ (2001), 5 ICSID Rep. 299 (2002), Decision on Annulment, July 3, 2002, *reprinted at* 17 ICSID Rev.—FILJ __ (2002), 5 ICSID Rev. 240 (2002).

Appendix II

Text of Cited Treaty and Contract Provisions

The Netherlands-Bolivia BIT

Article 1(b) the term "nationals" shall comprise with regard to either Contracting Party:

i. natural persons having the nationality of that Contracting Party in accordance with its law;

ii. without prejudice to the provisions of (iii) hereafter, legal persons constituted in accordance with the law of that Contracting Party;

iii. legal persons controlled directly or indirectly, by nationals of that Contracting Party, but constituted in accordance with the law of the other Contracting Party.

Article 9

1) For the purpose of resolving disputes that may arise from investments between one Contracting Party and a national of the other Party to the present Agreement, consultation will be held with a view to settling, amicably the conflict between the parties to the dispute.

2) If a dispute cannot be settled within a period of six months from the date on which the interested national shall have formally notified it, the dispute shall, at the request of the interested national, be submitted to an arbitral tribunal.

3) The arbitral tribunal shall be constituted ad hoc, in such a way that each party shall nominate an arbitrator, and the arbitrators shall agree on the choice of a national of a third State as chairman of the tribunal. The arbitrators shall be nominated within a period of two months, and the chairman within a period of three months, from the time the interested national shall have communicated his wish to submit the dispute to an arbitral tribunal.

4) If the time limits provided for in paragraph 3 are not observed, either of the parties to the dispute shall, if no other provisions apply between the parties to the dispute, be empowered to request the President of the Court of Arbitration of the Paris International Chamber of Commerce to proceed to make the necessary appointments.

5) Paragraphs 4 to 7 of article 13 of the present Agreement shall apply mutatis mutandis.

6) If both Contracting Parties have acceded to the Convention on the Settlement of Investment Disputes between States and Nationals of other States of 18 March 1965, any disputes that may arise from investment between one of the Contracting Parties and a national of the other Contracting Party shall, in accordance with the provisions of that Convention, be submitted for conciliation or arbitration to the international Centre for Settlement of Investment Disputes.

The Bolivian Constitution

Artículo 24 Las empresas y súbditos extranjeros están sometidos a las leyes bolivianas, sin que en ningún caso puedan invocar situación excepcional ni apelar a reclamaciones diplomáticas.

[**Article 24** Foreign subjects and enterprises are subject to Bolivian laws, and in no case may they invoke exceptional position or have recourse to diplomatic claims.]

Artículo 136 Son de dominio originario del Estado, además de los bienes a los que la Ley les da esa calidad, el suelo y el subsuelo con todas sus riquezas naturales, las aguas lacustres, fluviales y medicinales, así como los elementos y fuerzas físicas susceptibles de aprovechamiento. La ley establecerá las condiciones de este dominio, así como las de su concesión y adjudicación a los particulares.

[**Article 136** Within the regional original domain of the State, in addition to property to which the law gives that character, are the soil and the subsoil with all their natural resources: lake, river and thermal waters; and all physical elements and forces susceptible of utilization. Laws shall establish the conditions of such ownership, and those for their concession and allotment to private individuals.]

The Concession

Artículo 37.1 Cada Accionista Fundador deberá mantener más del 50% de su porcentaje original de participación en el capital con derecho a voto del Concesionario por lo menos durante los primeros siete (7) años de las Concesiones. No obstante lo anterior, nada en este Contrato impide a los Accionistas gravar sus acciones como garantía ante las Entidades Financieras

[**Article 37.1** Every Founding Stockholder keep more than 50% of the original equity percentage in voting shares of the Concessionaire at least over the first seven (7) years of the Concessions.]

Artículo 41.2 El Concessionario reconoce la jurisdicción y competencia de las autoridades que componen e Sistema de Regulación Sectorial (SIRESE) y tribunales de la República de Bolivia, de conformidad con la Ley SIRESE y otras leyes bolivianas aplicables.

[**Article 41.2** [The Concessionaire] recognizes the jurisdiction and competence of the authorities that make up the System of Sectoral Regulation (SIRESE) and of the courts of the Republic of Bolivia, in accordance with the SIRESE law and other applicable Bolivian laws.]

Artículo 41.3 Las estipulaciones del presente Contrato no podrán interpretarse como renuncia por parte de los Accionistas, los Accionistas Fundadores, incluyendo los Accionistas Útlimos, a mecanismos de Resolución de controversias establecidos en tratados internacionales reconocidos por la República de Bolivia.

[**Article 41.3** The provisions of the present Contract are not to be interpreted as a renunciation on the part of the Shareholders, the Founding Shareholders, including the Ultimate Shareholders, of methods of dispute resolution established in International Treaties recognized by the Republic of Bolivia.]

Artículo 41.5 Las Partes reconocen que dichos Accionistas y Accionistas Últimos del Concesionario incluyendo los Accionistas Fundadores, son libres para ampararse en aquellos

métodos de resolución de disputas que puedan serles legalmente disponibles de acuerdo a la Ley Boliviana (como por ejemplo arbitraje bajo las reglas de CCI, ICSID, o UNCITRAL y otros organismos internacionales similares). Las Partes acuerdan cooperar en el proceso arriba mencionado, en la medida que les sea permitido por Ley.

> [**Article 41.5** The Parties [the Regulator of Water and AdT] recognize that the Shareholders and Ultimate Shareholders including the Founding Shareholders are free to have recourse to those methods of dispute resolution which are legally available to them in accordance with Bolivian Law (such as example arbitration under the rules of the ICC, ICSID or UNITRAL or other similar international organizations). The Parties agree to cooperate in the above-mentioned process, to the extent permitted by Law.]

The ICSID Convention

Article 25

(1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally.

(2) "National of another Contracting State" means:

(a) any natural person who had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration as well as on the date on which the request was registered pursuant to paragraph (3) of Article 28 or paragraph (3) of Article 36, but does not include any person who on either date also had the nationality of the Contracting State party to the dispute; and

(b) any juridical person which had the nationality of a Contracting State other than the State party to the dispute on the date on which the parties consented to submit such dispute to conciliation or arbitration and any juridical person which had the nationality of the Contracting State party to the dispute on that date and which, because of foreign control, the parties have agreed should be treated as a national of another Contracting State for the purposes of this Convention.

(3) Consent by a constituent subdivision or agency of a Contracting State shall require the approval of that State unless that State notifies the Centre that no such approval is required.

(4) Any Contracting State may, at the time of ratification, acceptance or approval of this Convention or at any time thereafter, notify the Centre of the class or classes of disputes which it would or would not consider submitting to the jurisdiction of the Centre. The Secretary-General shall forthwith transmit such notification to all Contracting States. Such notification shall not constitute the consent required by paragraph (1).

Article 43
Except as the parties otherwise agree, the Tribunal may, if it deems it necessary at any stage of the proceedings,

(a) call upon the parties to produce documents or other evidence, and

(b) visit the scene connected with the dispute, and conduct such inquiries there as it may deem appropriate.

The ICSID Arbitration Rules

Article 34 Evidence: General Principles

(1) The Tribunal shall be the judge of the admissibility of any evidence adduced and of its probative value.

(2) The Tribunal may, if it deems it necessary at any stage of the proceeding:

(a) call upon the parties to produce documents, witnesses and experts; and

(b) visit any place connected with the dispute or conduct inquiries there.

(3) The parties shall cooperate with the Tribunal in the production of the evidence and in the other measures provided for in paragraph (2). The Tribunal shall take formal note of the failure of a party to comply with its obligations under this paragraph and of any reasons given for such failure.

(4) Expenses incurred in producing evidence and in taking other measures in accordance with paragraph (2) shall be deemed to constitute part of the expenses incurred by the parties within the meaning of Article 61(2) of the Convention.

Article 41 Objections to Jurisdiction

(1) Any objection that the dispute or any ancillary claim is not within the jurisdiction of the Centre or, for other reasons, is not within the competence of the Tribunal shall be made as early as possible. A party shall file the objection with the Secretary-General no later than the expiration of the time limit fixed for the filing of the counter-memorial, or, if the objection relates to an ancillary claim, for the filing of the rejoinder—unless the facts on which the objection is based are unknown to the party at that time.

(2) The Tribunal may on its own initiative consider, at any stage of the proceeding, whether the dispute or any ancillary claim before it is within the jurisdiction of the Centre and within its own competence.

(3) Upon the formal raising of an objection relating to the dispute, the proceeding on the merits shall be suspended. The President of the Tribunal, after consultation with

its other members, shall fix a time limit within which the parties may file observations on the objection.

(4) The Tribunal shall decide whether or not the further procedures relating to the objection shall be oral. It may deal with the objection as a preliminary question or join it to the merits of the dispute. If the Tribunal overrules the objection or joins it to the merits, it shall once more fix time limits for the further procedures.

(5) If the Tribunal decides that the dispute is not within the jurisdiction of the Centre or not within its own competence, it shall render an award to that effect.

Appendix III

Text of January 29, 2003 Letter from the Tribunal to Earthjustice, Counsel for Petitioners

Professor David D. Caron
C/o Ms. Margrete Stevens
Senior Counsel
International Centre for the Settlement of Investment Disputes, MC6-611
The World Bank Group
Washington, D.C. 20433 U.S.A.

January
29, 2003

J. Martin Wagner
Director, International Program, Earthjustice
426 17th Street, 6th Floor
Oakland, CA 94612

Dear Mr. Wagner:

I write in response to your letter of August 28th 2002 to the Secretary-General of the International Centre for Settlement of Investment Disputes (ICSID) requesting that he forward to the Tribunal a petition for intervention in ICSID Case No. Arb/02/03, *Aguas del Tunari v. The Republic of Bolivia.* The Secretary-General promptly forwarded your request to me and the other members of the Tribunal, José Alberro and Henri Alvarez. You were entirely correct in directing your request to the Tribunal, rather than ICSID itself, as ICSID plays only an administrative and support function in any tribunal's handling of cases.

The Tribunal has given extended consideration to your request. Moreover, the Tribunal requested, and subsequently received, the views of the parties to the dispute. As indicated on the ICSID public register for this case, the Tribunal was constituted under the Rules, without objection from the parties, on July 5, 2002, and held the First Session in this matter on December 9, 2002. Your letter and the request in it were discussed at that meeting and considered by the Tribunal. I write to you and your co-petitioners on behalf of the Tribunal with our response to the particular requests specified in your petition (copy attached hereto).

First, it is the Tribunal's unanimous opinion that your core requests are beyond the power or the authority of the Tribunal to grant. The interplay of the two treaties involved (the Convention on the Settlement of Investment Disputes and the 1992 Bilateral Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and Bolivia) and the consensual nature of arbitration places the control of the issues you raise with the parties, not the Tribunal. In particular, it is manifestly clear to the Tribunal that it does not, absent the agreement of the Parties, have the power to

join a non-party to the proceedings; to provide access to hearings to non-parties and, *a fortiori,* to the public generally; or to make the documents of the proceedings public.

Second, the consent required of the Parties to grant the requests is not present. Although the Tribunal did not receive any indication that such consent may be forthcoming, the Tribunal remains open to any initiative from the parties in this regard.

Third, the Tribunal is of the view that there is not at present a need to call witnesses or seek supplementary non-party submissions at the jurisdictional phase of its work. We hold this view without in anyway prejudging the question of the extent of the Tribunal's authority to call witnesses or receive information from non-parties on its own initiative.

The Tribunal wishes to emphasize that it has given serious consideration to your request. The briefness of our reply should not be taken as an indication that your request was viewed in other than a serious manner. Rather, the Tribunal has endeavored to answer the request in a manner that is both responsive and efficient. In addition, given your status as a non-party to this dispute, we necessarily have been careful in our response not to breach the undertakings in our declarations as arbitrators, signed under Arbitration Rule 6(2), to maintain the confidentiality of the proceedings.

The Tribunal appreciates that you, and the organizations and individuals with whom you work, are concerned with the resolution of this dispute. The duties of the Tribunal, however, derive from the treaties which govern this particular dispute. It has been reported that the new bilateral investment treaty between Singapore and the United States contains provisions for the *amicus* participation of non-governmental organizations. The duty of a tribunal in any case that arises under that instrument will be to follow its dictates. It is no less our duty to follow the structure and requirements of the instruments that control this case.

The Tribunal thanks you for your letter and the attached petition. Your letter and petition will remain on file with the Secretariat. The ICSID Secretariat and the Parties have been informed of our views.

On behalf of myself and the other members of the Tribunal, I am

Respectfully yours,

David D. Caron
President of the Tribunal in the matter of
Aguas del Tunari vs. The Republic of Bolivia

Appendix IV

Text of October 1, 2004 Letter from the Tribunal to the Government of the Netherlands

Professor David D. Caron
C/o Ms. Margrete Stevens
Senior Counsel
International Centre for Settlement of Investment Disputes,
1818 H St., N.W.
Washington, D.C. 20433, U.S.A.

October 1, 2004

Mr. J.G. Lammers
Legal Adviser
Ministerie van Buitenlandse Zaken
PO Box 20061
2500 EB The Hague, The Netherlands

Dear Mr. Lammers:

I write regarding three parliamentary questions and replies made between 21 February and 5 June 2002 that have been introduced as evidence relevant to the matter of *Aguas del Tunari v. Republic of Bolivia*, an arbitration before the International Centre for Settlement of Investment Disputes (ICSID), Case No. Arb/02/03.

I write on behalf of the Tribunal constituted to address the above-referenced matter, that Tribunal consisting of José Luis Alberro-Semerena, Henri Alvarez, and myself as President. Claimant in this case bases the jurisdiction of the Tribunal on the Bilateral Investment Treaty (BIT) between the Netherlands and Bolivia, signed 10 March 1992 and entered into force on 1 November 1994. The Tribunal has heard arguments as to its jurisdiction and is currently deliberating on the matter. The Tribunal recognizes the obligation of the Netherlands under the ICSID Convention to not provide diplomatic protection to its nationals in the case of investment disputes covered by the Convention.[1] In this sense, the Tribunal wishes to emphasize that it does not seek the view of the Netherlands as to the Tribunal's jurisdiction in this matter, rather it seeks only to secure the comments of the Netherlands as to specific documentary bases for written responses which the Dutch government provided to parliamentary questions.

---

[1] See Articles 25-27 of the ICSID Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, especially Article 27:

(1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

(2) Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute.

Specifically, the parties in this case have presented evidence and made arguments addressing the interpretation held by the Government of the Netherlands regarding provisions of its BIT with Bolivia. The parties do so in part by referencing three sets of responses to parliamentary questions. It is in regard of these responses to parliamentary questions that the Tribunal writes. We attach the Dutch originals of the responses to parliamentary questions, as well as the unofficial English translations of them, as they were provided to the Tribunal.[2]

The three sets of responses to parliamentary questions in outline are as follows.

First, on 21 February 2002, MP Van Bommel submitted written questions to the State Secretary for Economic Affairs and the Minister for Development Cooperation concerning, *inter alia*, whether certain corporations could invoke the Dutch-Bolivian BIT in the dispute addressed by this Tribunal.[3] On behalf of the Minister for Development Cooperation and his Ministry, the State Secretary for Economic Affairs (Minister Ybema) replied on 6 March 2002. He declined to state whether the current dispute fell under the BIT, stating instead, *inter alia,* that the answer is up to the "discretion of the arbitration tribunal to which a dispute has been submitted."[4]

Second, on 25 March 2002, MP Van Bommel submitted further written questions, requesting that the State Secretary and Minister "state clearly and unambiguously whether these multinationals can invoke the Dutch-Bolivian investment treaty in this case."[5] The State Secretary replied on 5 April 2002, referred the MP to his 6 March 2002 reply, and made further comments of a general nature which may be found at attachments three and four.

