NATIONAL TREATMENT CLAUSE IN AN INTERNATIONAL INVESTMENT AGREEMENT: DETERMINING THE STANDARD OF ENFORCEMENT.

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I. Introduction

With an advent of the global economy over the past few years, an increasing trend has been witnessed in overseas investment.[1] Laws regulating such transactions have not been left unaffected by this mutating trend, hence major alterations have been observed in both the national and international laws governing the aforementioned sphere. The Foreign Direct Investment (FDI) flows have seen unprecedented growth most specifically in the large economies such as Brazil, India, China and Russia.[2] The aforementioned countries belong to a specific class of 'emerging markets' which are characterized by high rates of economic growth, expanding gross domestic product (GDP) and a dominant educated middle class.[3] In summation, these highlighted points make such nationalities hot bed for foreign investment. The central authorities in these countries have been historically in favor of attracting more capital inflow from non-citizen corporate entities. Needless to say, this object is thus made possible by a liberal FDI policy, giving ample leeway to foreign investors.[4] The International Investment Agreements (IIAs), often playing a crucial yet ambiguous role in the FDI regime, have increased such investments by several folds.[5] Although the nations have been liberal, in the recent past, with the foreign entities

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1 JOSE E. ALVAREZ & KARL P. SAUVANT , THE EVOLVING INTERNATIONAL INVESTMENT REGIME EXPECTATIONS, REALITIES, OPTIONS (2011).

2 Anonymous, Emerging Markets, Dream On?, THE ECONOMIST, June 21, 2012, http://www.economist.com/node/21559339.

3 David Collins, National Treatment in Emerging Market Investment, CITY UNIVERSITY LONDON CITY RESEARCH ONLINE, http://openaccess.city.ac.uk/2395/1/National%20Treatment%20in%20Emerging%20Market%20Investment%20 Treaties.pdf (last visited September 5, 2013).

4 United Nations Convention on Trade and Development, (July 5, 2012), available at http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf.

5 Id at xx.

but instances of protectionist attitude towards domestic producers are still dominant in most developing economies. Since a foreign investor practically risks entering an unknown market, being exposed to instances of pecuniary losses,[6] the presence of a 'national treatment' provision in the IIA helps the individual/corporation to attain a certain sense of security in its dealings.

The present paper is an analysis of the au-courant state of being of national treatment obligations in an IIA. The second part of the paper deals with the presumptions held sacrosanct to call for a valid applicability of the national 'like' treatment clause, the element of presence of competition in the relevant product market being the key triggering effect. The subsequent part of the paper analyses the situation from the vantage point of an emerging market where blanket acceptance of a national treatment obligation is neither financially feasible nor economically viable. The fourth part of the paper delves into the merits and demerits of restricting the absolutist terminology of a national treatment obligation; synching it with the real world situations, making the commitment more prone to externalities. The last part of the paper concludes the analysis by stressing upon the need to balance the conflicting demands of both the parties involved, ultimately achieving a competitively priced product; enhancing the developmental aspirations of the host country, while generating ample profit margins for the foreign investors.

II. Presumptions For Applicability Of The National Treatment Clause: An Overview.

Such an undertaking by two or more contracting parties has been duly recognized by the United National Conference on Trade and Development ('UNCTAD').[7] In essence the clause means that the host country is mandated to treat foreign products no less favorably than

6 Nicholas DiMascio & Joost Pauwelyn, Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin, 102 A.J Int' L 48, 67 (2008).

7 United Nations Convention on Trade and Development Series on Issues in International Investment Agreements (New York and Geneva, United Nations, 1999) at 1.