Third, on 18 April 2002, a five member group of MPs, including MP Van Bommel, submitted further questions to the Minister of Housing, Spatial Planning and Environment, the Minister for Development Cooperation and the State Secretary for Economic Affairs.[6] The MPs asked: "Are you familiar with the publication 'Water, Human Right or Merchandise' of the association Milieudefensie ('Friends of the Earth')? What is your general opinion on this publication?"[7] On behalf of himself and the State Secretary, the Minister for Housing, Spatial Planning, and Development (Minister Pronk) replied on 5 June 2002:

> Yes. Access to safe and clean water is important. The publication brings a number of aspects of the complicated water issue to the attention of a larger public. The topic deserves this attention. However, the formulation in this pamphlet is sometimes factually incorrect or suggestive. One particular point I would like to mention with emphasis. On p. 16 (Water war in Bolivia) it is stated that Aguas del Tunari can resort to the dispute settlement commission of the World Bank under the Dutch-Bolivian Investment Treaty. This is incorrect. As recently stated in response to questions of MP Van Bommel

[2] See attachments 1-6.

[3] See Parliamentary questions ("Kamervragen"), Parliamentary year 2001-2002, no. 765; see attachment 1, Unofficial English translation; and attachment 2, Dutch original.

[4] See *Id.,* answer 6.

[5] Parliamentary questions, no. 959; see attachment 3, unofficial English translation; and attachment 4, Dutch original.

[6] Parliamentary questions, no. 1229; see attachment 5, unofficial English Translation; and attachment 6, Dutch original. See also attachment 7, unofficial English translation of an excerpt of the publication; and attachment 8, Dutch Original.

[7] *Id.,* question 1.

> [citing to the previous replies to Van Bommel], the Government is of the view that the investment treaty is not applicable to this particular case.[8]

The ICSID Convention entrusts the Tribunal with deciding upon its jurisdiction in this matter. The parties to this arbitration have put in issue provisions of the BIT between the Netherlands and Bolivia. Given that the Government of the Netherlands is not a party or otherwise present in this arbitration, the Tribunal concludes that information from the Government of the Netherlands would assist the work of the Tribunal. Given further the above quoted Article 27 of the ICSID Convention and the fact that the Netherlands is not a party to this arbitration, the Tribunal is also of the view that such questions must be specific and narrowly tailored, aimed at obtaining information supporting interpretative positions of general application rather than ones related to a specific case. It is the opinion of the Tribunal that it possesses the authority to seek this information under Rule 34 of the ICSID Arbitration Rules.

With all of these considerations in mind, the Tribunal notes that the written responses to parliamentary questions, summarized above and attached in full, do not in and of themselves provide reasons of general application. If the Government's statement replying to the Parliamentary questions of 18 April 2002 reflects an interpretative position of general application held by the Government of the Netherlands, the Tribunal requests that the Government provide the Tribunal with information (of the type suggested by Articles 31 and 32 of the Vienna Convention on the Law of Treaties as being possibly relevant) upon which that general interpretative position is based. The Tribunal advises that it already has before it the text of the BIT and the Explanatory Note set forth at Staten-Generaal, Parliamentary Year 1992-1993, 22870 (R 1452), nos. 37 and 1.

The Tribunal is proceeding with its deliberations on this matter. To be effective your response will need to be received by the Tribunal before 15 November 2004.

The Tribunal thanks you for your attention to this matter. On behalf of myself and the other members of the Tribunal, I am

Respectfully yours,

David D. Caron
President of the Tribunal in the matter of
Aguas del Tunari v. Republic of Bolivia

[List of Attachments not reprinted]

[8] See *Id.*, answer 1. See also attachment 5, Unofficial English translation; and attachment 6, Dutch original.

ANNEX 20

IN THE MATTER OF AN UNCITRAL ARBITRATION

between

NATIONAL GRID PLC
(Claimant)

and

THE ARGENTINE REPUBLIC
(Respondent)

DECISION ON JURISDICTION

Members of the Tribunal
Dr. Andrés Rigo Sureda, President
E. Whitney Debevoise, Esq., Arbitrator
Professor Alejandro Garro, Arbitrator

Secretary of the Tribunal
Mrs. Mercedes Cordido-Freytes de Kurowski

Representing the Claimant
Mr. Nigel Blackaby
Mr. Lluís Paradell
Ms. Andrea Saldarriaga
Freshfields Bruckhaus Deringer
Paris, France

Dr. Uriel O'Farrell
Estudio O'Farrell
Buenos Aires, Argentina

Representing the Respondent
Dr. Osvaldo Césár Guglielmino
Procurador del Tesoro de la Nación
Argentina

Washington, D.C., June 20, 2006

TABLE OF CONTENTS

Page

I. **PROCEDURAL HISTORY** 1

II. **FACTS** 6

A. The Investment Project 6

B. The Facts Giving Rise to the Dispute 9

C. Notification of the Dispute and Claim 10

III. **CONSENT TO ARBITRATION** 11

IV. **APPLICABLE LAW** 11

V. **OBJECTIONS TO JURISDICTION**

1. First Objection: *The Most-Favored Nation ("MFN") Clause Does Not Apply to Provide the Investor with a More Favorable Dispute Resolution Mechanism* 12

a) Positions of the Parties

i) Position of the Respondent 13

ii) Position of the Claimant 18

b) Considerations of the Tribunal 23

2. Second Objection: *The Claimant Is Not an "Investor"* 29

a) Positions of the Parties

i) Position of the Respondent 30

ii) Position of the Claimant 32

b) Considerations of the Tribunal 38

3. Third Objection: *The Dispute Is Not a "Dispute with Regard to an Investment"* 41

a) Positions of the Parties

i) Position of the Respondent 42

ii) Position of the Claimant 44

b) Considerations of the Tribunal 48

4. Fourth Objection: *The Dispute Is Not a "Legal Dispute"* 50

a) Positions of the Parties

i) Position of the Respondent 50

TABLE OF CONTENTS

Page

ii) Position of the Claimant 54

b) Considerations of the Tribunal 57

5. Fifth Objection: *Letters of Understanding* 58

a) Positions of the Parties

i) Position of the Respondent 58

ii) Position of the Claimant 59

b) Considerations of the Tribunal 60

6. Sixth Objection: *Exclusive Jurisdiction of the Federal Courts of Buenos Aires* 60

a) Positions of the Parties

i) Position of the Respondent 61

ii) Position of the Claimant 61

b) Considerations of the Tribunal 62

VI. **DECISION** 63

National Grid plc v. Argentine Republic

Decision on Jurisdiction

I. PROCEDURAL HISTORY

1. By notice dated April 25, 2003, National Grid Transco plc[1] (hereinafter "National Grid" or the "Claimant") requested the institution of an arbitration proceeding against the Argentine Republic (hereinafter "Argentina" or the "Respondent") under the Arbitration Rules of the United Nations Commission on International Trade Law (hereinafter the "UNCITRAL Rules") pursuant to the Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Argentine Republic for the Promotion and Protection of Investments, which was signed on December 11, 1990, and entered into force on February 19, 1993 (the "Treaty").

2. The Claimant and the Respondent appointed as arbitrators Mr. Eli Whitney Debevoise and Professor Alejandro Garro, respectively. In accordance with Article 7(1) of the UNCITRAL Rules, the party-appointed arbitrators selected Mr. Andrés Rigo Sureda as the third arbitrator and president of the Tribunal.

3. On March 29, 2004, the Arbitral Tribunal issued its Procedural Order No. 1 recording that it had been constituted in accordance with the UNCITRAL Rules and proposing a date for a preparatory meeting with the parties.

4. Messrs. Nigel Blackaby, Lluís Paradell and Uriel O'Farrell, and Ms. Andrea Saldarriaga represent the Claimant. Dr. Osvaldo César Guglielmino, Procurador del Tesoro de la Nación Argentina, represents the Respondent. Dr. Juan José Galeano and Professor Beatriz Pallarés, acting on instruction from the Procurador del Tesoro de la Nación Argentina, represented the Respondent at

[1] By its letter of August 19, 2005, the Claimant informed the Tribunal of its change of name from National Grid Transco plc to National Grid plc.

the preparatory meeting.

5. During the preparatory meeting of June 25, 2004, in Washington, D.C., U.S.A., the parties confirmed that the Tribunal had been properly constituted in accordance with the UNCITRAL Rules without raising any objections to the appointment of any member of the Tribunal.

6. The parties also agreed on several other procedural matters which were later recorded in the written minutes signed by the President of the Tribunal. In the course of the meeting, Washington, D.C. was agreed as the seat of the arbitration. It was also agreed that the parties would request the Secretariat of the International Centre for Settlement of Investment Disputes (hereinafter "ICSID") to provide administrative services for the arbitration proceedings.

7. By letters of June 28 and July 1, 2004, the parties requested such services of the ICSID Secretariat. By letter of July 9, 2004, the Acting Secretary-General of ICSID informed the parties and the members of the Tribunal that the Centre would provide administrative services for the arbitration proceedings, as requested. On August 11, 2004, Mr. Francisco Ceballos, ICSID Counsel, was appointed as Secretary of the Tribunal.

8. On July 12, 2004, the Tribunal issued its Procedural Order No. 2 concerning the presentation of the parties' pleadings. The Tribunal requested the Claimant to file the statement of claim within four months of its receipt of Procedural Order No. 2. In the event that no jurisdictional plea was entered, the Respondent was directed to file its statement of defense within four months from its receipt of the statement of claim; the Claimant, its reply two months from its receipt of the statement of defense; and the Respondent, its rejoinder two months from its receipt of the reply. In the event that the Respondent entered a plea on jurisdiction, it should do so within two months from its receipt of the statement of claim; the Claimant would then have two months to present its counter-memorial on jurisdiction; and the Tribunal would decide on the need for a

further exchange of submissions or hearings concerning its jurisdiction. The Tribunal further decided that in case it upheld its jurisdiction, the Respondent should file a statement of defense within four months of its receipt of the decision of the Tribunal less the time elapsed between the date of submission of the statement of claim and the date of submission of the plea on jurisdiction.

9. On November 16, 2004, the Claimant filed its Statement of Claim in English, and on December 1, 2004, filed the respective Spanish translation.

10. On December 14, 2004, the Tribunal informed the parties that in accordance with its Procedural Order No. 2, in the event that a plea on jurisdiction was entered by the Respondent, such plea was to be filed no later than February 10, 2005. In the event no plea was raised, the Respondent was to file its statement of defense no later than April 11, 2005.

11. On December 15, 2004, the Respondent challenged the President of the Tribunal.

12. On December 23, 2004, the Claimant expressed its opposition to the challenge and reserved its right to present further arguments.

13. On January 7, 2005, the Tribunal issued Procedural Order No. 3 establishing a schedule for submissions by the parties and the President in observance of the challenge procedures of the UNCITRAL Rules. The Tribunal also reaffirmed the deadlines established in Procedural Order No. 2. In accordance with the agreement of the parties, reflected in the minutes of the preparatory meeting of June 25, 2004, that a majority of the members of the Tribunal will constitute the quorum necessary to make decisions, Procedural Order No. 3 was subscribed by the two arbitrators not subject to the Respondent's challenge.

14. Following exchanges of submissions by the parties on the Respondent's challenge, on February 28, 2005, the President confirmed his intention not to resign.

15. On March 11, 2005, the Tribunal issued Procedural Order No. 4 granting the parties a term of 10 days to agree on an appointing authority for purposes of the procedure provided for in Article 12(1)(c) of the UNCITRAL Rules. Absent agreement, Procedural Order No. 4 authorized either Party to proceed, pursuant to Article 6 of the UNCITRAL Rules, to request the Secretary-General of the Permanent Court of Arbitration in The Hague ("PCA Secretary-General") to designate the appointing authority. The Tribunal also reserved for the award the fixing of fees and expenses of the appointing authority and of the PCA Secretary-General, as provided for in Article 38(f) of the UNCITRAL Rules.

16. In early September 2005, the Respondent completed the formalities necessary to request the PCA Secretary-General to designate the appointing authority.

17. On September 8, 2005, the PCA Secretary-General designated the International Court of Arbitration of the International Chamber of Commerce in Paris as appointing authority.

18. Following submissions by the Parties, on December 16, 2005, the International Court of Arbitration rejected the Respondent's challenge of the President of the Tribunal.

19. On February 10, 2005, the Respondent filed its plea on jurisdiction in Spanish. The English translation followed on February 25, 2005.

20. On March 11, 2005, the Tribunal issued its Procedural Order No. 4 confirming the deadlines established in its Procedural Order No. 2, as ratified in its Procedural Order No. 3.

21. On March 18, 2005, Mr. Francisco Ceballos was replaced by Mrs. Claudia Frutos-Peterson as Secretary of the Tribunal. In turn, on May 10, 2005, Mrs. Frutos-Peterson was replaced by Mr. José Antonio Rivas as Secretary of the Tribunal.

22. On April 29, 2005, the Claimant filed its response to the plea on jurisdiction. The Spanish translation followed on May 10, 2005.

23. On May 3, 2005, the Claimant sent the Tribunal a letter proposing that the jurisdictional debate proceed to oral hearing without need for further written submissions.

24. On May 27, 2005, the Tribunal issued its Procedural Order No. 5 deciding that no further exchange of pleadings on jurisdiction was required. The Tribunal further decided to hold a jurisdictional hearing on a date to be established in consultation with the parties.

25. On June 17, 2005, the Tribunal issued its Procedural Order No. 6 related to the Respondent's disqualification request.

26. On August 5, 2005, after consultations with the parties on their availability, the Tribunal confirmed that the hearing on jurisdiction would take place on November 7, 2005.

27. On August 10, 2005, the Tribunal issued its Procedural Order No. 7 related to the Respondent's disqualification request and confirming the deadlines set forth in its Procedural Order No. 2, as ratified in its Procedural Order No. 3.

28. On August 30 and September 27, 2005, the Tribunal issued Procedural Order No. 8 and Procedural Order No. 9, respectively, related to the Respondent's disqualification request and ratifying that the hearing on jurisdiction would take place on November 7, 2005.

29. The hearing on jurisdiction took place on November 7, 2005 in Washington, D.C. The Claimant was represented at the hearing by Messrs. Nigel Blackaby, Lluís Paradell and Uriel O'Farrell, and Ms. Andrea Saldarriaga. Messrs. Blackaby, Paradell and O'Farrell addressed the Tribunal on behalf of the Claimant. The Respondent was represented by Messrs. Martín Moncayo von Hase, Ariel Martins Mogo and Florencio Travieso from the Procuración del

Tesoro de la Nación Argentina, who addressed the Tribunal on behalf of the Respondent.

30. By letter of November 9, 2005, the Tribunal reaffirmed the invitation made to the Respondent during the course of the hearing on jurisdiction to furnish information to the Tribunal on the status of the renegotiations of certain foreign investment contracts in Argentina. By letter of November 24, 2005, the Respondent informed the Tribunal. By letter of December 15, 2005, the Claimant provided its comments on the information furnished by the Respondent.

31. On December 23, 2005, the Acting Director of ICSID informed the Tribunal that Mrs. Mercedes Kurowski had been appointed to replace Mr. José Antonio Rivas as Secretary of the Tribunal.

II. FACTS

A. The Investment Project

32. The dispute arises in the context of the privatization program carried out by the Respondent in the early 1990s, the guarantees offered to investors who bought assets in the electricity sector, and the measures taken by the Respondent to stem the Argentine economic crisis in 2001-2002.

33. Before privatization, the electricity assets of the Respondent were operated by *Agua y Energía Sociedad del Estado* ("A y E"), *Servicios Eléctricos del Gran Buenos Aires S.A.* ("SEGBA") and *Hidroeléctrica Nordpatagónica S.A.* ("Hidronor").

34. These three companies were restructured for purposes of privatization pursuant to Decree 634/91 of April 12, 1991,[2] and Law 24,065 of January 16, 1992[3] (the "Electricity Law"). According to this legal framework, the electricity generation, transmission and distribution assets belonging to those

[2] Claimant's Exhibit 11. Claimant's exhibits are referred to hereafter with the letter "C" followed by the exhibit number.

[3] Exhibit C-13.

three state companies were divided into individual business units. Thus, the electricity transmission assets held by A y E, SEGBA and Hidronor were transferred to one national high-voltage electricity transmission company – *Compañía de Transporte de Energía Eléctrica en Alta Tensión S.A.* ("Transener") – and six regional companies.

35. In December 1992, the Respondent offered, through an international bidding process, 65% of Transener's shares, in accordance with the terms and conditions set forth in the bidding rules.[4] In parallel, the Respondent approved the terms of a 95-year concession agreement granting Transener the right to provide high-voltage electricity transmission service in Argentina (the "Concession").[5]

36. In turn, the Argentine provinces privatized the electricity assets under their jurisdiction. Thus, in 1997, the Province of Buenos Aires (the "Province") launched an international public tender for the sale of 90% of the shares in *Empresa de Transporte de Energía Eléctrica por Distribución Troncal de la Provincia de Buenos Aires S.A.* ("Transba"), pursuant to the terms and conditions approved by Decree 107/97 of January 10, 1997 of the Province ("Transba Bidding Rules").[6] In July 1997, the Province approved the terms of a 95-year concession granting Transba the right to provide high-voltage electricity transmission service within the Province (the "Transba Concession").[7]

37. In 1993, National Grid Finance B.V., a wholly owned subsidiary of National Grid, together with two US companies – Duke Transener Inc. ("Duke") and Entergy Corp ("Entergy") – and two Argentine companies – *SADE Ingeniería y Construcciones S.A.* ("SADE"), a wholly-owned subsidiary of Perez Companc ("Perez Companc"), and *Eléctrica del Plata S.A.*, a subsidiary of *Sociedad*

[4] *See* "Pliego de Bases y Condiciones de Concurso Público Internacional para la Venta de 65% de las Acciones de la Compañía de Transporte de Energía Eléctrica en Alta Tensión Transener S.A." ("Transener Bidding Rules"), Exhibit C-20.

[5] Exhibit C-26.

[6] Exhibit C-40.

[7] Exhibit C-50.

Comercial del Plata S.A. ("SCP") – formed a consortium to participate in the international tender of shares in Transener (the "Consortium").[8] The Consortium incorporated an Argentine company – *Compañía Inversora en Transmisión Eléctrica Citelec S.A.* ("Citelec") – as a vehicle for its investment in Transener.[9] National Grid initially acquired a 15% share of Citelec for US$18.5 million.

38. Citelec successfully bid for the 65% stake in Transener for US$234.1 million, the assumption of US$54.2 million of debts transferred to Transener and a mandatory investment commitment of US$37 million. On June 30, 1993, Transener signed the Concession Contract with the Government of the Argentine Republic (the "Concession Contract").[10] Transener took over operation of the high voltage electricity system on July 17, 1993. Subsequently, National Grid purchased an additional 26.25% stake in Citelec for US$48.8 million, approved Transener's acquisition of a 90% stake in Transba for US$220.2 million and the assumption of a debt of US$10 million owed to the Government of the Province. Transener subsequently made investments in the upgrading of the electricity transmission system and in expansion projects. In 1997, 1999 and 2001, Transener was awarded three contracts to construct, operate and maintain transmission lines in return for periodic payments from the beneficiaries of the lines. These payments, or *cánones*, were to be calculated in US dollars and adjusted periodically in accordance with the US Consumer Price Index ("CPI") and the US Producer Price Index ("PPI").

39. In December 1999, National Grid acquired a further 1.243% interest in Citelec by way of a capitalization of contributions made by National Grid in October 1999 for an amount of US$32 million.

---

[8] Exhibit C-22.

[9] Exhibit C-24.

[10] The Concession Contract and the contract related to the Transba Concession are collectively referred to as the "Contracts". Transener and Transba are referred to collectively as the "Concessionaires." See Exhibit C-26 for the Concession Contract and Exhibit C-50 for the Transba Concession.

B. The Facts Giving Rise to the Dispute

40. On January 6, 2002, Law 25,561 – the Public Emergency and Exchange Rate Reform Law – (the "Reform Law")[11] abolished the currency board set up by the Convertibility Law in 1991.[12] Law 25,561 also terminated by operation of law the right to calculate public utility tariffs in US dollars and the right to adjust those tariffs on the basis of international price indices. Under the terms of Law 25,561, public service tariffs were converted into Argentine pesos ("pesos") at the rate of one peso to one dollar and were frozen at that rate (the so-called "pesification"). All other dollar-denominated payment obligations and their adjustment by international indices suffered the same fate. As of April 2003, the Argentine peso had fallen to 2.90 pesos to one US dollar.

41. The Reform Law forbade electricity transmission and public utility companies from suspending or modifying compliance with their obligations under their concessions and licenses. It also provided for the renegotiation of public utility contracts. At the time of filing the Statement of Claim, National Grid affirmed that the renegotiation process had achieved nothing. Respondent disputes such affirmation and objects to the jurisdiction of the Tribunal on the basis, *inter alia*, that there is an ongoing negotiation process touching upon the subject matter of this dispute.[13]

42. The Claimant alleges that the impact of the Reform Law and subsequent adverse regulations adopted by the Respondent (the "Measures") destroyed the value of its investment in Transener, and estimates that its losses range from US$100 million to US$130 million.[14]

43. In March 2004, National Grid agreed to sell its shares in Citelec to *Dolphin Management S.A.* ("Dolphin") for US$14 million. The Claimant alleges that this sale was undertaken to mitigate its losses and was made expressly

---

[11] Exhibit C-69.

[12] Law 23,928 of March 27, 1991, Exhibit C-10.

[13] Respondent's Plea on Jurisdiction, paras. 174-182; Respondent's Exhibit 6.

[14] Statement of Claim, paras. 23-24, Exhibit C-67.

without prejudice to its rights in this arbitration.[15]

C. Notification of the Dispute and Claim

44. Following adoption of the Measures, on April 10, 2002, the Claimant notified the Respondent of the existence of an investment dispute and sought the commencement of negotiations and consultations for its amicable settlement as provided in Article 8 of the Treaty.[16] The notification expressly invoked Article 3, the most-favored nation article of the Treaty, and claimed the benefit of Article 7(2) of the Treaty Between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment (the "US-Argentina Treaty"),[17] which provides for international arbitration after a six-month period of negotiations without prior referral to the Argentine courts.

45. On August 28, 2002, the Claimant sent a follow-up letter to the Respondent reiterating the request for amicable settlement.[18]

46. On September 27, 2002, the Procurador del Tesoro de la Nación, Rubén Miguel Citara, responded and proposed to suspend by mutual agreement the negotiations period until such date as the process of renegotiation of public service contracts had taken place. The Claimant replied on October 17, 2002, distinguishing between the renegotiation of the concessions involving Transener and Transba and negotiations with the Claimant concerning its Treaty claims.[19] The Claimant declined the proposal to suspend or extend the time period for amicable negotiations, although it did express a willingness to meet with the authorities to conduct negotiations.

---

[15] Statement of Claim, para. 24.

[16] Exhibit C-77.

[17] Treaty Between the United States of America and the Argentine Republic concerning the Reciprocal Encouragement and Protection of Investment, dated November 14, 1991, *available at* http://www.unctad.org/sections/dite/iia/docs/bits/argentina_us.pdf.

[18] Exhibit C-87.

[19] Exhibit C-94.

47. On February 20, 2003, the Claimant wrote to the Respondent again expressing a willingness to meet to explore ways to resolve the dispute, notwithstanding the expiration of the six-month negotiations period.[20]

48. On April 25, 2003, the Claimant submitted its Notice of Arbitration.

III. CONSENT TO ARBITRATION

49. Except as addressed below, the parties to the dispute have consented to arbitration and their consent is not in doubt or dispute. The Respondent consented to arbitration by offering under the terms of the Treaty the option to settle eventual disputes that may arise with investors who are nationals of the other State party. Claimant consented to arbitration by filing its Notice of Arbitration. Under Article 3.2 of the UNCITRAL Rules, the arbitration proceedings commenced on the date that the Notice of Arbitration was received by the Respondent.[21]

IV. APPLICABLE LAW

50. The applicable law for purposes of determining the jurisdiction of the Tribunal has not been a matter of contention between the parties, and it has only been indirectly addressed by them in their submissions.[22]

51. The jurisdiction of the Tribunal is governed by the terms of the instruments expressing the parties' intent to submit to arbitration the dispute identified in the Notice of Arbitration. Article 21.1 of the UNCITRAL Rules empowers the Tribunal to rule on objections that it has no jurisdiction. It follows that the primary task of the Tribunal is to assess whether the dispute submitted in

---

[20] Exhibit C-109.

[21] There is no requirement under the UNCITRAL Rules that consent must be given in the same instrument by both parties to the proceedings. In the case of arbitration under the terms of a bilateral investment treaty, arbitral tribunals have consistently held that consent to arbitration has been given by the State party through the treaty concerned and by the investor through the instrument initiating the arbitration proceedings. See *American Manufacturing & Trading, Inc. v. Republic of Zaire (Award)*, 36 *ILM.(*1997) p. 1531 at para. 5.23, and *Lanco International Inc. v. Argentine Republic* (Preliminary Decision on Jurisdiction), 40 *ILM* (2001) p. 454 at paras. 42-44.

[22] *See, e.g.*, Respondent's Memorial on Jurisdiction at para. 62.

the Notice of Arbitration falls within the terms of Article 8 of the Treaty and whether the Tribunal has the authority to decide on the objections raised by the Respondent. To the extent that this assessment requires the interpretation of the Treaty, the Tribunal shall apply the treaty interpretation rules enshrined in Articles 31 and 32 of the Vienna Convention on the Law of Treaties ('the Vienna Convention"),[23] which reflect customary international law. Furthermore, the Tribunal observes that the Vienna Convention is binding on both State parties to the Treaty.[24]

V. OBJECTIONS TO JURISDICTION

52. The Respondent has raised six objections to the jurisdiction of the Tribunal. The Tribunal will now address them in the order that they have been raised.

1. First Objection: The Most-Favored Nation ("MFN") Clause Does Not Apply to Provide the Investor with a More Favorable Dispute Resolution Mechanism

53. The Claimant has submitted its claim to arbitration without first submitting it to the Argentine courts as required by Article 8(1) and Article 8(2)(a) of the Treaty. Article 8(2)(a) permits a claimant to institute arbitration proceedings only if the Respondent's courts have not given a final decision within eighteen months after the dispute was submitted to them. The Claimant has considered it unnecessary to file a claim before Argentine courts on the basis that the dispute resolution clause in the US-Argentina Treaty[25] does not require such step. According to the Claimant, under Article 3(2) of the Treaty an investor who is a national of the United Kingdom is entitled to rely on the more favorable procedural regime contained in the US-Argentina Treaty. The Claimant has also

[23] Vienna Convention on the Law of Treaties (23 May 1969), 1155 *UN Treaty Series* 331.

[24] The Argentine Republic signed the Vienna Convention on May 23, 1969, and ratified it on December 5, 1972; the United Kingdom signed the Convention on April 20, 1970 and ratified it on June 25, 1971.

[25] US-Argentina Treaty, *supra* note 17.

argued that the requirement to submit its claim to the local courts first is a procedural step leading to inefficiency and inequity in the settlement of disputes, thus defeating the object and purpose of the Treaty. We will consider first the arguments advanced by the parties in connection with the application of the MFN clause, followed by the considerations and conclusion reached by the Tribunal.

(a) Positions of the Parties

(i) Position of the Respondent

54. The Respondent takes exception to the application of the MFN clause in this case. According to the Respondent, this clause is governed by the *ejusdem generis* principle expressed by the International Law Commission ("ILC") in the following terms: "The beneficiary State may not invoke, by reason of the most-favored nation clause, rights other than those relative to the object of the clause and those included within the scope of the same."[26] This principle was applied by the Arbitration Commission that decided the *Ambatielos* case: "the Commission holds that the most-favored nation clause can only attract matters belonging to the same category of subject as that to which the clause itself relates."[27]

55. The Respondent argues further that the interpretation given by the Claimant to the MFN clause in the Treaty would render superfluous the clause requiring that a dispute be brought first before the local courts. The United Kingdom so argued in the *Anglo-Iranian Oil Co.* case:

> "It [the UK] asserts that a legal text should be interpreted in such a way that a reason and meaning can be attributed to every word in the text. It may be said that this principle should in general be applied when

[26] Article 7 of the Draft International Law Commission Report on the Most-Favored-Nation Clause, contained in Volume II of the International Law Commission Annual Report for 1973, U.N. Doc. A/CN.4/266.

[27] *Ambatielos (Greece v. United Kingdom of Great Britain and Northern Ireland)*, Award (6 March 1956), XII R.I.A.A. 91, 107.

interpreting the text of a treaty…"[28]

56. As a third argument, the Respondent alleges that it is evident from the text of the Treaty itself that the parties had no intention to include the settlement of disputes within the scope of the MFN clause. Article 3(2) reads as follows:

> "Neither Contracting Party shall in its territory subject investors of the other Contracting Party, **as regards their management, maintenance, use, enjoyment or disposal** of their investments, to treatment less favorable than that which it accords to its own investors or to investors of a third State."[29]

57. The Respondent notes that the text of Article 3(2) of the Treaty is different from the MFN clause in the BIT concluded between Spain and Argentina, which the arbitral tribunal in *Maffezini* [30] interpreted to include matters related to dispute settlement and on which the Claimant bases its argument. Contrary to what is alleged by the Claimant, the Respondent affirms that the text of the MFN clause in the Treaty is not as clear as the terms of the MFN clauses that were subject to interpretation in *Ambatielos* and *Maffezini*. In these cases, the clause being interpreted referred to "all matters relating to commerce and navigation"[31] and *"todas las materias regidas por el presente Acuerdo*"[32], respectively. The Arbitration Commission in *Ambatielos* and the arbitral tribunal in *Maffezini* observed that the agreement concerned did not expressly refer to dispute settlement in the MFN clause and hence it was necessary to determine the intention of the parties. The Respondent further notes that, in *Maffezini*, the arbitral tribunal made sure that, if it accepted the investor's position, the

---

[28] *Anglo-Iranian Oil Co. (United Kingdom v. Iran)*, Preliminary Objection (22 July 1952), [1952] *ICJ Reports* 93, 105.

[29] Treaty, Art. 3(2) (as it appears in the Respondent's Plea on Jurisdiction at para. 39). (Emphasis added by the Tribunal.)

[30] *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (25 January 2000), 16 ICSID Rev.—FILJ 212 (2001).

[31] Respondent's Plea on Jurisdiction, para. 44 (citing *Ambatielos*, *supra* note 27).

[32] *Id.* (citing *Maffezini*, *supra* note 30).

interpretation of such MFN clause by the arbitral tribunal in that particular case would not necessarily open the floodgates to expansive interpretations of other MFN clauses in future arbitrations.

58. The Respondent finds its interpretation of the clause and analysis of *Maffezini* confirmed by the decision on jurisdiction in the case of *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan* ("*Salini*")[33]. In that decision, the tribunal observed that:

> "…[T]he circumstances of this case are different. Indeed, Article 3 of the BIT between Italy and Jordan does not include any provision extending its scope of application to dispute settlement. It does not envisage 'all rights covered by the agreement'. Furthermore, the Claimants have submitted nothing from which it *might* be established that the common intention of the Parties was to have the most-favored-nation clause apply to dispute settlement."[34]

59. The Respondent finds that the Tribunal in this case faces the same situation as the arbitral tribunal in *Salini*. If the text of the MFN clause in the Treaty is completely different from the text of the MFN clauses on which *Ambatielos* and *Maffezini* based their decisions, as well as different from other MFN clauses in other bilateral investment treaties signed by the United Kingdom (such as the bilateral treaty signed by the UK with Albania, where settlement of disputes is expressly included in the scope of the MFN clause), then the strategy of the Claimant is to confound the Tribunal. The Respondent has no doubt that matters related to the administration of justice are excluded from and cannot be imported into the Treaty via the MFN clause as proposed by the Claimant.