'like' domestic products.[8] The underlying purpose of national treatment is to maintain competitive environment between the domestic and the foreign investors 'in like circumstances'.[9] The principle clauses in an IIA, historically, have been drafted in accordance with the dominant party i.e the developed country wanting to operate in a resource rich developing country. This disproportionate power division, according to critics of national treatment clause, stands to be aggravated by a treaty obligation which makes it absolutely necessary not to differentiate between the domestic and foreign operators in any sphere possible. Where one view justifies the differential treatment of large multinational corporations, having diversified operations all across the globe, vis-à-vis concentrated local producers having limited sources to engage in an economic transactions;[10] the other view sides with the international players demanding 'no less favorable' treatment.

A. Different Standards For Non-Dominant Foreign Players?

Contrary to popular conception not all foreign actors are large economic entities but can well be a relatively small initiative, in certain cases even a sole excursion outside the home state,[11] owned and handled by individuals operating abroad.[12] These isolated individuals or entities

8 The presence of similar clauses has been seen in various parts of the WTO including the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS); GATT art. 3 obliges the WTO members to provide national treatment to imports of foreign goods, GATT art 3(4) has the textual structure which is closest to a typical national treatment clause in a investment treaty setting.

9 The term 'in like situation' has often been used in the national treatment clauses, See also North American Free Trade Agreement. US.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993). art 1102(1) 'Each party shall accord to investors of another Party treatment no less favorable than it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments'.

10 M SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT (2010) at 203.

11 SD Myers Inc v. Canada Partial Award, ¶ 244-250 (UNCITRAL/NAFTA, Partial Award, November 13, 2000).

12 Marvin Roy Feldmen Karpa v. United Mexican States (ICSID Case No ARB(AF)/99/1M (NAFTA), Award, December 16, 2002).

are the ones at the highest risk parameter who stand to get affected by the political economy surrounding the foreign investment restrictions.[13] Given the constrained resources available with these players the probability of asymmetric information is commonplace. At least in these limited circumstances the investment arbitral tribunal should consider fairly distributing the burden of production[14] and the complementary burden of persuasion[15] between the contesting foreign actor and the host state.[16] Thence operability of this clause, seemingly, can only be demanded when the investor is a non-dominant player in the host country.

B. Competition as a pre-requisite to determine applicability of the clause: A sound presumption?

More often than not, presence of a foreign player indicates towards presence of competitive practices in the domestic market.[17] At one instance the pre-conditionality of checking whether there is competition in the market seems rather reasonable; given the market tendency to extract profit by making available competitive goods in the domestic market.[18] In the case of Occidental v Ecuador[19] the arbitral tribunal squarely rejected the role of competition as a pre-requisite to prove national treatment. The case portrayed a national treatment obligation as a disciplined approach divorced from the competition requirement, as seen in the GATT-WTO framework,[20] not limiting operability of

13 Supra note 1, 254; The Political economy of the state is dependent upon the size of the foreign investment in the host state and its employment capabilities; See G Grossman & E Helpman, Foreign Investment with Endogenous Protection in R FEENSTRA, THE POLITICAL ECONOMY OF TRADE POLICY: PAPERS IN HONOR OF JAGDISH BHAGWATI (1996) at 216.

14 The responsibility to produce evidence before the adjudicator.

15 The type and amount of evidence deemed necessary to persuade an adjudicator.

16 For the distinction between burden of production, termed burden of proof, and burden of persuasion, termed standard of proof, See Islamic Republic of Iran v. US ¶ 30-39 (ICJ Reports 225, November 6, 2003).

17 Supra note 11; Pope & Talbot v. Canada ¶ 78 (UNCITRAL/NAFTA, Award on the Merits of Phase 2, April 10, 2001).

18 A recent argument on the aforemtioned lines regarding national treatment was taken in the case of Corn Products International Inc. v. United Mexican States (ICSID Case No. ARB(AF)/04/1 NAFTA).