60. The Respondent concludes by drawing the attention of the Tribunal (A) to the real objectives of Article 8 of the Treaty, namely, to afford Argentine

[33] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction (29 November 2004), 20 ICSID Rev.—FILJ 148 (2005).

[34] *Id.*, para. 118.

courts the opportunity to apply and vindicate international law, and (B) to its view that it would be an affront to international law for an international tribunal to apply a rule of interpretation to reach a result that differed from the intent of the parties to the Treaty.

61. During the hearings, Argentina placed special emphasis on the importance of the parties' intent in the interpretation of the MFN clause. According to the Respondent, the parties to the Treaty had no intention to apply the MFN clause to dispute resolution matters, as is evident if the text of the MFN clause in the Treaty is compared with the one included in the bilateral investment treaty between the United Kingdom and Albania.[35] The Respondent referred to two decisions on jurisdiction – *Salini*[36] and *Plama v. Bulgaria*[37]- this latter decision having been rendered since the Respondent had filed its plea on jurisdiction. The Respondent pointed out that, in *Salini*, the arbitral tribunal, after comparing the Spain-Argentina BIT with the Italy-Jordan BIT, concluded that the circumstances of that case were different:

> "Indeed, Article 3 of the BIT between Italy and Jordan does not include any provision extending its scope of application to dispute settlement. It does not envisage 'all rights or all matters covered by the agreement.' Furthermore, the claimants have submitted nothing from which it *might* be established that the common intention of the parties was to have the most-favored-nation clause applied to dispute settlement."[38]

62. The Respondent also drew the attention of the Tribunal to the holdings of the tribunal in *Plama* as regards the undue emphasis on the object and purpose of a treaty, the need for the parties to express the intention to

---

[35] Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Albania for the Promotion and Protection of Investments, dated 30 March 1994, Exhibit C-157.

[36] *Salini*, *supra* note 33.

[37] *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (8 February 2005), 20 ICSID Rev.—FILJ 262 (2005).

[38] Transcript from the Hearing on Jurisdiction, English version, pp. 18-19 (quoting *Salini*, *supra* note 33, para. 118). All references to the Transcript hereafter shall refer to the English version.

incorporate dispute settlement provisions clearly and unambiguously, the autonomy of dispute settlement clauses, and the difficulty in applying provisions of one bilateral investment treaty to another negotiated in a different context.[39] The Respondent reminded the Tribunal of the extensive criticism of *Maffezini* by the *Plama* tribunal, in particular in respect of the statement made in *Maffezini* on the harmonization of dispute resolution regimes through MFN clauses:

> "The present Tribunal fails to see how this harmonization of dispute settlement provisions can be achieved by reliance on the MFN provision. Rather, the 'basket of treatment' and 'self-adaptation of the MFN provision' in relation to dispute settlement provisions (as alleged by the Claimant) has as effect that the investor has the option to pick and choose provisions from the various BITs. If that were true, a host State which has not specifically agreed thereto can be confronted with a large number of permutations of dispute settlement provisions from the various BITs which it has concluded. Such a chaotic situation – actually counterproductive to harmonization – cannot be presumed to be the intent of the contracting parties."[40]

63. The Respondent further noted the criticism of *Plama* in connection with the decision on jurisdiction in *Siemens*[41] as evidence of the dangers of *Maffezini*'s approach: "The principle is retained in the form of string citation of principle, and the exceptions are relegated to a brief examination prone to falling soon into oblivion."[42]

64. The Respondent concluded by requesting the Tribunal to respect the intent of the parties to the Treaty.

---

[39] *Id.*, pp. 20-21.

[40] *Id.*, pp. 23-24 (paraphrasing from *Plama*, *supra* note 37, para. 219).

[41] *Siemens A.G. v. The Argentine Republic,* ICSID Case No. ARB/02/08, Decision on Jurisdiction (3 August 2004), *available at* http://www.worldbank.org/icsid/cases/awards.htm#award42.

[42] Transcript, English version, p. 25 (quoting *Plama*, *supra* note 37, para. 226, which refers to *Siemens*, *supra* note 41, paras. 105, 109 and 120).

(ii) Position of the Claimant

65. The Claimant argues that the text of a treaty is assumed to be the authentic expression of the parties' mutual intent. The MFN clause is very broad; it applies to "investments", "investors" and "management, maintenance, use, enjoyment or disposal" of investments. The Claimant observes that the term "maintenance" covers preservation, protection, safeguard and continuation of investments; and that recourse to dispute settlement is a normal feature of the management and enjoyment of an investment.

66. The Claimant points to the addition of the following paragraph to the regular MFN clause in BITs concluded by the UK after 1993[43]:

> "For the avoidance of doubt it is confirmed that[44] the treatment provided in paragraphs (1) and (2) above shall apply to the provisions of Articles 1 to 11[45] of this Agreement."[46]

67. According to the Claimant this addition, by using terms such as "for the avoidance of doubt" and "it is confirmed", demonstrates that the intention in paragraph 1 and 2 was to incorporate into the MFN clause all matters aimed at protecting an investment, including matters relating to the settlement of disputes. The resulting paragraph, by its terms, does not purport to extend the scope of paragraphs (1) and (2) but to confirm their existing scope.

68. The Claimant argues that when the parties to the Treaty wished to limit the scope of the Treaty, they did so expressly and unequivocally. Thus, Article 7 excludes expressly from the operation of the MFN clause the benefit of any treatment, preference or privilege resulting from customs unions, regional economic integration or similar agreements, specifically listing bilateral

[43] Claimant's Counter-Memorial on Jurisdiction, para. 176 (referring to the UK-Honduras BIT, UK-Albania BIT and UK-Venezuela BIT). *See* Exhibits C-157 to C-159.

[44] Emphasis added by the Claimant.

[45] Articles 1 to 11 cover the entire Treaty except the final clauses and include the dispute resolution clauses.

[46] *Id.* (citing Art. 3(3) of the BITs listed *supra* in note 43).

agreements providing for concessional financing, and domestic legislation or international agreements or arrangements relating wholly or mainly to taxation. Claimant concludes that the MFN clause was intended to apply to the whole Treaty and, by the very application of the *ejusdem generis* principle, the MFN clause applies to matters related to the method for settling disputes arising under the Treaty.

69. The Claimant replies to an argument hinted at by Argentina in the sense that an MFN clause is a clause of an exceptional nature because it limits the application of the principle *res inter alios acta*. In response, Claimant points out that the MFN clause itself is not *res inter alios acta* and that there is no special rule of interpretation for MFN clauses. An MFN clause should be interpreted as any other clause in the Treaty, that is, "in the light of its object and purpose" as required by the Vienna Convention.[47] The object and purpose of the Treaty is to promote and protect investments. As clearly stated by the tribunal in *SGS v. Philippines*: "It is legitimate to resolve uncertainties in its [the BIT's] interpretation so as to favor the protection of covered investments."[48] According to the Claimant, the object of the Treaty would be defeated by an interpretation that excluded the application of the MFN clause to dispute resolution.

70. The Claimant relies on case law in support of its contention that dispute settlement provisions are related to the treatment afforded to a foreign investor. Thus, in *Ambatielos*, the commission of arbitration held that: "Protection of the rights of traders naturally finds a place among the matters dealt with by treaties of commerce and navigation."[49] Also in *Maffezini* the arbitral tribunal concluded that dispute resolution matters in BITs are "inextricably related to the protection of foreign investors, as they are also related to the protection of rights

---

[47] Vienna Convention, *supra* note 23, Art. 31(1).

[48] *Société Générale de Surveillance S.A. (SGS) v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction (29 January 2004), 8 ICSID Rep. 518 (2005), para. 116.

[49] *Ambatielos, supra* note 27.

of traders under treaties of commerce".[50] The same arbitral tribunal considered that international arbitration and other dispute settlement arrangements are "closely linked to the material aspects of the treatment accorded."[51] The arbitral tribunal in *Siemens* reached a similar conclusion, recalling that the International Court of Justice ("ICJ") had also held, in *Rights of US Nationals in Morocco,*[52] that MFN clauses may extend to provisions related to jurisdictional matters.

71. The Claimant contests the relevance of *Salini* to this case. First, the arbitral tribunal in *Salini* did not identify the concerns it claimed to share nor who had raised those concerns when it stated that "it shares the concerns that have been expressed in numerous quarters with regard to the solution adopted in the *Maffezini* case."[53] Second, the arbitral tribunal in *Salini* stated that the circumstances in that case were different from those in *Maffezini* and that its decision was based on the particular wording of the MFN clause of the Italy-Jordan BIT. Third, the tribunal in *Salini* was addressing the question whether the MFN clause could be used to create jurisdiction over contractual disputes when the applicable BIT expressly excluded those disputes from arbitration and did not consider their application to a general procedural requirement for the submission of disputes to arbitration. In fact, always according to the Claimant, in *Salini* "there was no need for the tribunal to interpret the scope of the MFN clause because there had been an express exclusion of the right sought by the claimant through most favored nation treatment."[54] The Claimant concludes that the decision in *Salini* "cannot be invoked as a general proposition that MFN clauses do not apply to dispute resolution matters."[55]

72. The Claimant then addresses the issue of whether the Argentine Republic's public policy requires submission of the dispute to local courts for a

---

[50] *Maffezini*, *supra* note 30, para. 54.
[51] *Id.*, para. 55.
[52] *Rights of Nationals of the United States of America in Morocco*, Judgment (27 August 1952), (1952) *ICJ Reports,* 176, 192.
[53] *Salini*, *supra* note 33, para. 115.
[54] Claimant's Counter-Memorial on Jurisdiction, para. 207.
[55] *Id.*, para. 208.

period of time prior to submission to arbitration. According to the Claimant, out of 57 BITs signed by the Argentine Republic, only 10 include the requirement of prior submission to local courts; out of 41 BITs signed by the Argentine Republic since October 1992, only one has this requirement; and none of the 21 BITs signed by the Argentine Republic since September 1994 includes such a requirement. The Claimant concludes that, as noted in *Maffezini*, the Argentine Republic has abandoned its policy to require prior submission to local courts. The Claimant also recalls the observation of the arbitral tribunal in *Siemens,* which noted the lack of consistency among the BITs entered into by the Respondent leading to the conclusion that the requirement of instituting proceedings before the local courts could not be considered a sensitive issue of economic or foreign policy conditioning the Argentine Republic's consent to submit to arbitration.[56]

73. The Claimant concludes that the MFN clause in Article 3 of the Treaty extends to the dispute resolution provisions of the Treaty, allowing Claimant to rely on the more favorable procedural regime established in the US-Argentina Treaty. According to the Claimant: "The contrary result would give rise to a clear discrimination between UK claimants and other foreign claimants against Argentina in the Argentina arbitrations and would destroy the very purpose of MFN clauses which is to avoid such discrimination."[57]

74. The Claimant further argues that the eighteen-month requirement is merely a procedural matter which would lead to inefficiency and inequity, thus defeating the object and purpose of the Treaty. The Claimant points out that the submission to the Argentine Republic's courts would be futile in that the dispute would not be resolved in eighteen months, and costly for National Grid in terms of court taxes, scheduled counsel fees and the Argentine Republic's costs if National Grid withdrew its court case in order to pursue arbitration, which defeats the purpose of the Treaty to create favorable conditions for greater investment.

[56] *Id.*, paras. 211-212.
[57] *Id.*, para. 213.

The Claimant draws the attention of the Tribunal to arbitral practice that has found strict application of investment treaty procedural requirements unnecessary where to do so would be futile or formalistic and lead to inefficiency and inequity.[58] Claimant concludes that a different approach would lead "to inefficiency and inequity, as the Claimant would simply be entitled to resubmit the very same issues to an UNCITRAL tribunal after waiting in vain for the Argentine courts to rule on the issues in dispute for eighteen months."[59]

75. During the hearing, the Claimant pointed out that the Argentine Republic failed to refer to *Gas Natural v. Argentine Republic*, decided subsequently to *Plama*, in which the Tribunal held that:

> "Unless it appears clearly that the state parties to a BIT or the parties to a particular investment agreement settled on a different method for resolution of disputes that may arise, most-favored-nation provisions in BITs should be understood to be applicable to dispute resolution."[60]

76. According to Claimant, the real change brought about by the BITs is not the protection of the substantive rights of the investor, which have been widely recognized under international law, but rather direct access to an independent tribunal at the behest of the individual investor. According to Claimant: "it is a critical part of what protection is granted, and to seek to divorce the protection of access to an independent Tribunal from the substantive rights that that Tribunal seeks to protect is […] a false distinction."[61]

77. Claimant takes issue with the relevance of *Salini* and *Plama* to this case. In *Salini*, the claimant attempted to submit a contractual claim by way of an umbrella clause in another bilateral treaty, when the treaty between Italy and

[58] *Id*. paras. 220-222.
[59] *Id*., para. 223.
[60] Transcript, p. 132 (citing para. 49 of *Gas Natural SDG, S.A. v. Argentine Republic,* ICSID Case No. ARB/03/10, Decision of the Tribunal on Preliminary Questions on Jurisdiction (17 June 2005), *available at* http://www.asil.org/pdfs/GasNat.v.Argentina.pdf).
[61] *Id*., p. 141.

Jordan specifically required that such claims be submitted to the procedure foreseen in the investment agreement. In *Plama,* the tribunal was dealing with an old BIT, under which the only matter that could be brought to arbitration under UNCITRAL Rules was the adequacy of compensation in case of expropriation. The claimant in that case tried through an umbrella clause 'to extend the material scope of what is submitted to arbitration to cover everything, and […] access ICSID arbitration into the bargain."[62] Furthermore, in *Plama* there had been negotiations between the State parties to the treaty concerning the possibility of amending it, and the negotiations were unsuccessful. The arbitral tribunal concluded that since the contracting parties had looked into the matter and rejected it, they had no intention to extend the relevant clauses.[63]

78. The Claimant concluded at oral argument that in the instant case there is *no question of seeking access to ICSID without a separate consent*; the consent to arbitration had already been given, and the dispute resolution clause already covers all disputes.[64]

(b) Considerations of the Tribunal

79. The arguments and counter-arguments of the parties raise the following issues: rules for interpretation of the MFN clause, interpretation of the clause to ascertain the will of the parties from the text of the clause, differences in the terms of the MFN clause in this case and the MFN clause in *Maffezini*, and the meaning of "treatment" of foreign investors referred to in the MFN clause in the Treaty. The Tribunal will now consider these issues in this sequence.

80. As already stated above, the Tribunal will interpret the Treaty as required by the Vienna Convention. Article 31 of the Convention requires an international treaty to "be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its

---

[62] *Id.*, p. 149.
[63] *Id.*, p. 150.
[64] *Id.*

object and purpose."[65] As regards the intention of the parties, the approach of the Vienna Convention and of the ICJ is that "what matters is the intention of the parties as expressed in the text, which is the best guide to the more recent common intention of the parties."[66] The Convention does not establish a different rule of interpretation for different clauses. The same rule of interpretation applies to all provisions of a treaty, be they dispute resolution clauses or MFN clauses.

81. Article 3 of the Treaty reads thus:

> "National Treatment and Most-favored Nation Provisions
>
> (1) Neither Contracting Party shall in its territory subject investments or returns of investors or companies of the other Contracting Party to treatment less favorable than that which it accords to investments or returns of its own investors or companies or to investments or returns of nationals or companies of any third State.
>
> (2) Neither Contracting Party shall in its territory subject investors or companies of the other Contracting Party, as regards their management, maintenance, use, enjoyment or disposal of their investments, to treatment less favorable than that which it accords to its own investors or to investors of any third State."

82. The Tribunal observes that the MFN clause does not expressly refer to dispute resolution or for that matter to any other standard of treatment provided for specifically in the Treaty. On the other hand, dispute resolution is not included among the exceptions to the application of the clause. As a matter of interpretation, specific mention of an item excludes others: *expressio unius est exclusio alterius.*[67]

---

[65] Vienna Convention, *supra* note 23, Art. 31(1).

[66] I. BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW (6th ed. 2003), p. 602.

[67] This interpretation is confirmed by the following statement on the general rules of application of the MFN clause in the *Encyclopedia of Public International Law*: "*By its nature, the unconditional clause, unless otherwise agreed, attracts all favors extended on whatever grounds by the*

83. The Tribunal observes further that, as pointed out by the Respondent, the MFN clause in the Treaty does not refer to "*todas las materias regidas por el presente Acuerdo*" as is the case of the MFN clause in the investment treaty between Spain and the Argentine Republic. The review of the MFN clauses included in the investment treaties concluded by Spain, which was carried out by the tribunal in *Maffezini,* found that the MFN clauses in all the other treaties omit reference to "…all matters subject to this Agreement"[68] and merely provide that "this treatment" shall be subject to the clause. Without further elaboration, the arbitral tribunal held such formulation to be more restrictive. In *Ambatielos*, the commission had to ascertain whether administration of justice in the local courts was covered by the MFN clause. The commission found that it was, considering the Contracting Parties' "intention that the trade and navigation of each country shall be placed, in all respects, by the other on the footing of the most favored nation."[69]

84. The decision in *Salini* also considered relevant that the MFN clause in the investment treaty between Italy and Jordan did not include a reference to "all rights or matters covered in this agreement" to reach the conclusion that that clause did not apply to dispute settlement clauses.[70] The issue for the Tribunal is whether reference only to most-favorable "treatment," absent a reference to all matters covered by the Treaty, excludes a procedural prerequisite to dispute resolution from the scope of application of the MFN clause. To answer this question, the Tribunal will consider the subsequent practice of the parties to the Treaty and the substantive content of treatment in the context of the protection afforded to investors under the BITs.

85. Since 1991, the MFN clause in the UK model investment treaty has included a third paragraph stating that: "*For the avoidance of doubt*", the MFN

---

granting State to the third State." R. Bernhardt (ed.), 8 ENCYCLOPEDIA OF PUBLIC INTERNATIONAL LAW 411, 415 (1985).

[68] *Maffezini*, *supra* note 30, para. 60.

[69] *Ambatielos*, *supra* note 27. (Emphasis in the original.)

[70] *Salini*, *supra* note 33, paras. 117-119.

clause extends to Articles 1 to 11 of the treaty and, hence, to dispute resolution matters. The implication in the wording of this additional paragraph is that, all along, this was the UK's understanding of the meaning of the MFN clause in previously concluded investment treaties.[71] On the other hand, after the decision on jurisdiction in *Siemens*, the Argentine Republic and Panama exchanged diplomatic notes with an "interpretative declaration" of the MFN clause in their 1996 investment treaty to the effect that, the MFN clause does not extend to dispute resolution clauses, and that this has always been their intention.[72] The Tribunal has not been furnished with any evidence that at any point in time an interpretation of such nature was considered by either party to the Treaty. Neither has the Tribunal received any evidence that the Argentine Republic adopted similar interpretations of the MFN clause incorporated in the more than 50 bilateral investment treaties concluded with other States parties. While it is possible to conclude from the UK investment treaty practice contemporaneous with the conclusion of the Treaty that the UK understood the MFN clause to extend to dispute resolution, no definite conclusion can be reached regarding the Argentine Republic's position at that time. Therefore, the review of the treaty practice of the State parties to the Treaty with regard to their common intent is inconclusive. The Tribunal will now turn to whether "treatment" may be understood to extend to mechanisms of dispute resolution.

86. The Tribunal recalls that in considering whether the application of national laws concerning the administration of justice, namely local remedies, should be available to foreign traders, the arbitral commission in *Ambatielos* stated:

> "It is true that 'the administration of justice', when viewed in isolation, is a subject-matter other than 'commerce and navigation', but this is not necessarily so when it is viewed in connection with the protection of the

[71] The practice of the UK of including the expression "For the avoidance of doubt" in paragraph 3 of the MFN clause does not seem to have been consistent. The investment treaty with Honduras includes it, but the investment treaty with Venezuela does not. *See* Exhibits C-157 and C-159.

[72] Transcript, pp. 136-137.

rights of traders. Protection of the rights of traders naturally finds a place among the matters dealt with by Treaties of commerce and navigation.

Therefore, it cannot be said that the administration of justice, in so far as it is concerned with the protection of these rights, must necessarily be excluded from the field of application of the most-favored-nation clause, when the latter includes 'all matters relating to commerce and navigation'. The question can only be determined in accordance with the intention of the Contracting Parties as deduced from a reasonable interpretation of the Treaty."[73]

87. When the ICJ considered the case of the *Rights of US Nationals in Morocco*, it concluded that under the MFN clause in the US-Morocco treaty of 1836, the US was entitled to invoke the provisions of other treaties relating to the capitulatory regime.[74]

88. In *Maffezini*, the tribunal also considered that the MFN clause in the Spain–Argentina BIT allowed the Argentine investor to benefit from the mechanisms for the settlement of disputes incorporated into other treaties concluded by Spain to the extent that those mechanisms were more favorable to the protection of the investor's rights. The Tribunal stated :

"…[T]here are good reasons to conclude that today dispute settlement arrangements are inextricably related to the protection of foreign investors, as they are also related to the protection of rights of traders under treaties of commerce. (…)

International arbitration and other dispute settlement arrangements….are essential, however, to the protection of the rights envisaged under the pertinent treaties; they are also closely linked to the material aspects of the treatment accorded. (…)

[73] *Ambatielos*, *supra* note 27, p. 107.
[74] *Rights of Nationals*, *supra* note 52, p. 190.

From the above considerations it can be concluded that if a third party treaty contains provisions for the settlement of disputes that are more favorable to the protection of the investor's rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favored nation clause as they are fully compatible with the ejusdem generis principle."[75]

89. The *Ambatielos* arbitration commission, the ICJ, and the arbitral tribunal in *Maffezini* all concurred that the element of dispute settlement at issue was part of the protection – treatment – of investors. The most recent decision concerning the same matter put it in these terms:

"provision for international investor-state arbitration in bilateral investment treaties is a significant incentive and protection for foreign investors; further, that access to such arbitration only after resort to national courts and an eighteenth-month waiting period is a less favorable degree of protection than access to arbitration immediately upon expiration of the negotiating period."[76]

90. During the hearing, the parties discussed extensively the decisions in *Salini* and *Plama,* which came to light after the submission of Claimant's Statement of Claim and had reached different conclusions from *Maffezini* and *Siemens* on the application of the MFN clause to particular matters related to dispute settlement.

91. Both tribunals considered extensions of the MFN clause to situations widely different from the situation considered here or, for that matter, in *Maffezin*i, *Siemens,* and *Gas Natural*. The claimant in *Salini* sought to include an umbrella clause where the basic treaty had none. In *Plama,* there was no ICSID clause in the basic treaty. In the present case, the parties had agreed to arbitration under UNCITRAL Rules and the issue is the avoidance, by virtue of an

---

[75] *Maffezini*, *supra* note 30, paras. 54-56.
[76] *Gas Natural*, *supra* note 60, para. 31.

MFN clause, of a procedural requirement that the Argentine Republic has dispensed with in its investment treaties concluded since 1994.

92. The Tribunal concurs with *Maffezini*'s balanced considerations in its interpretation of the MFN clause and with its concern that MFN clauses not be extended inappropriately. It is evident that some claimants may have tried to extend an MFN clause beyond appropriate limits. For example, the situation in *Plama* involving an attempt to create consent to ICSID arbitration when none existed was foreseen in the possible exceptions to the operation of the MFN clause in *Maffezini.*[77] But cases like *Plama* do not justify depriving the MFN clause of its legitimate meaning or purpose in a particular case. The MFN clause is an important element to ensure that foreign investors are treated on a basis of parity with other foreign investors and with national investors when they invest abroad.

93. To conclude, the Tribunal considers that, in the context in which the Respondent has consented to arbitration for the resolution of the type of disputes raised by the Claimant, "treatment" under the MFN clause of the Treaty makes it possible for UK investors in Argentina to resort to arbitration without first resorting to Argentine courts, as is permitted under the US-Argentina Treaty. Therefore, the Tribunal rejects this objection to its jurisdiction.

94. Having reached this conclusion, the Tribunal does not deem it relevant to consider the Claimant's contention that the requirement to submit the claim first to local courts is merely a procedural matter that would lead to inefficiency in the proceeding and inequity among the parties, thus defeating the object and purpose of the Treaty.

2. Second Objection: The Claimant Is Not an "Investor"

(a) Positions of the Parties

[77] *Maffezini*, *supra* note 30, para. 63.

(i) Position of the Respondent

95. The Respondent argues that the legal link between the Claimant and the investment protected by the Treaty ceased to exist once the shares of National Grid in Citelec were transferred to Dolphin on August 18, 2004. As of that date, according to the Respondent, National Grid ceased to have the quality of "investor" required to be party to this arbitration under Article 8 of the Treaty. It is the position of the Respondent that customary international law requires Claimant to maintain its status as an "investor" throughout the arbitral proceedings and not only at the time of submission of its claim.[78] The Respondent argues that the rationale of *Loewen* applies in this case. Loewen, the Canadian claimant, was found by the tribunal not to be a party in interest at the time its operations were reorganized in a U.S. company:

> "Raymond Loewen argues that his claim under NAFTA survived the reorganization. Respondent originally objected to Raymond Loewen's claim on the ground that he no longer had control over his stock at the commencement of the proceeding. The Tribunal allowed Raymond Loewen to continue in the proceeding to determine whether he in fact continued any stock holding in the company. No evidence was adduced to establish his interest and he certainly was not a party in interest at the time of the reorganization of TLGI."[79]

96. The Respondent points out that the Claimant justifies the sale of its shares in Citelec as a means to mitigate the losses caused by the Measures. The Argentine Republic disagrees with this position, arguing that the sale was a free business decision and that the Treaty does not protect an investor from the effects of its voluntary decision to sell its shares of a company undergoing a contract renegotiation. If National Grid did not obtain a better price for its shares, this can only be attributed to the moment chosen by the Claimant to sell them.

[78] Respondent's Plea on Jurisdiction, paras. 77-79.

[79] *Id.*, para. 74 (quoting *The Loewen Group, Inc. and Raymond L. Loewen v. United States,* ICSID Case No. ARB(AF)/98/3, Award (26 June 2003), 7 ICSID Rep. 442 (2005), para. 239).

According to Respondent, National Grid's decision to sell had no causal link to Respondent's actions, remaining a unilateral decision by National Grid.[80]

97. The Respondent takes issue with the arguments of the Claimant regarding the arbitrability of public policy decisions of States. According to the Respondent, such decisions are not subject to the jurisdiction of any international arbitral tribunal, because they are sovereign acts as was recognized by the arbitral tribunal in *CMS* in the following terms:

> "[…] questions of general economic policy not directly related to the investment, as opposed to measures specifically addressed to the operation of the business concerned, will normally fall outside the jurisdiction of the Centre. A direct relationship can, however, be established if those general measures are adopted in violation of specific commitments given to the investor in treaties, legislation or contracts. What is brought under the jurisdiction of the Centre is not the general measures in themselves but the extent to which they may violate those specific commitments."[81]

98. It is also the position of Respondent that if there had been an expropriation as argued by the Claimant, it would be the new investor and not National Grid that would be entitled to compensation under the general principle that rights are transferred as owned by the seller.[82]

99. Finally, the Respondent draws the attention of the Tribunal to the fact that the Concession and the Transba Concession are meant to last 95 years. Paying heed to Claimant's demands would amount to treating the investments protections under the Treaty as an insurance policy against all conceivable risks, making it impossible for governments to adapt long-term contracts to new

---

[80] *Id.*, paras. 92-93.

[81] *Id.*, para. 88 (quoting para. 27 of *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction (17 July 2003), 42 ILM 788 (2003)).

[82] *Id.*, para. 89.

circumstances when the public interest so requires.[83]

100. At the hearing, the Respondent emphasized the following points:

(A) The voluntary disposition of the shares of National Grid in Citelec, questioning the relevance of the cases adduced by the Claimant in its Counter-Memorial: Mondev[84] was deprived of a permit for urban development by the municipality of Boston, Senegal rescinded a contract of SOABI[85] for the construction of housing complexes, and at no time did CSOB[86] let go of its assets voluntarily;[87]

(B) National Grid's opportunistic behavior of instituting arbitration proceedings while it had been considering and preparing the sale of its shares for months;

(C) Transener's shares doubled in value between 2002 and 2005; and

(D) The sale of shares by National Grid was conducted in an environment of uncertainty, and it is not the purpose of BITs to protect investors against uncertainty or to neutralize international corporate risk.[88]

(ii) Position of the Claimant

101. The Claimant argues that, under the Treaty, the critical date for determining the Claimant's standing with regard to ownership of the investment is the date on which the dispute arose, that under well established case law the jurisdiction of the Tribunal must be determined at the time proceedings are instituted, and that Claimant's standing to bring this claim finds support in

[83] *Id.*, para. 97.

[84] *Mondev International Ltd. v. United States,* ICSID Case No. ARB(AF)/99/2, Award (11 October 2002), 6 ICSID Rep. 192 (2004).

[85] *Société Ouest Africaine des Bétons Industriels (SOABI) v. Senegal,* ICSID Case No. ARB/82/1, Award (25 February 1988), 6 ICSID Rev.—FILJ 125 (1991).

[86] *Ceskoslovenska obchodni banka, a.s. (CSOB) v. Slovak Republic,* ICSID Case No. ARB/97/4, Decision on Objections to Jurisdiction (24 May 1999), 14 ICSID Rev.-FILJ 251 (1999).

[87] Transcript, pp. 34-36.

[88] *Id.*, pp. 39-45.

fundamental principles of equity and justice, as articulated by international case law.

102. The Claimant contends that the text of the Treaty is "the best guide to the more recent common intention of the parties", pointing to what Claimant perceives as a fair reading of Article 8(1):

> "…[T]he jurisdiction to arbitrate a claim under the Treaty depends on a dispute having arisen with regard to an investment within the terms of the Treaty between an investor of one Contracting Party and the other Contracting Party. The requirements are, therefore, that a treaty dispute arose with regard to an 'investment' at that time, and that it arose with regard to an 'investor' also at that time. The date on which the dispute arose is the same date on which the investor and the investment must have existed."[89]

103. The Claimant finds confirmation of this reasoning by a further analysis of paragraph 1 of Article 8. This paragraph refers to submission of disputes "at the request of *one of the Parties to the dispute*."[90] Similarly, Article 8(2) refers to submission to arbitration "if one of the Parties so requests" and if "the Parties are still in dispute."[91] Article 8(3) refers to "the investor and the Contracting Party concerned in the dispute" in the context of agreement on the modality of arbitration proceedings, Article 8(3) also refers twice to the "Parties to the dispute".[92] The Claimant concludes this textual analysis by affirming that "the dispute" is the key element of reference:

> "Standing to pursue dispute resolution proceedings is acquired by being a party to the dispute; the status of being a disputing party crystallizes at the

[89] Claimant's Counter-Memorial on Jurisdiction, para. 99.
[90] *Id.*, para. 100. (Emphasis added by the Claimant.)
[91] *Id.*
[92] *Id.*

moment the dispute arises."[93]

104. The Claimant further contends that the same result is reached from the perspective of the object and purpose of the Treaty. The Treaty's purpose is to provide protection to investors against detrimental action by the State. The protections stipulated in the Treaty may apply in cases where, because of the State's adverse measures, the investment does not subsist, has been destroyed or is in such precarious state that its maintenance is impossible or commercially unreasonable. According to the Claimant:

> "If a State were to expropriate title to an asset and the former owner of that asset were to claim for expropriation, it would be nonsense for the State to argue non-justiciability of the dispute because the claimant no longer owns the asset! Yet this is what Argentina's argument amounts to."[94]

105. The Claimant then relies on *Mondev*, which was decided under Chapter 11 of the NAFTA, where the US objected to the jurisdiction of the arbitral tribunal on the ground that the foreclosure on a mortgage related to the project extinguished the rights and interests of the claimant. The US had argued that before the arbitration proceeding was instituted, and even before some of the acts complained took place, no investment owned or controlled by the claimant subsisted. The tribunal dismissed this jurisdictional objection in the following terms:

> "the Tribunal would […] observe that [NAFTA] Article 1105, and even more so Article 1110, will frequently have to be applied after the investment in question has failed. In most cases, the dispute submitted to arbitration will concern precisely the question of responsibility for that failure. To require the Claimant to maintain a continuing status as an investor under the law of the host State at the time the arbitration is

[93] *Id.*

[94] *Id.*, para. 102.