19 Occidental Exploration and Production Co. v. Ecuador ¶ 1 (LCIA Case No UN3467, UNCITRAL, Final Award, July 1, 2004).

20 Supra note 1, 250-255; elaborated in the Occidental case ¶ 174.

national treatment clause to a mere protectionist undertaking.[21] The case was monumental for small investors, as noted in the preceding part, since the tribunal was of the view that 'in like situations' cannot be analyzed in a narrow sense. The purpose of the clause being protection of investors, hence a wider connotation, irrespective of the operational field of the investors, has to be given while interpreting the clause. Although the decision mentioned the underlying aim of 'protection' but a generic mention cannot logically be termed reasonable to address all the woes of a foreign investor. The case of Methanex v. United States[22] reiterated, in essence, the decision in Occidental and in doing so painted a similar problematic picture. The tribunal in the case decided against an accusation made by a non-citizen operating in the host country for discrimination against him and his area of chemical production. The tribunal made it clear that there indeed was discrimination between different chemical producers but since the differentiation was applicable to both resident as well as non-resident production houses it is not against the protection made available under the national treatment clause.

Following the Methanex principle, if the 'identically' placed players are at a level field there shall be no breach of national treatment, what this oversimplification ignores is a case where the product market in question has a close substitute product market, latter being dominated by the domestic producers. If the state discriminates the former from the latter, there would be no source of grievance redressal for the foreign investors. The narrow approach in the case based solely on the functionality of the products being manufactured, as noted in the preceding few lines, is counterproductive to the notion of 'protection' of investors' interest.[23] A more reasoned approach would plausibly hinge on the consumers' notion of whether or not the two products can be substituted.[24] What emerges out of the observations made is a need to develop a mechanism that recognizes measures by the states solely for protectionist purposes. On the aforementioned lines the most favored

21 Id., ¶ 171.

22 Methanex Corp v. US Part IV, Chapter B (UNCITRAL/NAFTA, Final Award of the Tribunal on Jurisdiction and Merits, August 3, 2005).

23 Id., ¶ 28.

24 Supra note 1, 261.

(domestic) investor test can be quoted; the foreign investor needs to show that a single domestic producer in the like situation is being given more favored treatment than him, the presence of other similarly placed non advantageous domestic producers becomes irrelevant under this measure.[25] Despite the narrowed approach followed in the most favored arrangement, it still remains the prevailing norm in the investment arbitral jurisprudence.[26]

III. Blanket International Obligation To Provide 'Like' Treatment: An Emerging Market Perspective.

Having analyzed the situation from an individual foreign actor having a relatively lower degree of control in an over protectionist nation, it becomes imperative to view the situation from a more realistic perspective of a yet developing and/or emerging market flooded with investors from developed nationalities. The underlying assumption is to iron out the uneven applicability of laws governing domestic and foreign investors; although given the undeniable inequalities in the economic and financial dominance possessed by certain nations, a rational criterion of differentiation is not logically unsound. A newly industrialized yet resource rich state cannot overlook the possibility of enriching its domestic industries, thence there exist a number of IIAs with such nations where no explicit promise of national treatment is made to the contracting party.[27] While on the other hand, a domestic law could very well be burdensome on the home industries itself, its application on a foreign investor, following the dictates of 'similar' treatment of both domestic and international investors, may not lead to an amicable situation.[28] Thus a standalone international obligation to follow identical norms for both classes of investors cannot satiate the quench of international markets to diversify by ensuring fair conditions for all players. By not bypassing the domestic dispute settlement

25 As explained in the case of Pope & Talbot Inc v. Canada ¶ 45-79 (UNCITRAL/NAFTA, Award on the Merits of Phase 2, April 10, 2001).

26 View approved in the case of Methanex, Archer Daniel Midlands Co. and Tate & Lyle Ingredients Americas Inc v. United Mexican States (ICSID Case No ARB(AF)/04/5 (NAFTA), Award, November 12, 2007).