> commenced would tend to frustrate the very purpose of Chapter 11, which is to provide protection to investors against wrongful conduct including uncompensated expropriation of their investment and to do so throughout the lifetime of an investment up to the moment of its 'sale or other disposition' […] On that basis, the Tribunal concludes that NAFTA should be interpreted broadly to cover any legal claims arising out of the treatment of an investment as defined in Article 1139, whether or not the investment subsists as such at the time of the treatment which is complained of."[95]

106. As regards the argument made by the Respondent based on *Loewen*, the Claimant observes that in *Loewen* the Canadian claimant had ceased to exist and its operations were reorganized in a US company. The issue there was one of the continuous foreign nationality of the claimant and not the continuity of ownership or control of the investment. In this respect, the decision in *Loewen* upholds the finding of the tribunal in *Mondev* to the effect that:

> "…the Tribunal [in Mondev] appropriately found that the loss of the investment through foreclosure of the mortgage could not be the basis for denying Mondev's right to pursue its remedies under NAFTA. It pointed out that such set of events could occur quite often to indenters and that the whole purpose of NAFTA's protection would be frustrated if such disputes could not be pursued."[96]

107. The Claimant points out that, under international law, jurisdiction is determined, at the latest, on the date of a submission of a dispute to an international judicial forum. According to the Claimant, this is confirmed by cases arbitrated under the ICSID Convention in relation to issues of ownership of the investment. Thus, in *CSOB*, the claimant assigned all its rights in the subject matter of the dispute to its majority owner, the Czech Republic. In support of the

---

[95] *Id.*, para. 103 (quoting para. 91 of *Mondev*, *supra* note 84).
[96] *Id.*, para. 105 (quoting para. 227 of *Loewen*, *supra* note 79).

standing of the transferee, the arbitral tribunal upheld its jurisdiction with the following reasoning:

> "…[I]t is generally recognized that the determination whether a party has standing in an international judicial forum for the purposes of jurisdiction to institute proceedings is made by reference to the date on which such proceedings are deemed to have been instituted. Since the Claimant instituted these proceedings prior to the time when the two assignments were concluded, it follows that the Tribunal has jurisdiction to hear this case regardless of the legal effect, if any, the assignments may have had on Claimant's standing had they preceded the filing of the case."[97]

108. According to the Claimant, the date of institution of a proceeding has been held by ICSID tribunals to be the critical date to determine foreign control[98] and the juridical status of a person.[99] Similarly, the ICJ has held that:

> "The Court recalls that according to its settled jurisprudence, its jurisdiction must be determined at the time that the act instituting proceedings was filed. Thus, if the Court has jurisdiction on the date the case is referred to it, it continues to do so regardless of subsequent events.
>
> […]
>
> Under settled jurisprudence, the critical date for determining the admissibility of an application is the date on which it is filed."[100]

109. The Claimant argues further that equity and justice prevent a party from taking advantage of its own wrong:

---

[97] *Id.*, para. 109 (quoting para. 31 of *CSOB*, *supra* note 86).

[98] *Amco Asia Corporation and Others v. The Republic of Indonesia,* ICSID Case No. ARB/81/1, Award on Jurisdiction (25 September 1983), 1 ICSID Rep. 389 (1993), para. 14, and *Liberian Eastern Timber Corp. (LETCO) v. Republic of Liberia*, ICSID Case No. ARB/83/2, Award (31 March 1986), 2 ICSID Rep. 346 (1994), p. 351.

[99] *SOABI*, *supra* note 85, paras. 29 and 41.

[100] Claimant's Counter-Memorial on Jurisdiction, para. 114 (quoting paras. 24, 26 and 40 of the *Arrest Warrant of 11 April 2000 (Democratic Republic of Congo v. Belgium)*, Judgment (14 February 2002), [2002] *ICJ Reports* 3).

> "If a State cannot allege lack of jurisdiction where it has directly expropriated an asset on the basis that the investor had no qualifying investment, it should not be able to do so in the event of indirect expropriation when its acts have emptied the asset of substantially its entire value."[101]

110. The Claimant alleges that it disposed of its investment as a result of Respondent's dismantlement of the regulatory framework that had attracted the investment. The alternative for the Claimant was to continue pumping money into a ruinous enterprise, a reckless approach that no one could be reasonably expected to adopt. Claimant sought to mitigate the losses caused by the Measures relinquishing 90% of the value of the investment. Under those circumstances, this sale could hardly be described as a free or voluntary transaction.[102]

111. During the hearing, the Claimant pointed out that the concept of the voluntary nature of the disposition of assets, considered a key point by the Respondent, finds no mention in the relevant case law.[103] According to the Claimant, Transener was a failed investment which had defaulted on its debts and "…It only managed to keep going because of other laws in Argentina which required it to keep going."[104] In this regard, Claimant underlined the holding in *Mondev*,

> "To require the claimant to maintain a continuing status as an investor under the law of the host state at the time of the arbitration is commenced, would tend to frustrate the very purpose of Chapter XI, which is to provide protection to investors against wrongful conduct, including uncompensated expropriation of their investment and to do so throughout

---

[101] *Id.*, para. 116.
[102] *Id.*, paras. 117, *et seq.*
[103] Transcript, p. 107.
[104] *Id.*, p. 109.

the lifetime of that investment up to the moment of its sale or disposition."[105]

112. The Claimant denied that National Grid had acted in bad faith when it sold its shares in Citelec. According to the Claimant, it was clear under the terms of the documentation that the seller did not transfer any of its rights vis-a-vis Argentina. Moreover, Claimant recalled that "Argentina did not require in any sense that this claim be abandoned or suspended or any other such condition when its various regulatory consents were granted to that transfer.[106]

113. The Claimant reaffirmed at the hearing that:

(A) in all cases discussed and in *Soabi v. Senegal*[107] and *LETCO v. Liberia*,[108] the critical date adopted consistently by arbitral tribunals has been the date of consent, and the ICJ in the *Arrest Warrant* case considered settled jurisprudence that, for jurisdictional purposes, its jurisdiction must be determined at the time that the act instituting the proceeding was filed;[109] and

(B) National Grid gave up hope that any satisfactory solution could be achieved after two-and-a-half years of a process of renegotiation, which was initially meant to last 120 days and, as a commercial company, had an obligation to its shareholders to limit its losses.[110]

(b) Considerations of the Tribunal

114. For the purpose of ascertaining the limits to the jurisdiction of the Tribunal, the key issue to decide is whether the sale of Claimant's shares in Citelec, subsequent to the initiation of this proceeding, has deprived the Claimant of its standing as an "investor" under the terms of the Treaty.

---

[105] *Id.*, p. 112 (quoting *Mondev*, *supra* note 84, para. 91).
[106] *Id.*, p. 118.
[107] *SOABI*, *supra* note 85.
[108] *LETCO*, *supra* note 98.
[109] Transcript, pp. 118-120.
[110] *Id.*, pp. 120-125.

115. The textual analysis of Article 8 of the Treaty developed by the Claimant is helpful but does not fully dispose of the issue. The Tribunal agrees that the meaning of Article 8 is that the dispute must exist at the time the arbitration proceeding is instituted and it is at that point in time when the parties to the proceeding must be parties to the dispute. From this it may be implied, as does the Claimant, that events beyond the date of instituting the proceeding are irrelevant for purposes of the jurisdiction of the Tribunal. However, it suffices to review the views expressed by the Respondent to realize that Article 8 is not as clear and self-evident as Claimant suggests. Indeed, in order to dispose of the issue of standing, it is necessary to reach beyond the Treaty and, as the parties have already done, to examine the practice of the ICJ and other tribunals.

116. Before doing so, the Tribunal recalls that in the instant case the issue of standing does not concern a change in the Claimant's nationality - National Grid continues to be a British company - but rather the investor's continuity in the ownership of the investment. The quotation on continuity of ownership from Professor Brownlie's *Principles of Public International Law*, which the Respondent brought to the attention of this Tribunal,[111] refers to continuity of nationality for purposes of diplomatic protection; it does not concern the continuity of ownership by a claimant who has not changed its nationality. Even with regard to continuity of nationality to retain standing, Professor's Brownlie himself noted that "there is a respectable body of opinion which would reject the principle altogether."[112] To this respectable body of opinion one may add the conclusion reached by the Rapporteur on Diplomatic Protection of the ILC, Professor Dugard, to the effect that there is no established rule at all on that matter.[113]

117. As pointed out by the Claimant, the ICJ held in the *Arrest Warrant*

---

[111] I. BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW (5th ed. 1998), p. 483, cited in Respondent's Plea on Jurisdiction, para. 79.

[112] *Id.*

[113] Referred to by J. Paulsson, "Continuous Nationality in Loewen," 20 Arbitration International (2004), 213-215.

case that it was its settled jurisprudence that: "its jurisdiction must be determined at the time the act instituting the proceedings was filed. Thus, if the Court has jurisdiction on the date the case is referred to it, it continues to do regardless of subsequent events."[114] However, the Court went on to say: "Such events might lead to a finding that an application has subsequently become moot and to a decision not to proceed to judgment on the merits, but they cannot deprive the Court of jurisdiction."[115]

118. As a general matter, all the arbitral tribunals in the cases discussed by the parties - *Amco*, *SOABI, CSOB*, *LETCO*, and *Mondev* - held that the critical date to meet the jurisdiction requirements is the date when the proceedings are instituted. *Loewen* also supports this position, as pointed out by the Claimant and as becomes evident when reviewing the previously quoted statement relied on by the Respondent.[116]

119. The Argentine Republic has contended that in none of these cases were assets transferred voluntarily. However, the voluntary or involuntary nature of the transfer does not seem to have been part of the considerations of the tribunals in reaching their respective decisions. In CSOB the tribunal held:

> "Since the Claimant instituted these proceedings prior to the time when the two assignments were concluded, it follows that the Tribunal has jurisdiction to hear this case regardless of the legal effect, if any, the assignments might have had on Claimant's standing had they preceded the filing of this case."[117]

120. *In Mondev*, the tribunal went further and dissociated the investment

---

[114] Claimant's Counter-Memorial on Jurisdiction, para. 114 (citing *Arrest Warrant, supra* note 100, para. 26).

[115] *Arrest Warrant*, *supra* note 100, para. 26. This sentence follows after the quotation adduced by the Claimant in its argument.

[116] "Raymond Loewen argues that his claim under NAFTA survived the reorganization. Respondent originally objected to Raymond Loewen's claim on the ground that he no longer had control over his stock *at the commencement of the proceeding* […]" (Emphasis added by the Tribunal). *Loewen, supra* note 79, para. 239.

[117] *CSOB*, *supra* note 86, para. 31.

and the arbitration proceeding, dispensing with the requirement that an investor maintain its ownership interest in the investment at the time the arbitration was commenced:

> "To require the claimant to maintain a continuing status as an investor under the law of the host State at the time the arbitration is commenced would tend to frustrate the very purpose of Chapter 11, which is to provide protection to investors against wrongful conduct including uncompensated expropriation of their investment and to do so throughout the lifetime of an investment up to the moment of its 'sale or other disposition' (Article 1102(2))."[118]

According to Mondev, the key factor is to have been an investor and to have suffered a wrong before the sale or disposition of its assets, without the need to remain an investor for purposes of the arbitration proceedings.

121. The Respondent has also argued that, if a right to pursue the claims under the dispute would be recognized, then such right would have been transferred to the purchaser of the shares. The Tribunal observes that such right was retained by the Claimant as part of the terms of the sale of shares and that such terms were approved by the competent authorities of the Argentine Republic.[119]

122. For the above stated reasons, the Tribunal finds this objection without merit.

3. Third Objection: The Dispute Is Not a "Dispute with Regard to an Investment"

(a) Positions of the Parties

[118] *Mondev, supra* note 84, para. 91.
[119] Exhibit C-132.

(i) Position of the Respondent

123. The Respondent repeats here in part the argument made previously that, for an investor to request the protection provided for in the Treaty, the allegedly prejudicial measures taken by the Argentine Republic should have been specifically directed to the investment. According to the Respondent, general measures taken by a government destined to have an impact on the economic life of the nation are not matters for the consideration of this Tribunal. The Tribunal does not have jurisdiction to decide on matters of public policy, but rather to settle legal issues arising under or connected with the investment dispute submitted to its consideration. It does not suffice for the investor to be affected by a measure in order for the Tribunal to assume jurisdiction; it is necessary to show a legal link between the measure and the investment. In this respect, the Respondent refers to the already quoted statement of the tribunal in *CMS*, to the effect that matters of general economic policy are not in principle within the jurisdiction of ICSID and ICSID tribunals; it is necessary to establish a breach of specific contractual commitments made to the investor.[120]

124. The Respondent argues that it is not sufficient that the Argentine Republic had assumed general commitments in "treaties, laws or contracts", but rather that the Claimant must show which specific commitments assumed by the Argentine Republic were breached by the devaluation of the peso, the establishment of a new parity, the temporary "pesification" of tariffs and obligations, and the adoption of a fiscal policy in consonance with these Measures.[121]

125. The Respondent draws a parallel between the jurisdictional issue at stake in *Methanex* and the qualification of Claimant's dispute as an investment dispute under the Treaty. In *Methanex*, as explained by the Respondent, the NAFTA tribunal dealt with the question whether the measures taken by a State

[120] Respondent's Plea on Jurisdiction, paras. 100-101.
[121] *Id.*, para. 102.

party to NAFTA were "relating to" the investment or the investor. Methanex had claimed that it was sufficient that a measure affected the investor or the investment to give rise to a claim under international law. The State parties to NAFTA disagreed with that interpretation. The Tribunal found that a textual interpretation of "relating to" was of scant help and considered the context, object and purpose of the Article 1101(1) of NAFTA, concluding thus:

> "If the threshold provided by Article 1101(1) were merely one 'affecting', as Methanex contends, it would be satisfied wherever any economic impact was felt by an investor or an investment. For example, in this case, the test could be met by suppliers to Methanex who suffered as a result of Methanex's alleged losses, suppliers to those suppliers and so on, towards infinity. As such, Article 1101(1) would provide no significant threshold to NAFTA arbitration. A threshold which could be surmounted by an indeterminate class of investors making a claim alleging loss is no threshold at all; and the attractive simplicity of Methanex's interpretation derives from the fact that it imposes no practical limit. It may be true, to adapt Pascal's statement, that the history of the world would have been much affected if Cleopatra's nose had been different, but by itself cannot mean that we are related to the royal nose. The chaos theory provides no guide to the interpretation of this important phrase; and a strong dose of practical common-sense is required."[122]

126. The Respondent finds in *Methanex* a correct statement about the causal link of a legal nature that is needed to connect the alleged facts to the investor:

> "In a legal instrument such as NAFTA, Methanex's interpretation would produce a surprising, if not an absurd, result. The possible consequences of human conduct are infinite, especially when comprising acts of

[122] *Id.*, para. 107 (quoting para. 137 of *Methanex Corporation v. United States,* First Partial Award (7 August 2002), *available at* http://www.state.gov/documents/organization/12613.pdf).

governmental agencies; but common sense does not require that line to run unbroken towards an endless horizon. In a traditional legal context, somewhere the line is broken; and whether as a matter of logic, social policy or other value judgment, a limit is necessarily imposed restricting the consequences for which that conduct is to be held accountable […]"[123]

127. The Respondent has also argued that the facts underlying the link between the Measures and the Claimant must be proven in this phase of the proceedings and not together with the merits of the case. At least, the Claimant must show that it has a legitimate *prima facie* claim based on international law and not a mere contractual conflict or a mere conflict of interests with the Respondent.[124]

128. The Respondent concludes by affirming that the Claimant has not shown a direct, proximate and immediate connection between the Measures and its "alleged investment", and that it would be impossible for the Claimant to do so because the Measures were not addressed specifically against the investment nor were they related to the investment.[125]

(ii) Position of the Claimant

129. The Claimant affirms that its claim is not related to the Argentine Republic's general measures but to specific commitments made by the Respondent and upon which the Respondent reneged in violation of the Treaty. The direct connection between the Measures and the investment is based on the fact that the Measures directly affected the Claimant's rights associated with its investment and protected under international law.

130. The Claimant finds support for its position in *CMS*, quoting a passage cited by the Respondent and by the Tribunal at paragraph 97[126] above

---

[123] *Id.*, para. 109 (quoting *Methanex*, *supra* note 122, para. 138).
[124] *Id.*, para. 103.
[125] *Id.*, para. 110.
[126] *See* para. 97, above.

and in the following additional language, which the Claimant quotes in full:

> "On the basis of the above considerations the Tribunal concludes on this point that it does not have jurisdiction over measures of general economic policy adopted by the Republic of Argentina and cannot pass judgment on whether they are right or wrong. The Tribunal also concludes, however, that it has jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[127]

131. The Claimant observes that the question whether certain measures affected rights and caused injury to the Claimant is a matter linked to the merits of the dispute. According to the Claimant, the Tribunal must only be satisfied that there is *prima facie* a sufficiently direct connection between the Measures and the investment concerned. The Claimant again refers to *CMS*:

> "While conceptually the line between one and the other matter is clear, in practice whether a given claim falls under one or the other heading can only be established in light of the evidence which the parties will produce and address in connection with the merits of the case. (…) This means in fact that the issue of what falls within or outside the Tribunal's jurisdiction will be subsumed in the determination of whether a given claim is or is not directly connected with specific measures affecting the investment.
>
> For the time being, the fact that the Claimant has demonstrated prima facie that it has been adversely affected by measures adopted by the Republic of Argentina is sufficient for the Tribunal to consider that the claim, as far as this matter is concerned, is admissible and that it has

[127] *CMS*, *supra* note 81, para. 35 (quoted in the Claimant's Counter-Memorial on Jurisdiction, para. 45). (Emphasis added by the Claimant.)

jurisdiction to examine it on the merits."[128]

132. The Claimant notes that this position of the tribunal in *CMS* is consistent with "the traditional restraint that tribunals have exercised in reviewing the nature of the disputes submitted to ICSID arbitration."[129] The Claimant also observes that the threshold requirement is that of Article 8 of the Treaty and not Article 25(1) of the ICSID Convention: "disputes with regard to an investment" as opposed to "any legal dispute arising directly out of an investment."[130]

133. The Claimant restates the summary of claims included in the Statement of Claim, which reads as follows:

> "Argentina breached its obligations to National Grid under the Treaty by the Measures adopted since January 2002, described in Section III above, which run openly and directly against specific and critical provisions contained in the Regulatory Framework of the investment, and in particular by:
>
> (i) failing to respect the promise that Transener's and Transba's tariff-based remuneration would be 'fair and reasonable' and sufficient to cover reasonable operating costs, taxes, amortizations and provide a 'reasonable rate of return';
>
> (ii) abolishing Transener's and Transba's right to calculate all their remuneration in US dollars and express it in pesos at the exchange rate applicable at the time of billing;
>
> (iii) abolishing Transener's and Transba's right to adjust their remuneration every six months in accordance with US PPI and US CPI indices;
>
> (iv) converting all of Transener's and Transba's remuneration into

[128] *Id.* para. 34-35 (quoted in the Claimant's Counter-Memorial on Jurisdiction, para. 46).
[129] Claimant's Counter-Memorial on Jurisdiction, para. 47.
[130] *Id.*, para. 48.

pesos at the artificial rate of one peso to one dollar, in spite of the fact that the dollar-peso parity established under the Convertibility Law was also abolished, allowing the peso to float freely, thus rapidly falling in value, and eventually stabilizing at about three pesos to one dollar;

(v) freezing Transener's and Transba's tariff-based remuneration for the electricity transmission service completely as of January 2002, at one third of its approved 2001 level in dollar terms;

(vi) failing to conduct the Five Year Review of Transener's (due 2003) and Transba's (due 2002) tariff-based remuneration in order to ensure the tariffs' continued compliance with the guarantees provided by the Regulatory Framework, particularly that of providing a 'fair and reasonable' tariff sufficient to satisfy reasonable operating costs, taxes, amortizations and a 'reasonable rate of return'; and

(vii) failing to adjust Transener's and Transba's tariff-based remuneration on the basis of 'objective and justified' circumstances, and/or on the basis that remuneration had become 'unjust, unreasonable, unduly discriminatory or preferential', as a result of the January 2002 Law.

Argentina's Measures, with their consequential losses to National Grid and its investment, constitute breaches of the Treaty, in particular:

(i) an expropriation of National Grid's investment without compensation, in violation of Article 5(1) of the Treaty […]

[…]

(ii) mistreatment of National Grid's investment in violation of the standards of treatment provided by Article 2(2) of the Treaty […]"[131]

[131] *Id.*, para. 49.

The Claimant concludes that those claims refer to specific measures having a direct effect on the investment. The claims do not question general measures *per se*, such as the devaluation or the establishment of a different exchange rate parity, but rather "the very specific and concrete repudiation" by the Respondent of commitments in the Regulatory Framework.[132]

134. As regards *Methanex*, the Claimant observes that NAFTA establishes in Article 1101(1) a higher threshold than Article 8(1) of the Treaty. Article 1101(1) refers to measures "relating to" the investor or the investment, Article 8(1) refers to a dispute "with regard to an investment."[133] The Claimant argues that Article 8(1) does not require a direct connection between the measures giving rise to the dispute and the investment, as opposed to the *Methanex* tribunal's interpretation of Article 1101(1), calling for a "legally significant connection" between the measure and the investment or the investor.[134] The Claimant affirms that this understanding of Article 1101(1) must be read together with the holding in *Pope & Talbot* rejecting "Canada's submissions that a measure can only relate to an investment if it is primarily directed at that investment and that a measure aimed at trade in goods ipso facto cannot be addressed as well under Chapter 11."[135] Thus, there must be a "legally significant connection" between the measures in question and the claimant and its investments, but this connection does not need to be "primarily directed" at the investments.[136] The Claimant affirms that its claim meets the "legally significant connection," although such connection is not required under the Treaty.[137]

(b) Considerations of the Tribunal

135. This jurisdictional objection submitted by the Argentine Republic

---

[132] *Id.*, para. 52.
[133] *Id.*, paras. 54-55.
[134] *Id.* (stating standard of "relating to" enunciated in *Methanex, supra* note 122, para. 147).
[135] *Id.*, para. 55 (quoting Preliminary Motion by the Government of Canada to dismiss the claim because it falls outside the scope and coverage of NAFTA).
[136] *Id.*, para. 56
[137] *Id.*

raises the issue whether the Tribunal is competent to pass judgment on matters of public policy and whether the Measures were taken with regard to the "investment", as required by Article 8 of the Treaty.

136. The Tribunal has no difficulty in recognizing the Argentine Republic's sovereign prerogative to adopt the policies it sees fit. The Tribunal readily subscribes to the holding of *CMS* in this respect, namely:

> "On the basis of the above considerations the Tribunal concludes on this point that it does not have jurisdiction over measures of general economic policy adopted by the Republic of Argentina and cannot pass judgment on whether they are right or wrong."[138]

137. However, the *CMS* tribunal did not stop here as submitted by the Respondent. It added:

> "The Tribunal also concludes, however, that it has jurisdiction to examine whether specific measures affecting the Claimant's investment or measures of general economic policy having a direct bearing on such investment have been adopted in violation of legally binding commitments made to the investor in treaties, legislation or contracts."[139]

138. Thus the issue is not passing judgment on policy measures of a State or considering measures that simply affect an investment, but whether the Measures had a direct bearing on the investment and violated binding obligations between Argentina and the Claimant.

139. The parties have discussed the meaning of "related to" and "with regard to" an investment. The Tribunal does not find the difference between these two expressions significant in the instant case; both refer to a connection, a

[138] *CMS*, *supra* note 81, para. 33.
[139] *Id.*

relation to the word that follows them.[140] There has to be a connection between the Measures and the investment. The connection does not need to be exclusive. There may be other investments to which the Measures are related. As stated in *CMS*, the measures adopted need to contravene "legally binding commitments made to the investor in treaties, legislation or contracts."[141]

140. The Argentine Republic has requested that the Claimant prove the connection between the Measures and the Argentine Republic's commitments at this stage of the proceedings. There is no doubt that National Grid made an investment in Argentina and, were it not for its sale of the shares in Citelec, the Argentine Republic would have accepted that the Claimant would be an investor under the Treaty. There is no doubt either that the Argentine Republic solicited the investment and that the execution of the Treaty had as its purpose to attract such investment. There is no denial that certain laws were passed by the Argentine Republic to ensure that such legislative framework would encourage investments. The dispute, as it has been framed and presented by the Claimant, is about the changes introduced to this legislative framework and the effect those changes had on the investment and the contractual obligations under related agreements. To the Tribunal, this is sufficient to establish the existence, *prima facie, of a* dispute with regard to the investment. The Tribunal does not need to be satisfied any further for purposes of deciding on its jurisdiction under the Treaty.

141. Therefore, the Tribunal rejects this objection to its jurisdiction.

4. Fourth Objection: The Dispute Is Not a "Legal Dispute"

(a) Position of the Parties

(i) Position of the Respondent

142. First, the Respondent argues that under the Treaty the dispute

[140] The UK has used both expressions indistinctly in its treaty practice. In fact, the two model investment agreements submitted during these proceedings use *"in relation to.*"

[141] *CMS, supra* note 81, para. 33.

must be related to the violation of legal rights and not a mere conflict of interest and that the dispute must be susceptible of settlement by the application of the law. According to the Respondent, the disagreement between the parties on a point of fact or of law must be directed to the international obligations of the State, as stated by the tribunal in *Generation Ukraine v. Ukraine*.[142] However, the Respondent argues that, in the instant case, the alleged violations refer to specific contractual violations. Accordingly, Respondent claims that the tribunals competent to decide on the alleged violations are the Argentine courts, as "freely agreed between the parties to the dispute."[143]

143. The Respondent adds that:

(A) this Tribunal should not assume the role of the national administrative courts. The claim is clearly a claim for adjustment due to "increased costs" (*mayores costos)* for which there is a specific administrative procedure to restore the equilibrium of the contract;[144]

(B) simple affirmations of supposed violations of the Treaty by the Argentine Republic are not sufficient to turn allegations of a failed administrative mechanism of tariff adjustment based on criteria of public policy and equity into a "dispute about an investment" under the Treaty;[145] and

(C) "whether there exists an international dispute is a matter for objective determination", as stated by the ICJ in *Interpretation of Peace Treaties*.[146]

144. Second, the Respondent argues that if the claim were of a legal nature, then it would be a contractual claim. All the facts presented by the Claimant refer to violations of contractual obligations, while the remedies requested to solve the contractual problem are remedies directed at obtaining

---

[142] *Generation Ukraine Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award (16 September 2003), 44 ILM 404 (2005), para. 18.4.
[143] Respondent's Plea on Jurisdiction, paras. 112-116.
[144] *Id.*, para. 119.
[145] *Id.*, para. 123.
[146] *Id.*, para. 124 (citing *Interpretation of Peace Treaties with Bulgaria, Hungary and Romania*, 1st Phase, Advisory Opinion (30 March 1950), [1950] *ICJ Reports,* 65, 74).

restitution of the investment. The Respondent refers to the principle of the "essential basis of a claim" introduced by the Annulment Committee in *Vivendi II.*[147] According to *Vivendi II*, when the essential basis of a claim submitted to an international tribunal is a breach of contract, the tribunal shall respect any valid clause of forum selection clause in the contract. In this case, the Respondent affirms that the basis of the claim is a nearly completed renegotiation of concession contracts and not the dismantling of an investment or a breach of international standards under the Treaty.[148]

145. Under this line of argument, the Respondent alleges that the Tribunal has the authority to determine the admissibility of the claim at this jurisdictional phase of the proceeding. For this purpose, the Tribunal requires only a careful reading of the Statement of Claim. The Respondent relies further on the authority of *SGS v. Philippines,*[149] where the tribunal remanded the case to the local courts in its decision on jurisdiction. Respondent also relies on the decision of the ICJ in the *Nuclear Tests* case, stating the advantage of tribunals limiting the scope of their specific jurisdiction, as well as the importance of doing so at the earliest available opportunity.[150]

146. Third, the Respondent argues that, this being a contractual claim, the Claimant has no *ius standi* to submit this claim to arbitration. The affected legal rights are those belonging to the concessionaire companies and not those of the Claimant.[151] Derivative claims are not admissible under Argentine law or international law. The Respondent conducts a comparative review of the treatment of derivative claims under NAFTA, the US-Chile Free Trade Agreement, and US law, for the purpose of showing the exceptional nature of

---

[147] *Compañia de Aguas del Aconquija S.A. and Vivendi Universal v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment (3 July 2002), 19 ICSID Rev.—FILJ 89 (2004).

[148] Respondent's Plea on Jurisdiction, paras. 128, 132 and 135.

[149] *SGS v. Philippines, supra* note 48.

[150] Respondent's Plea on Jurisdiction, paras. 137-139 (citing *Nuclear Tests (Australia v. France)*, Judgment (20 December 1974), [1974] *ICJ Reports* 253).

[151] *Id.*, paras. 140-141.

those claims.[152]

147. The Respondent further argues that, in principle, there does not exist any right to a particular value of a share and that, under Argentine law, the only patrimonial right of a shareholder, *strictu sensu,* is the right to share in the liquidation value of the company. The Respondent then distinguishes between direct and derivative claims according to the different claims recognized by a shareholder who suffered a specific injury, as opposed to the injuries suffered by all shareholders. The Respondent also discusses the underlying policies or interests sought to be protected by both types of claims, namely, the integrity of the corporation on the one hand and the rights of creditors on the other. Failing to take this distinction into account, argues the Respondent, would amount to a preference for the interest of a shareholder who decides to file a claim over the needs of the company and of interested third parties taken as a whole.[153] The Respondent also points out that, in the case of a claim for special damages and injuries, the decision of the court is based on the facts presented in the claim and not in the allegation of the claimant or on how the claimant qualifies its claim.[154] For all these reasons, contends the Respondent, the Tribunal should not proceed to the merits. If the Tribunal were to do otherwise, and were to decide the case in favor of the shareholders, given the commitments made by Transener to the Respondent in the letter of understanding, the amount awarded by the Tribunal to the shareholders would not be paid into the corporate treasury and would lead to the liquidation of the company. Thus, the Tribunal would be destroying the capital needed for the company to recover from the alleged expropriation. In fact, the Tribunal would be expropriating a public services company to favor a few shareholders, thus assuming implicit powers to liquidate the company, which powers the Tribunal is not entitled to assume.[155]

---

[152] *Id.*, paras. 151-158.
[153] *Id.*, paras. 159-170.
[154] *Id.*, para. 163.
[155] *Id.*, para. 173.