27 Indonesia-Romania Treaty, June 26, 1997.

28 SURYA P SUBEDI, INTERNATIONAL INVESTMENT LAW: RECONCILING POLICY AND PRINCIPLE (2012) at 71-72.

forums and letting the state judiciary to interpret its laws harmoniously with other international obligations the issue may be resolved in an efficacious manner; transgression of the sovereignty of the host state being antithetical to the notions of free and fair treatment for all.[29]

A. National treatment clause being subjected to pre-conditions: Exploring the Practical Implications.

The national treatment not being a product of international customary law and the precedents having been evolved out of the decisions emanating out of NAFTA,[30] the focus of such a clause in an emerging market scenario has often been ignored. At this juncture it shall be fruitful to delve into the discussion related to practices in emerging markets guaranteeing national treatment either pre or post establishment. The difference is essential since the applicability is then restricted to the limited span either pre or post establishment of the business endeavor in the host country as the case may be. For example the Bilateral Investment Treaty (BIT) between Philippines and Czech Republic makes apparent the post establishment applicability of the clause.[31] Furthermore, emerging markets by a clear mention in the IIAs have even restricted the operable field of the clause by making it conditional to the domestic laws in the field.[32] For instance the BIT between India and Switzerland mentions that the treaty obligations are not the sole governing principles, the 'general policy in the field of foreign investment' is also made operable.[33] Although post-establishment safeguards are a common feature in the emerging markets IIAs but pre-establishment operability of national treatment clauses is not wholly absent. BITs between Singapore- India[34] and Vietnam-Japan[35] duly recognize the functionality of the provision before the commercial operations are fully established in the host nation. Terminology adopted in an IIA can be crucial to determine the sphere of applicability, a

29 SANTIAGO MONTT, STATE LIABILITY IN INVESTMENT TREATY ARBITRATION (2009) at 366.

30 Nicholas DiMascio & Joost Pauwelyn, Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin, 102 A.J Int' L 48 (2008) at 67.

31 By stating "...investors and investments once admitted…", April 5, 1995.

32 Malaysia-Korea Treaty art. 3(1), April 11, 1988.

33 India-Switzerland Treaty art. 3(1), April 4. 1997.

34 Singapore-India Treaty art. 6.3(1), June 29, 2005.

35 Vietnam-Japan Treaty art. 2.1, November 14, 2003.

mention of 'to the extent possible' or 'in accordance with the laws of the contracting parties'[36] can very well limit the functionality of a seemingly absolute national treatment obligation.

An understanding of the dangers that can well be anticipated due to overt foreign competition in a yet maturing economy has molded the comparatively conservative outlook of Association of Southeast Asian Nations (ASEAN). The members are given a leeway to 'block' certain segments of its industrial undertaking from the national treatment obligation.[37] This when read in connection with the 'best efforts' clause in the Russia's BIT with Canada, where the parties are under an obligation to provide the national treatment only to their best levels, it can well be seen that the black and white extremes have been blurred to give a more realistic shape to the obligations between the parties involved. What is even more bewildering is a complete lack of such commitments in certain IIAs so concluded with certain emerging Asian nationalities, namely Indonesia[38], Singapore[39] and Philippines[40]. The reason for such drastic steps could be the internal decision of the economies to keep an upper hand while deciding the management issues but with no iota of doubt it can be concluded that such measures might result in discouraging the foreign investments altogether.

IV. Limiting The Scope Of The 'Like Treatment' Obligation: Pitching For A Flexible Investment Regime.

Having analyzed the realities of the emerging markets and the placement of national treatment clause in the IIAs it is important to note certain limiting circumstances which can well be added in a BIT legitimately by both developed and developing economies alike, to restrict the operability of the clause. Such restrictions have historical roots in the first few BITs signed by the United States;[41] 'policy