(ii) Position of the Claimant

148. First, the Claimant observes that Respondent's arguments refer to principles of Argentine corporate law and domestic rules relating to the doctrine of legal personality of companies, which are not relevant to this arbitration. The Claimant reaffirms that its claims are based on the Treaty and not the domestic law of the Argentine Republic or any other domestic legal system. With respect to jurisdiction, the applicable law is found in the jurisdictional provisions of the Treaty as stated in *CMS* and *Siemens*.[156]

149. Second, the Claimant recalls that it has filed its Statement of Claim as a UK investor in Argentina; its claim arises directly from its rights under the Treaty and the breach by the Respondent of its obligations under the Treaty: "There is nothing indirect or derivative about these claims," states the Claimant.[157]

150. The Claimant notes that the Argentine Republic's argument ignores that the commitments made to the concessionaires in their respective contracts were made to the foreign investors as part of the efforts made by the Argentine Republic to attract bidders in the privatization of its public utilities. These commitments were "part of the entire Regulatory Framework for the privatization of the electricity industry, established by Argentina in laws, decrees, and resolutions as well as in the Contracts themselves."[158]

151. The Claimant refers to the considerations that led the tribunal in *Enron v. Argentina* to find that the Claimant had *ius standi*:

> "…[T]he Information Memorandum issued in 1992 and other instruments related to the privatization of the gas industry had specifically invited foreign investors to participate in this process. A road show followed in key

[156] Claimant's Counter-Memorial on Jurisdiction, paras. 135-138 (citing *CMS*, *supra* note 81, para. 42 and *Siemens*, *supra* note 41, para. 31).
[157] *Id.*, para. 140.
[158] *Id.*, para. 142.

> cities around the world […]
>
> The conclusion that follows is that participation of the Claimant was specifically sought […] The Claimant cannot be considered to be only remotely connected to the legal arrangements governing the privatization, they are beyond any doubt the owners of the investment made and their rights are protected under the Treaty as clearly established treaty-rights and not merely contractual rights related to some intermediary. The fact that the investment was made through CIESA and related companies does not in any way alter this conclusion."[159]

152. The Claimant notes that the same considerations apply to the process of privatization of Transener described in the Statement of Claim.[160] There cannot be any doubt that the addressees of the commitments made by the Respondent were the investors, in particular the foreign investors. Transener and subsequently Transba were "simply the local entities through which the foreign investment was funneled."[161] The Claimant adds that BITs were part of these commitments. As noted in *Enron (Ancillary Claim)*: "That the Treaty was made with the specific purpose of guaranteeing the rights of the foreign investors and encouraging their participation in the privatization process, is beyond doubt."[162]

153. The Claimant concludes its second argument by affirming that it is a directly interested party and is independently entitled to submit its claim to the Tribunal, irrespective of whether the alleged breach of the Treaty may also involve a breach of the Contracts.[163]

---

[159] *Id.*, para. 143 (quoting paras. 55-56 of *Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction (14 January 2004), *available at* http://ita.law.uvic.ca/documents/Enron-Jurisdiction.pdf).

[160] *Id.*, para. 144 (citing the Statement of Claim, paras. 78-83).

[161] *Id.*, para. 145.

[162] *Id.*, para. 146 (quoting para. 32 of *Enron Corporation and Ponderosa Assets, L.P. v. The Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction (Ancillary Claim) (2 August 2004), *available at* http://ita.law.uvic.ca/documents/Enron-DecisiononJurisdiction-FINAL-English.pdf).

[163] *Id.*, paras. 147-149.

154. Third, the Claimant argues that the wording of the Treaty does not support Respondent's position. The Treaty defines broadly the term "investment" and includes "shares, […] and any other form of participation […] in a company."[164] This provision covers the Claimant's participation in Transener and Transba and the Claimant is entitled to bring a claim in respect of these investments. If they are damaged as a result of a breach of the Treaty, the Claimant is entitled to be compensated for it.[165]

155. Fourth, the Claimant refers to the numerous arbitration cases in which a similar *ius standi* objection has been rejected, i.e. *CMS*, *Enron*, *Azurix*, *Siemens* and *Maffezini*. The Tribunal will limit the reference to a few of the findings of these tribunals quoted by the Claimant.

156. Thus, in *CMS*, the tribunal found:

> "…no bar in current international law to the concept of allowing claims by shareholders independently from those of the corporation concerned, not even if those shareholders are minority or non-controlling shareholders […] [this] can now be considered the general rule, certainly in respect of foreign investments and international claims and increasingly in respect of other matters."[166]

157. The tribunal in *Enron* held:

> "Whether the locally incorporated company may further claim for the violation of its rights under contracts, licenses or other instruments, does not affect the direct right of action of foreign shareholders under the Bilateral Investment Treaty for protecting their interests in the qualifying

[164] *Id.*, para. 150 (citing Treaty, Art. I(a)(ii)).
[165] *Id.*, para. 150.
[166] *CMS*, *supra* note 81, para. 48.

investment."[167]

158. The Claimant also points out that shareholder claims were allowed in *Goetz*, *AAPL*, *Genin*, and *CME*, and concludes by saying that all these cases show that such claims are well recognized in international law.[168]

(b) Considerations of the Tribunal

159. The Respondent questions whether a legal dispute exits and, if it exists, then the Respondent contends that it is a contractual dispute that should be submitted to the federal courts of the City of Buenos Aires, as agreed in the Contracts. This objection and its reasoning overlap in part with the Sixth Objection. To avoid repetition, the Tribunal will address the second part of the issue of the forum selection in the Contracts when considering that objection.

160. In addressing Respondent's objections, the Tribunal finds useful the definition of "legal dispute" found in the Report of the Executive Directors of the International Bank for Reconstruction and Development to the Board of Governors accompanying the draft ICSID Convention: "The dispute must concern the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation."[169] Although this Report does not apply to the interpretation of the Treaty, we find the foregoing language illustrative of the appropriate approach in this case. The arguments advanced by the parties and the facts alleged by them show that a

[167] Claimant's Counter-Memorial on Jurisdiction, para. 154 (citing *Enron*, Decision on Jurisdiction, *supra* note 159, para. 49).

[168] *Id.*, paras. 161-162 (citing *Antoine Goetz et consorts v. République du Burundi*, ICSID Case No. ARB/95/3, Award (10 February 1999), 6 ICSID Rep. 5 (2004), paras. 6, 87 and 89; *Asian Agricultural Products Ltd (AAPL) v. Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award (27 June 1990), 6 ICSID Rev. —FILJ 526 (1991), para. 95; *Alex Genin, Eastern Credit Limited, Inc. and AS Baltoil v. The Republic of Estonia*, ICSID Case No. ARB/99/2, Award (25 June 2001), 17 ICSID Rev.—FILJ 395 (2002), paras. 323-325; and *CME Czech Republic BV v. The Czech Republic*, UNCITRAL Case, Partial Award (13 September 2001), para. 392, *available at* http://ita.law.uvic.ca/documents/CME-2001PartialAward.pdf).

[169] *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (18 March 1965), adopted by Resolution No. 214 of the Board of Governors of the International Bank for Reconstruction and Development on 10 September 1964, 1 ICSID Rep. 23, 28 (1993).

dispute exists between them as to whether the protection due to the investor under the Treaty has been violated and as to whether commitments were made to the investor under the laws of the Argentine Republic that would give rise to a claim under the Treaty. These claims extend beyond claims for breach of contract as contemplated in *Vivendi II*. Therefore, the Tribunal is satisfied that a dispute exists between the parties concerning an obligation of the Respondent with regard to an investment of the Claimant, as required under Article 8 of the Treaty, and rejects this objection to the extent that it concerns the absence of a legal dispute.

5. Fifth Objection: Letters of Understanding

(a) Positions of the Parties

(i) Position of the Respondent

161. The Respondent brings to the attention of the Tribunal letters of understanding signed by Transener and Transba on February 2, 2005 in the context of the renegotiation of the Contracts. In the case of Transener, Transener and its shareholders committed themselves to suspend, and desist from, any claim or recourse filed before any administrative, judicial or arbitral body in Argentina or elsewhere based on facts or measures taken in respect of the Concession Contract as a result of the emergency situation established by Law No. 25,561. Furthermore, in case the shareholders or former shareholders of Transener were to obtain an award or judgment in their favor, Transener would be responsible for payment of any compensation awarded, including fees and costs, and would hold Respondent harmless even in case of contract termination. It was also agreed that any such compensation, fees and costs, would not be recoverable through increased charges to the users of Transener's services. The parties to the letter of understanding confirm that the letter is the result of the renegotiation process provided for in Law No. 25,561 and ancillary statutes, and that the renegotiation's objective was to re-establish the conditions to provide the Public Service of Transport of High-Voltage Electric Power. A similar commitment

was made by Transba.[170]

162. It is the Respondent's position that, since it has reached a clear understanding with Transener and Transba, which are the Concessionaires entitled to the rights claimed in these arbitration proceedings, the Tribunal lacks jurisdiction to continue with the arbitration proceedings. Since neither Transener, nor Transba nor their shareholders could file claims against the Argentine Republic for measures taken since December 2001, neither could National Grid do so, having sold its shares at its own risk. National Grid suffered no harm and, as stated by the ICJ in *Nuclear Tests*, he who does not suffer any harm is not entitled under international law to request the protection of a tribunal.[171]

(ii) Position of the Claimant

163. The Claimant contends that the letters of understanding executed by Transener and Transba after National Grid's disposal of its investment are irrelevant for the purpose of determining the Tribunal's jurisdiction over this dispute. National Grid has never participated nor is it participating in the renegotiation and its Treaty claims are independent of the renegotiation. The Claimant draws the attention of the Tribunal to the statement made by the tribunal in *CMS*, responding to a similar jurisdictional objection:

> "It is not for the Tribunal to rule on the perspectives of the renegotiation process or on what TGN might do in respect of its shareholders, as these are matters between Argentina and TGN or between TGN and its shareholders."[172]

164. The Claimant observes that it was the Respondent that imposed the renegotiation process upon the Concessionaires and alleges that a process in which the Claimant plays and can play no part cannot block its Treaty

[170] Respondent's Plea on Jurisdiction, paras. 174, *et seq.*
[171] *Id.*, paras. 181-182 (citing *Nuclear Tests*, *supra* note 150, para. 53).
[172] *CMS*, *supra* note 81, para. 86 (quoted in the Claimant's Counter-Memorial on Jurisdiction, para. 165).

claims.[173]

(b) Considerations of the Tribunal

165. The Respondent's argument is based on the contention that the shareholders hold no direct rights to claim protection under the Treaty and that, since the Measures are unassailable by Transener and Transba, those Measures are also unassailable by Transener's and Transba's shareholders. This argument advanced by the Respondent ignores the possibility of direct claims by National Grid based on obligations undertaken by the Argentine Republic in the Treaty. The Tribunal has already accepted *prima facie* the allegation that certain commitments were made by the Argentine Republic to the shareholders of Transener in order to attract their investment. The Tribunal has also upheld its jurisdiction to decide whether the Measures breached any treaty obligations. The Tribunal notes that neither Transener nor Transba had any rights to pursue claims under the Treaty and hence lacked legal capacity to negotiate them away with the Respondent. The fact that as part of this negotiation the Respondent obtained assurances of compensation by the Concessionaires in the event the Tribunal should award compensation to the Claimant, and the intimation by the Argentine Republic that such an eventual award might bankrupt a public utility should have no effect on the jurisdiction of this Tribunal to settle this dispute, for those are matters negotiated with third parties to these proceedings. The holding of the tribunal in *CMS* quoted above applies equally here.

166. For these reasons, the Tribunal rejects this objection to its jurisdiction.

6. Sixth Objection: Exclusive Jurisdiction of the Federal Courts of Buenos Aires

(a) Position of the Parties

[173] Claimant's Counter-Memorial on Jurisdiction, para. 166.

(i) Position of the Respondent

167. The Respondent observes that Article 38 in both Contracts provides for jurisdiction of the federal courts of Argentina's federal capital. The Respondent invites the Tribunal to read carefully the decisions in the *Woodruff Case*[174] and *North American Dredging Company*[175] recognizing the primacy of the specific jurisdiction agreed in a contract over the jurisdiction established under an international agreement. Respondent contends that this case is no different. If National Grid accepted the jurisdiction in the Contract when the remedies under the Treaty were already known, National Grid now is precluded by its own acts from resorting to such remedies.[176] The Respondent observes that this criterion has been confirmed by the tribunals in the *SGS* cases, quoting the following statement from *SGS v. Philippines*:

> "[…] the question is whether a party should be allowed to rely on a contract as the basis of its claim when the contract itself refers that claim exclusively to another forum. In the Tribunal's view the answer is that it should not be allowed to do so, unless there are good reasons, such as force majeure, preventing the claimant from complying with its contract. This impediment, based as it is on the principle that a party to a contract cannot claim on that contract without itself complying with it, is more naturally considered as a matter of admissibility than jurisdiction."[177]

(ii) Position of the Claimant

168. The Claimant refers to a long line of cases - *CMS, Enron, Azurix, Compañía de Aguas del Aconquija SA and Compagnie Générale des Eaux, Vivendi II, Lanco, Salini,* and *CME* – to the effect that it is "well established in international case law that claims alleging a cause of action under a BIT are not

[174] *Woodruff*, United States-Venezuela Mixed Commission, IX R.I.A.A. 213.

[175] *North American Dredging Company of Texas*, United States-Mexico General Claims Commission, IV R.I.A.A. 26.

[176] Respondent's Plea on Jurisdiction, paras. 184-190.

[177] *Id.*, para. 192 (quoting *SGS v. Philippines*, *supra* note 48, para. 154).

subject to the exclusive jurisdiction of the local courts pursuant to an underlying contract."[178]

(b) Considerations of the Tribunal

169. The Tribunal recalls the simple fact that National Grid is not a party to the Concession Contracts, in which the Concessionaires agreed to the exclusive jurisdiction of the federal courts in Argentina's federal capital. This should distinguish this case from some of the others adduced by the parties and facilitate the Tribunal's task. The Tribunal finds it somewhat contradictory that the Respondent would base its jurisdictional objection on preserving the integrity of the corporate personality of the Concessionaires while at the same time contending that the Claimant is bound by a commitment that it has not made. The Tribunal realizes that the Respondent's defense relies on rejecting the possibility that Claimant may bring claims under the treaty separately from claims arising under the Contracts. However, this is a matter to be proven by the Claimant at the time of discussing the merits of its claims. As characterized by the Claimant, the claims brought before this Tribunal fall *prima facie* under the Treaty. As held in *SGS v. Pakistan*: "…[I]f the facts asserted by the Claimant are capable of being regarded as alleged breaches of the BIT, consistently with the practice of ICSID tribunals, the Claimant should be able to have them considered on their merits."[179]

170. Therefore, the Tribunal rejects the sixth objection to its jurisdiction and the fourth objection to the extent that it relates to the same matter.

[178] Claimant's Counter-Memorial on Jurisdiction, paras. 79-87.

[179] *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan,* Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction (6 August 2003), para. 145.

DECISION

1. Having considered the parties' arguments in their written and oral pleadings and for the reasons above stated, the Tribunal unanimously decides that:

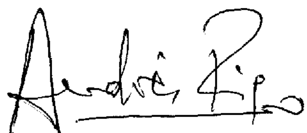
1. The Tribunal has jurisdiction to consider the claims of National Grid set forth in its Notice of Arbitration and its Statement of Claim.

2. National Grid has *ius standi* to present such claims.

The Tribunal has, accordingly, made the necessary order, in accordance with Procedural Order No. 2, to establish the dates for the parties to submit their Counter-Memorial, Reply and Rejoinder on the merits.

Each party has requested that the costs of the jurisdictional phase of the proceedings, including its own costs, be borne by the other. The Tribunal further decides to consider and decide this matter together with the merits of the dispute.

Done in English and Spanish, both versions being equally authoritative, in Washington, D.C. on June 20, 2006.



Dr. Andrés Rigo Sureda
President

E. Whitney Debevoise, Esq.
Arbitrator

Professor Alejandro M. Garro
Arbitrator