36 Argentina-Canada Treaty art. 4, November 5, 1991.

37 Framework Agreement on the ASEAN Investment Area art. 9, February 26, 2009.

38 Indonesia-Thailand Treaty, February 17, 1998 and Indonesia-Sweden Treaty, September 17, 1992.

39 Singapore-Mongolia Treaty, July 24, 1995 and Singapore-Peru Treaty, February 27, 2003.

40 Philippines-UK Treaty, December 3, 1980.

41 SURYA P SUBEDI, INTERNATIONAL INVESTMENT LAW: RECONCILING POLICY AND PRINCIPLE (2012) at 81.

42 China-Cambodia Treaty, July 19, 1996.

flexibility' as a condition precedent before ensuring the favorable treatment clause to the foreign entity has been a common practice. It has to be noted in the aforementioned context that the underlying state ideology plays a significant role in determining the level of leeway that the national authorities are willing to provide to an alien entity, for instance China with its state-owned enterprises finds it difficult to afford such treatment to foreign investors;[42] the observation corroborates the case-by-case nature of such clauses in an IIA. More importantly the previously mentioned exceptions under an IIA for national treatment is wholly justified if it is interlinked with the fields of environment, public health and/or maintenance of social order.[43] The named exceptions are most dominantly express in the field of 'cultural industries', a complete sealing of the product market that deals mainly in cultural commodities is well observed in the Latin American countries. A foreign dominance in these niche markets is often, legitimately, seen as a threat to the operating domestic producers.[44] The influx of subsidies by the local government to struggling home based industries is another instance where such grants are allowed by the international community provided they do not hinder the transactions of the foreign counterparts operating in the domestic market.[45]

These limiting or conditional pre-requisites in an IIA can well be justified if the wider practical implications on the emerging markets of the newly industrialized economies are considered. Although the balance between a dominant foreign player vis-à-vis a developing nation and between an isolated small foreign investor vis-à-vis an over protective host nation is yet to be achieved.

V. Conclusion

What emerges out of the discussion in the preceding few paragraphs is a cycle of liberalized approach in the present market based economy.

43 Many IIAs specifically adopt the language of the General Exceptions contained in the GATS art. XIV, e.g. Jordan-Singapore Treaty art. 18, May 16, 2004.

44 Chile's RTA with Canada also exempts cultural industries from all protections contained in the instrument, Annex O-06, December 5, 1996. This restriction could equally reflect Canada's desire to protect French language and culture in the province of Quebec.

45 See China-Guyana Treaty art. 4.6, March 27, 2003.

The stress has been towards a quid pro quo situation where more liberal national policies with regard to foreign investors shall result in more FDI inflow. Howsoever attractive this arrangement might seem, it has its inherent flaws. A mandatory international obligation upon a developing economy to open up its resources for the dominant foreign powers to exploit cannot be termed as reasonable. A clear understanding with regard to the varied economic/financial standing of nations in their developmental phase is crucial; a blanket applicability of national treatment to treat non national investors in exact same fashion as the domestic investors cannot be pitched at this juncture. Pre-conditions firmly rooted in a rationale differentiating ideology which shall provide for required flexibility to an emerging economy is well justified. In the same breath one cannot ignore the sporadic yet significant instances where an over-protectionist regime may completely sabotage the economic interests of an individual foreign player. It is in this context that the national treatment clause in an IIA ought to come to play.

In the practical course of things, keeping in view the unequal standing of parties where a BIT is entered into between a developing and a develop nation, unlike a few decades ago when the treaty obligation was between two developed nations, a uniform standard for national treatment cannot be accepted. Even with the international investment law statutorily mandating the contracting parties to provide for a national treatment clause emerging Asian economies have consistently shied away from such commitments; the result being more strenuous investment arbitration proceedings. The arbitrators in this regard are supposed to be contextual in their approach and must take into consideration the surrounding circumstances of both the parties involved in the procedure. National treatment is no doubt the grundnorm of international investment law but it cannot be denied that the developed economies, lobbying for a blanket anti-protectionist policy employed restrictive trade practices during their respective phases of development. Hence a well rounded approach for a way forward in the investment scenario shall keep into account the interests of both the host country and the foreign investing entities. It is in the interest of both parties to reach a consensus so that better commodities are provide to the target consumers at competitive rates with ample profit margins for the investors to continue their business endeavors.